S.98

An act relating to captive insurance companies and risk retention groups

It is hereby enacted by the General Assembly of the State of Vermont:

* * * Captive Insurance Company Formation * * *

Sec. 1. 8 V.S.A. § 6006(c) is amended to read:

(c) A captive insurance company incorporated or organized in this State shall have ~~not less than three~~ one or more incorporators or ~~three~~ one or more organizers ~~of whom not less than one~~, at least one of which shall be a resident of this State.

* * * Sponsored Captive Insurance Companies * * *

Sec. 2. 8 V.S.A. § 6004 is amended to read:

§ 6004. MINIMUM CAPITAL AND SURPLUS; LETTER OF CREDIT

(a) No captive insurance company shall be issued a license unless it shall possess and thereafter maintain unimpaired paid-in capital and surplus of:

(1) in the case of a pure captive insurance company, not less than $250,000.00;

(2) in the case of an association captive insurance company, not less than $500,000.00;

(3) in the case of an industrial insured captive insurance company, not less than $500,000.00;

(4) in the case of a risk retention group, not less than $1,000,000.00; and

(5) in the case of a sponsored captive insurance company, not less than ~~$500,000.00~~ $250,000.00.

(b) The Commissioner may prescribe additional capital and surplus based upon the type, volume, and nature of insurance business transacted.

(c) Capital and surplus may be in the form of cash, marketable securities, a trust approved by the Commissioner and of which the Commissioner is the sole beneficiary, or an irrevocable letter of credit issued by a bank approved by the Commissioner.

Sec. 3. 8 V.S.A. § 6032 is amended to read:

§ 6032. DEFINITIONS

As used in this subchapter, unless the context requires otherwise:

(1) "General account" means all assets and liabilities of the sponsored captive insurance company not attributable to a protected cell.

(2) "Incorporated protected cell" means a protected cell that is established as a corporation, mutual corporation, nonprofit corporation with one or more members, limited liability company, or reciprocal insurer separate from the sponsored captive insurance company of which it is a part.

~~(2)~~(3) "Participant" means an entity as defined in section 6036 of this title, and any affiliates thereof, that are insured by a sponsored captive insurance company, where the losses of the participant are limited through a

participant contract to such participant's pro rata share of the assets of one or more protected cells identified in such participant contract.

~~(3)~~(4) "Participant contract" means a contract by which a sponsored captive insurance company insures the risks of a participant and limits the losses of each such participant to its pro rata share of the assets of one or more protected cells identified in such participant contract.

~~(4)~~(5) "Protected cell" means a separate account established by a sponsored captive insurance company formed or licensed under the provisions of this chapter, in which assets are maintained for one or more participants in accordance with the terms of one or more participant contracts to fund the liability of the sponsored captive insurance company assumed on behalf of such participants as set forth in such participant contracts, and shall include an "incorporated protected cell," as defined in this section.

~~(5)~~(6) "Sponsor" means any entity that meets the requirements of section 6035 of this title and is approved by the Commissioner to provide all or part of the capital and surplus required by applicable law and to organize and operate a sponsored captive insurance company.

~~(6)~~(7) "Sponsored captive insurance company" means any captive insurance company:

(A) in which the minimum capital and surplus required by applicable law is provided by one or more sponsors;

(B) that is formed or licensed under the provisions of this chapter;

(C) that insures the risks only of its participants through separate participant contracts; and

(D) that funds its liability to each participant through one or more protected cells and segregates the assets of each protected cell from the assets of other protected cells and from the assets of the sponsored captive insurance company's general account.

Sec. 4. 8 V.S.A. § 6034 is amended to read:

§ 6034. PROTECTED CELLS

A sponsored captive insurance company formed or licensed under the provisions of this chapter may establish and maintain one or more protected cells to insure risks of one or more participants, subject to the following conditions:

* * *

(7) ~~In connection with the conservation, rehabilitation, or liquidation of a sponsored captive insurance company, the assets and liabilities of a protected cell shall, to the extent the Commissioner determines they are separable, at all times be kept separate from, and shall not be commingled with, those of other protected cells and the sponsored captive insurance company.~~

~~(8) The "general account" of a sponsored captive insurance company shall mean all assets and liabilities of the sponsored captive insurance company not attributable to a protected cell.~~

~~(9)~~ Each sponsored captive insurance company shall annually file with the Commissioner such financial reports as the Commissioner shall require, which shall include accounting statements detailing the financial experience of each protected cell.

