

REGULATION C-81-2

CAPTIVE INSURANCE FINANCIAL REGULATION

SECTION 1: PURPOSE AND AUTHORITY

The purpose of this regulation is to set forth the financial and reporting requirements which the commissioner deems necessary for the regulation of captive insurance companies, as authorized by the Captive Insurance Company Act, 8 V.S.A., Section 6015. Reference hereunder to "company" shall mean captive insurance company or companies, unless otherwise specified.

SECTION 2: ANNUAL REPORTING REQUIREMENTS

A risk retention group domiciled in this state shall annually submit to the commissioner a report of its financial condition, verified by oath of two of its executive officers. The report shall be that required by 8 V.S.A., Section 3561.

A pure, sponsored, association, or industrial insured captive insurance company domiciled in this state shall annually submit to the commissioner a report of its financial condition, verified by oath of two of its executive officers. The report shall be that prescribed by the commissioner as "Captive Annual Statement: Pure or Industrial Insured".

SECTION 3: ANNUAL AUDIT AND ACTUARIAL CERTIFICATION

All companies shall have an annual audit by an independent certified public accountant, authorized by the commissioner and shall file such audited financial report with the commissioner on or before June 30 for the year ending December 31 immediately preceding. Companies that have received approval to report on other than a calendar year basis shall file such statements within 180 days after the end of their fiscal year.

The annual audit report shall be considered part of the company's annual report of financial condition except with respect to the date by which it must be filed with the commissioner.

The annual audit shall consist of the following:

(A) Opinion of Independent Certified Public Accountant

Financial statements furnished pursuant to this section shall be audited by independent certified public accountants in accordance with generally accepted auditing standards as determined by the American Institute of Certified Public Accountants.

The opinion of the independent certified public accountant shall cover all years presented.

The opinion shall be addressed to the company on stationery of the accountant showing the address of issuance, and shall be signed and dated.

(B) Report of Evaluation of Internal Controls

This report shall include an evaluation of the internal controls of the company relating to the methods and procedures used in the securing of assets and the reliability of the financial records, including but not limited to such controls as the system of authorization and approval and the separation of duties.

The review shall be conducted in accordance with generally accepted auditing standards and the report filed with the commissioner.

(C) Accountant's Letter of Qualifications

The accountant shall furnish the company, for inclusion in the filing of the audited annual report, a letter stating:

(a) That he is independent with respect to the company and conforms to the standards of his profession as contained in the Code of Professional Ethics and pronouncements of the American Institute of Certified Public Accountants and pronouncements of the Financial Accounting Standards Board.

(b) The general background and experience of the staff engaged in audit including the experience in auditing captives or other insurance companies.

(c) That the accountant understands that the audited annual report and his opinions thereon will be filed in compliance with this regulation with the Department of Financial Regulation

(d) That the accountant consents to the requirements of Section 6 of this regulation and that the accountant consents and agrees to make available for review by the commissioner, his designee or his appointed agent, the work papers as defined in Section 6.

(e) That the accountant is properly licensed by an appropriate state licensing authority and that he is a member in good standing in the American Institute of Certified Public Accountants.

(D) Financial Statements

Statements required shall be as follows:

(a) Balance sheets reporting assets, liabilities, capital and surplus

(b) Statements of operations

(c) Statements of cash flow

(d) Statements of changes in capital and surplus

(e) Notes to financial statements

The notes to financial statements shall be those required by generally accepted accounting principles, or as required by any other comprehensive basis of accounting in use by the company and approved by the commissioner, and shall include:

(1) A reconciliation of differences, if any, between the audited financial report and the report of its financial condition filed with the commissioner in accordance with Section 2 hereof.

(2) A summary of ownership and relationship of the company and all affiliated corporations or companies insured by the captive.

(3) A narrative explanation of all material transactions and balances with the company.

(E) Certification of Loss Reserves and Loss Expense Reserves.