~~(10)~~(8) Each sponsored captive insurance company shall notify the Commissioner in writing within 10 business days of any protected cell that is insolvent or otherwise unable to meet its claim or expense obligations.

~~(11)~~(9) No participant contract shall take effect without the Commissioner's prior written approval, and the addition of each new protected cell and withdrawal of any participant or termination of any existing protected cell shall constitute a change in the business plan requiring the Commissioner's prior written approval.

~~(12)~~(10) If required by the Commissioner, in his or her discretion, the business written by a sponsored captive, with respect to each cell, shall be:

(A) ~~fronted~~ Fronted by an insurance company licensed under the laws of any state~~;~~.

(B) ~~reinsured~~ Reinsured by a reinsurer authorized or approved by the State of Vermont~~; or~~.

(C) ~~secured~~ Secured by a trust fund in the United States for the benefit of policyholders and claimants or funded by an irrevocable letter of credit or other arrangement that is acceptable to the Commissioner. The Commissioner may require the sponsored captive to increase the funding of any security arrangement established under this subdivision. If the form of security is a letter of credit, the letter of credit must be issued or confirmed by a bank approved by the Commissioner. A trust maintained pursuant to this subdivision shall be established in a form and upon such terms approved by the Commissioner.

(13) ~~Notwithstanding the provisions of chapter 145 of this title or other laws of this State, and in addition to the provisions of section 6038 of this chapter, in the event of an insolvency of a sponsored captive insurance company where the Commissioner determines that one or more protected cells remain solvent, the Commissioner may separate such cells from the sponsored captive insurance company, and may allow, on application of the sponsor, for the conversion of such protected cells into one or more new or existing sponsored captive insurance companies with a sponsor or sponsors, or one or more other captive insurance companies, pursuant to such plan or plans of operation as the Commissioner deems acceptable.~~ [Repealed.]

Sec. 5. 8 V.S.A. § 6034a is amended to read:

§ 6034a. INCORPORATED PROTECTED CELLS

* * *

(d) An incorporated protected cell formed after the effective date of this subsection shall have its own distinct name or designation, which shall include the words "Incorporated Cell" or the abbreviation "IC."

(e) It is the intent of the General Assembly under this section to provide sponsored captive insurance companies, including those licensed as special purpose financial insurance companies under subchapter 4 of this chapter, with the option to establish one or more protected cells as a separate corporation, mutual corporation, nonprofit corporation, limited liability company, or reciprocal insurer. This section shall not be construed to limit any rights or protections applicable to protected cells not established as corporations, mutual corporations, nonprofit corporations, limited liability companies, or reciprocal insurers.

Sec. 6. 8 V.S.A. § 6036(d) is amended to read:

(d) A participant shall ~~insure only its own risks through a sponsored captive insurance company~~ not insure any risks other than its own and the risks of affiliated entities or of controlled unaffiliated entities.

Sec. 7. 8 V.S.A. § 6038 is amended to read:

§ 6038. DELINQUENCY OF SPONSORED CAPTIVE INSURANCE COMPANIES

(a) Except as otherwise provided in this section, the provisions of chapter 145 of this title shall apply in full to a sponsored captive insurance company.

(b) Upon any order of supervision, rehabilitation, or liquidation of a sponsored captive insurance company, the receiver shall manage the assets and liabilities of the sponsored captive insurance company pursuant to the provisions of this subchapter.

(c) Notwithstanding the provisions of chapter 145 of this title:

(1) In connection with the conservation, rehabilitation, or liquidation of a sponsored captive insurance company, the assets and liabilities of a protected cell shall at all times be kept separate from, and shall not be commingled with, those of other protected cells and the sponsored captive insurance company.

(2) ~~the~~ The assets of a protected cell may not be used to pay any expenses or claims other than those attributable to such protected cell~~; and~~.

~~(2)~~(3) Unless the sponsor consents and the Commissioner has granted prior written approval, the assets of the sponsored captive insurance company's general account shall not be used to pay any expenses or claims attributable solely to a protected cell or protected cells of the sponsored captive insurance company. In the event that the assets of the sponsored captive insurance

company's general account are used to pay expenses or claims attributable solely to a protected cell or protected cells of the sponsored captive insurance company, the sponsor is not required to contribute additional capital and surplus to the sponsored captive insurance company's general account, notwithstanding the provisions of section 6004 of this title.