The annual audit shall be filed with a Statement of Actuarial Opinion evaluating the company's loss reserves and loss expense reserves. The individual who prepares the Statement of Actuarial Opinion shall be approved by the commissioner and shall be a Fellow of the Casualty Actuarial Society, a member in good standing of the American Academy of Actuaries, or an individual who has demonstrated his competence in loss reserve evaluation to the commissioner.

Certification shall be in such form as the commissioner deems appropriate.

SECTION 4: DESIGNATION OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

Companies, after becoming subject to this regulation, shall within ninety days report to the commissioner in writing, the name and address of the independent certified public accountant retained to conduct the annual audit set forth in this regulation.

SECTION 5: NOTIFICATION OF ADVERSE FINANCIAL CONDITION

A company shall require the independent certified public accountant to immediately notify in writing an officer and all members of the Board of Directors of the company of any determination by the independent certified public accountant that the company has materially misstated its financial condition in its report to the commissioner as required in Section 6007 of 8 V.S.A. The independent certified public accountant shall furnish such notification to the commissioner within five working days of notifying the company.

SECTION 6: AVAILABILITY AND MAINTENANCE OF WORKING PAPERS OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

Each company shall require the independent certified public accountant to make available for review by the commissioner or his appointed agent the work papers prepared in the conduct of the audit of the company. The company shall require that the accountant retain the audit work papers for a period of not less than five years after the period reported upon.

The aforementioned review by the commissioner shall be considered investigations and all working papers obtained during the course of such investigations shall be confidential. The company shall require that the independent certified public accountant provide copies, in such form as the commissioner deems appropriate, of any of the working papers which the Department of Financial Regulation considers relevant. Such working papers may be retained by the Department.

"Work Papers" as referred to in this section include, but are not necessarily limited to, schedules, analyses, reconciliations, abstracts, memoranda, narratives, flow charts, copies of company records or other documents prepared or obtained by the accountant and his employees in the conduct of their audit of the company.

SECTION 7: DEPOSIT REQUIREMENT

Whenever the commissioner deems that the financial condition of the company warrants additional security, he may require a company to deposit with the Treasurer of this state cash or securities approved by the commissioner or, alternatively, to furnish the commissioner a clean irrevocable letter of credit issued by a bank chartered by the State of Vermont or a member bank of the Federal Reserve System and approved by the commissioner.

The company may receive interest or dividends from said deposit or exchange the deposits for others of equal

value with the approval of the commissioner.

If such company discontinues business, the commissioner shall return such deposit only after being satisfied that all obligations of the company have been discharged.

SECTION 8: ORGANIZATIONAL EXAMINATION

In addition to processing of the application, an organizational investigation or examination may be performed before or after an applicant is licensed. Such investigation or examination shall consist of a general survey of the company's corporate records, including charter, bylaws and minute books; verification of capital and surplus; verification of principal place of business; determination of assets and liabilities; and a review of such other factors as the commissioner deems necessary.

SECTION 9: REINSURANCE

Any captive insurance company authorized to do business in this state may take credit for reserves on risks ceded to a reinsurer subject to the following limitations:

(A) No credit shall be allowed for reinsurance where the reinsurance contract does not result in the complete transfer of the risk or liability to the reinsurer.

(B) No credit shall be allowed, as an asset or a deduction from liability, to any ceding insurer for reinsurance unless the reinsurance is payable by the assuming insurer on the basis of the liability of the ceding insurer under the contract reinsured without diminution because of the insolvency of the ceding insurer.

Reinsurance under this section shall be effected through a written agreement of reinsurance setting forth the terms, provisions and conditions governing such reinsurance.

The commissioner in his discretion may require that complete copies of all reinsurance treaties and contracts be filed and/or approved by him.

(C) Reinsurance Guidelines for Risk Retention Groups Licensed as Captive Insurers

I. Permitted Reinsurance

- A. Risk retention groups shall not receive statement credit if all policies are ceded through one hundred percent (100%) reinsurance arrangements or any lesser percentage as determined in the sole discretion of the commissioner; and
- B. Credit for reinsurance will be permitted if the reinsurer complies with Section 3634a of 8 V.S.A. Chapter 101; or
- C. Credit for reinsurance may be permitted if the reinsurer maintains an A- or higher A.M. Best rating, or other comparable rating from a nationally recognized statistical rating organization, and the reinsurer maintains minimum capital and surplus in an amount acceptable to the commissioner based upon a review of the reinsurer's most recent audited financial statements; and the reinsurer is licensed and domiciled in a jurisdiction acceptable to the commissioner; or
- D. Credit for reinsurance may be permitted if the reinsurer satisfies all of the following requirements and any other requirements deemed necessary by the commissioner:
 - (1) The risk retention group licensed as a captive insurer shall file annually, on or before June 30, the reinsurer's audited financial statements, which shall be analyzed by the

- commissioner to assess the appropriateness of the reserve credit or the initial and continued financial condition of the reinsurer;
- (2) The reinsurer shall demonstrate to the satisfaction of the commissioner that it maintains a ratio of net written premium, wherever written, to surplus and capital of not more than 3 to 1;
 - (3) If the reinsurer is an affiliate of the risk retention group, the reinsurer shall not write third-party business without obtaining prior written approval from the commissioner;
 - (4) The reinsurer shall not use cell arrangements without obtaining prior written approval from the commissioner;
 - (5) The reinsurer shall be licensed and domiciled in a jurisdiction acceptable to the commissioner; and
 - (6) The reinsurer shall submit to the examination authority of the commissioner.

For purposes of this subsection (D), a reinsurer is affiliated with a risk retention group if more than 50% of the equity interests in such reinsurer are owned, directly or indirectly, by one or more of the members of the risk retention group.

- II. The commissioner shall either require a reinsurer not domiciled in the US to include language in the reinsurance agreement that states that in the event of the reinsurer's failure to perform its obligations under the terms of its reinsurance agreement, it shall submit to the jurisdiction of any court of competent jurisdiction in the US or shall require compliance with section III below.
- III. For credit for reinsurance and solvency regulatory purposes, the commissioner may require an approved funds-held agreement, letter of credit, trust or other acceptable collateral based on unearned premium, loss and LAE reserves, and IBNR.
- IV. Upon application, the commissioner may waive either of the reinsurance requirements in sections I.D.(2) or I.D.(6) in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the commissioner that the reinsurer is sufficiently capitalized based upon an annual review of the reinsurer's most recent audited financial statements, the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the commissioner, and the proposed reinsurance agreement adequately protects the risk retention group licensed as a captive insurer and its policyholders. Any such waiver should be included in the plan of operation, or any subsequent revision or amendment of the plan, pursuant to Section 3902(d)(1) of the Federal Liability Risk Retention Act of 1986 and the plan must be submitted by the risk retention group licensed as a captive to the commissioner of its state of domicile and each State in which the risk retention group licensed as a captive intends to do business or is currently registered. Any such waiver of a section I.D. requirement constitutes a change in the risk retention group's plan of operation in each of those states.
- V. Upon application, the commissioner may waive the requirement in section II above that a reinsurance arrangement must satisfy either section II or III in circumstances where the risk retention group licensed as a captive insurer or reinsurer can demonstrate to the satisfaction of the commissioner that the reinsurer is sufficiently capitalized based upon an annual review of the reinsurer's most recent audited financial statements, the reinsurer is licensed and domiciled in a jurisdiction satisfactory to the commissioner, and the proposed reinsurance agreement adequately protects the risk retention group licensed as a captive insurer and its policyholders. Any such waiver should be disclosed in Note 1 of the risk retention group's annual statutory financial statement.
- VI. Each approved captive manager or risk retention group licensed as a captive insurer shall assess the reinsurance programs of the risk retention groups licensed as captives under their management, and within 90 days of the effective date of these guidelines, submit a written report to the commissioner indicating whether such risk retention groups licensed as captives are in compliance with these guidelines. All risk retention groups licensed as captive insurers that fail to submit the report in a timely manner shall be examined, at the risk retention group's expense, to determine compliance with these guidelines.