(4) ~~a~~ A sponsored captive insurance company's capital and surplus shall at all times be available to pay any expenses of or claims against the sponsored captive insurance company.

(d) Notwithstanding the provisions of chapter 145 of this title or any other provision of law to the contrary, and, in addition to the provisions of this section, in the event of an insolvency of a sponsored captive insurance company where the Commissioner determines that one or more protected cells remain solvent, the Commissioner may separate such cells from the sponsored captive insurance company and, on application of the sponsor, may allow for the conversion of such protected cells into one or more new or existing sponsored captive insurance companies, or one or more other captive insurance companies, pursuant to a plan or plans of operation approved by the Commissioner.

Sec. 8. 8 V.S.A. § 6039 is added to read:

§ 6039. CLAIMANT RECOURSE

(a) Consistent with the provisions of this subchapter, a creditor of a sponsored captive insurance company shall have recourse against the assets attributable to a protected cell if, and only if it is a creditor of the protected cell. A creditor of a protected cell shall not be entitled to recourse against the assets attributable to any other protected cell or to the assets in the sponsored captive insurance company's general account.

(b) When a sponsored captive insurance company has an obligation to a creditor arising from a transaction, or otherwise imposed, with respect to a particular protected cell, the obligation:

(1) shall extend only to the assets attributable to that protected cell, and the creditor shall be entitled to recourse only against the assets attributable to that protected cell; and

(2) shall not extend to the assets of any other protected cell or to the assets in the sponsored captive insurance company's general account, and the creditor shall not be entitled to recourse against the assets attributable to any other protected cell or to the assets of the sponsored captive insurance company's general account.

(c) When an obligation of a sponsored captive insurance company relates solely to its general account, a creditor shall have recourse only against the assets in the general account.

(d) The establishment of one or more protected cells alone, and without more, shall not constitute or be deemed to be a fraudulent conveyance, an intent by the sponsored captive insurance company to defraud creditors, or the carrying out of business by the sponsored captive insurance company for any other fraudulent purpose.

* * * Risk Retention Groups; Governance Standards * * *

Sec. 9. 8 V.S.A. § 6052(g) is added to read:

(g) This subsection establishes governance standards for a risk retention group.

(1) As used in this subsection:

(A) "Board of directors" or "board" means the governing body of a risk retention group elected by risk retention group members to establish policy, elect or appoint officers and committees, and make other governing decisions.

(B) "Director" means a natural person designated in the articles of the risk retention group or designated, elected, or appointed by any other manner, name, or title to act as a director.

(C) "Independent director" means a director who does not have a material relationship with the risk retention group. A person that is a direct or indirect owner of or subscriber in the risk retention group – or is an officer, director, or employee of such an owner and insured, unless some other position of such officer, director, or employee constitutes a "material relationship" – as contemplated under subdivision 3901(a)(4)(E)(ii) of the federal Liability Risk Retention Act, is considered to be "independent." A director has a material relationship with a risk retention group if he or she, or a member of his or her immediate family:

(i) In any 12-month period, receives from the risk retention group, or from a consultant or service provider to the risk retention group, compensation or other item of value in an amount equal to or greater than five percent of the risk retention group's gross written premium or two percent of the risk retention group's surplus, as measured at the end of any fiscal quarter falling in such 12-month period, whichever is greater. This provision also applies to compensation or items of value received by any business with which the director is affiliated. Such material relationship shall continue for one year after the item of value is received or the compensation ceases or falls below the threshold established in this subdivision, as applicable.

(ii) Has a relationship with an auditor as follows: Is affiliated with or employed in a professional capacity by a current or former internal or

external auditor of the risk retention group. Such material relationship shall continue for one year after the affiliation or employment ends.

(iii) Has a relationship with a related entity as follows: Is employed as an executive officer of another company whose board of directors includes executive officers of the risk retention group, unless a majority of the membership of such other company's board of directors is the same as the membership of the board of directors of the risk retention group. Such material relationship shall continue until the employment or service ends.

(D) "Material service provider" includes a captive manager, auditor, accountant, actuary, investment advisor, attorney, managing general underwriter, or other person responsible for underwriting, determination of rates, premium collection, claims adjustment or settlement, or preparation of financial statements, whose aggregate annual contract fees are equal to or greater than five percent of the risk retention group's annual gross written premium or two percent of its surplus, whichever is greater. It does not mean defense counsel retained by a risk retention group, unless his or her annual fees are equal to or greater than five percent of a risk retention group's annual gross premium or two percent of its surplus, whichever is greater.