VII. These guidelines apply to risk retention groups licensed as captive insurers. Risk retention groups licensed as captive insurers who require additional time to comply with these guidelines shall be permitted to take credit for reinsurance for risks ceded to reinsurers not in compliance with these guidelines for a period not to exceed twelve (12) months from the effective date of these guidelines upon satisfactory demonstration to the commissioner that such delay of implementation will not cause a hazardous financial condition or potential harm to its member policyholders.

VIII. The "commissioner" refers to the commissioner of the Vermont Department of Financial Regulation

SECTION 10: INSURANCE MANAGERS & INTERMEDIARIES

No person shall, in or from within this state, act as an insurance manager, broker, agent, salesman, or reinsurance intermediary for captive business without the authorization of the commissioner. Application for such authorization must be on a form prescribed by the commissioner.

SECTION 11: DIRECTORS

Every company shall report to the commissioner within thirty days after any change in its executive officers or directors, including in its report a statement of the business and professional affiliations of any new executive officer or director.

No director, officer, or employee of a company shall, except on behalf of the company, accept, or be the beneficiary of, any fee, brokerage, gift, or other emolument because of any investment, loan, deposit, purchase, sale, payment or exchange made by or for the company but such person may receive reasonable compensation for necessary services rendered to the company in his or her usual private, professional or business capacity.

Any profit or gain received by or on behalf of any person in violation of this section shall inure to and be recoverable by the company.

SECTION 12: CONFLICT OF INTEREST

Each company chartered in this state is required to adopt a conflict of interest statement from officers, directors and key employees. Such statement shall disclose that the individual has no outside commitments, personal or otherwise, that would divert him from his duty to further the interests of the company he represents but this shall not preclude such person from being a director or officer in more than one insurance company.

Each officer, director, and key employee shall file such disclosure with the Board of Directors yearly.

SECTION 13: RESCISSION OF CAPTIVE LICENSE

The commissioner may, subject to the provisions of this section, by order rescind the license of the company:

(A) if the company has not commenced business according to its plan of operation within two years of being licensed; or

(B) if the company ceases to carry on insurance business in or from within Vermont;

(C) at the request of the company; or

(D) for any reason provided in 8 V.S.A., Section 6009.

Before the commissioner rescinds the license of a company under (A) or (B), the commissioner shall give the company notice in writing of the grounds on which he proposes to cancel the license, and shall afford the company an opportunity to make objection in writing within the period of thirty days after receipt of notice. The commissioner shall take into consideration any objection received by him within that period and, if he decides to cancel the license, cause the order of cancellation to be served on the company.

SECTION 14: ACQUISITION OF CONTROL OF OR MERGER WITH DOMESTIC COMPANY

No person other than the issuer shall make a tender offer of or a request or invitation for tenders of, or enter into any agreement to exchange securities for, seek to acquire, or acquire in the open market or otherwise, any voting security of a domestic company if, after the consummation thereof, such person would, directly or indirectly (or by conversion or by exercise of any right to acquire) be in control of such company; and no person shall enter into an agreement to merge with or otherwise to acquire control of a domestic company without the prior written approval of the commissioner. In considering any application for acquisition of control or merger with a domestic company, the commissioner shall consider all of the facts and circumstances surrounding the application as well as the criteria for establishment of a company set out in this chapter.

SECTION 15: CHANGE OF BUSINESS

Any change in the nature of the captive business from that stated in the company's plan of operation filed with the commissioner upon application requires prior approval from the commissioner.

Any change in any other information filed with the application must be filed with the commissioner but does not require prior approval.