(2) The board of directors shall determine whether a director is independent; review such determinations annually; and maintain a record of the determinations, which shall be provided to the Commissioner promptly,

upon request. The board shall have a majority of independent directors. If the risk retention group is reciprocal, then the attorney-in-fact is required to adhere to the same standards regarding independence as imposed on the risk retention group's board of directors.

(3) The term of any material service provider contract entered into with a risk retention group shall not exceed five years. The contract, or its renewal, requires approval of a majority of the risk retention group's independent directors. The board of directors has the right to terminate a contract at any time for cause after providing adequate notice, as defined in the terms of the contract.

(4) A risk retention group shall not enter into a material service provider contract without the prior written approval of the Commissioner.

(5) A risk retention group's plan of operation shall include written policies approved by its board of directors requiring the board to:

(A) provide evidence of ownership interest to each risk retention group member;

(B) develop governance standards applicable to the risk retention group;

(C) oversee the evaluation of the risk retention group's management, including the performance of its captive manager, managing general underwriter, or other person or persons responsible for underwriting, rate

determination, premium collection, claims adjustment and settlement, or preparation of financial statements;

(D) review and approve the amount to be paid under a material service provider contract; and

(E) at least annually, review and approve:

(i) the risk retention group's goals and objectives relevant to the compensation of officers and service providers;

(ii) the performance of officers and service providers as measured against the risk retention group's goals and objectives;

(iii) the continued engagement of officers and material service providers.

(6) A risk retention group shall have an audit committee composed of at least three independent board members. A nonindependent board member may participate in the committee's activities, if invited to do so by the audit committee, but he or she shall not serve as a committee member. The Commissioner may waive the requirement of an audit committee if the risk retention group demonstrates to the Commissioner's satisfaction that having such committee is impracticable and the board of directors is able to perform sufficiently the committee's responsibilities. The audit committee shall have a written charter defining its responsibilities, which shall include:

(A) assisting board oversight of the integrity of financial statements, compliance with legal and regulatory requirements, and qualifications, independence, and performance of the independent auditor or actuary;

(B) reviewing annual and quarterly audited financial statements with management;

(C) reviewing annual audited financial statements with its independent auditor and, if it deems advisable, the risk retention group's quarterly financial statements as well;

(D) reviewing risk assessment and risk management policies;

(E) meeting with management, either directly or through a designated representative of the committee;

(F) meeting with independent auditors, either directly or through a designated representative of the committee;

(G) reviewing with the independent auditor any audit problems and management's response;

(H) establishing clear hiring policies applicable to the hiring of employees or former employees of the independent auditor by the risk retention group;

(I) requiring the independent auditor to rotate the lead audit partner having primary responsibility for the risk retention group's audit, as well as the audit partner responsible for reviewing that audit, so that neither individual

performs audit services for the risk retention group for more than five consecutive fiscal years; and

(J) reporting regularly to the board of directors.

(7) The board of directors shall adopt governance standards, which shall be available to risk retention group members through electronic or other means, and provided to risk retention group members, upon request. The governance standards shall include:

(A) a process by which risk retention group members elect directors.

(B) director qualifications, responsibilities, and compensation;

(C) director orientation and continuing education requirements;

(D) a process allowing the board access to management and, as necessary and appropriate, independent advisors;

(E) policies and procedures for management succession; and

(F) policies and procedures providing for an annual performance evaluation of the board.

(8) The board of directors shall adopt a code of business conduct and ethics applicable to directors, officers, and employees of the risk retention group and criteria for waivers of code provisions, which shall be available to risk retention group members through electronic or other means, and provided to risk retention group members, upon request. Provisions of the code shall address:

(A) conflicts of interest;

(B) matters covered under the Vermont corporate opportunities doctrine;

(C) confidentiality;

(D) fair dealing;

(E) protection and proper use of risk retention group assets;

(F) standards for complying with applicable laws, rules, and regulations; and

(G) mandatory reporting of illegal or unethical behavior affecting operation of the risk retention group.

(9) The president or chief executive officer of a risk retention group shall promptly notify the Commissioner in writing of any known material noncompliance with the governance standards established in this subsection.

Sec. 10. EFFECTIVE DATE; APPLICATION

This act shall take effect on passage. Sec. 9 (governance standards applicable to risk retention groups) shall apply to risk retention groups first licensed on or after the effective date of this act, and shall apply to all other risk retention groups one year after the effective date of this act.