



COMMONWEALTH OF KENTUCKY  
DEPARTMENT OF INSURANCE  
Frankfort, Kentucky

**BULLETIN**  
**2011-02**

***The following Bulletin is to advise the reader of the current position of the Kentucky Department of Insurance (the "Department") on the specified issue. The Bulletin is not legally binding on either the Department or the reader.***

**TO:** All Domestic Captive Risk Retention Groups, Captive Insurance Trade Associations, and Other Interested Parties

**FROM:** Sharon P. Clark, Commissioner

**RE:** NAIC Accreditation Requirements for Risk Retention Group Captives

**DATE:** March 22, 2011

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The purpose of this Bulletin is to notify all domestic captive risk retention groups, captive insurance trade associations, and other interested parties of new accreditation requirements applicable to risk retention group captives (RRG Captives) established by the National Association of Insurance Commissioners' (NAIC). This Bulletin relates **solely** to requirements for RRG Captives and does not apply to any other captive insurers.

The Department must implement the NAIC's new accreditation requirements applicable to RRG captives by January 1, 2011, in order to avoid risking the loss of the Department's accreditation. It is the Department's position that all of the NAIC's new accreditation requirements are already applicable to Kentucky domestic RRG Captives by statute, regulation, procedure, or policy. Regardless, through this Bulletin, the Department seeks to clarify the expectations for RRG Captives with respect to compliance with the NAIC's new accreditation requirements.

## Holding Company Act

Under the new accreditation requirements, RRG Captives are subject to the Insurance Holding Company Act (KRS Chapter 304, Subtitle 37).

KRS 304.49-060(4) provides, in pertinent part, as follows:

The provisions of [Chapter 304], pertaining to mergers, consolidations, conversions, mutualizations, and redomestications, shall apply in determining the procedures to be followed by captive insurance companies in carrying out *any of the transactions described in Subtitles 24 and 37* of [Chapter 304]...

Based on KRS 304.49-060(4), the Department opines that RRG Captives are currently subject to the requirements in KRS Chapter 304, Subtitle 37 pertaining to Insurance Holding Company Systems. Consequently, the Department expects compliance with KRS Chapter 304, Subtitle 37 by RRG Captives that are a part of a holding company system.

KRS 304.37-020(1) requires any insurer subject to registration to annually register with the commissioner by April 1 of each year, unless the commissioner for good cause shown extends the time for registration. For RRG Captives, the commissioner agrees to extend the time for registration to June 1, 2011, in order to ensure that there is sufficient time for RRG Captives to comply with KRS 304.37-020(1). This extension applies only to the registration filing due for 2011.

Please note, if a disclaimer of affiliation is filed, a copy of the disclaimer must be filed as a change in business plan with all other states in which the RRG is registered.

## Reinsurance Intermediaries Act and Risk Limitations

Under the new accreditation requirements, RRG captives are subject to the Reinsurance Intermediaries Act (KRS 304.9-700 to 304.9-759) and the Limits of Risks statute (KRS 304.5-120).

KRS 304.49-110, governing reinsurance on risks ceded by other insurers or captive insurers, provides as follows:

(6) The commissioner may impose any other requirements that he or she deems necessary before permitting credit for reinsurance under this section, including but not limited to requiring an approved funds-held agreement, letter of credit, trust or other acceptable collateral based on unearned premium, loss and loss adjustment expense reserves, and incurred but not reported reserves.

Based on the provisions of KRS 304.49-110(6), the commissioner has the authority and discretion to impose requirements regarding reinsurance transactions upon RRG

Captives that she may deem necessary before permitting credit for reinsurance under KRS 304.49-110. In order to comply with NAIC accreditation requirements, it is necessary to impose upon RRG Captives the requirement of the Reinsurance Intermediaries Act at KRS 304.9-700 to 759 and the Limits of Risks provision at KRS 304.5-120.

Attached are new guidelines for RRG Captive reinsurance. The Department will enforce these guidelines pursuant to KRS 304.49-110(6). Please note that any reinsurance in-force prior to January 1, 2011, is grandfathered in and deemed acceptable. However, if an RRG Captive's reinsurance arrangements change or lapse, then the new guidelines will be applicable.

#### Acknowledgement Form

To the extent necessary, the Department will pursue legislation to implement and clarify the applicability of the accreditation changes to RRG Captives as soon as practicable. In the interim, the Department expects compliance by RRG Captives with the provisions outlined in this Bulletin. In order for the Department to demonstrate compliance with the NAIC's accreditation standards, the Department requests that currently licensed RRG Captives execute the attached Acknowledgement Form and return it to the Department as soon as possible but **no later than April 15, 2011**.

This Bulletin and applicable statutes are available on the Department's website, **[www.doi.state.ky.us](http://www.doi.state.ky.us)**. Any questions regarding this Bulletin should be directed to Russell Coy II, Captive Coordinator, Financial Standards & Examination Division, Kentucky Department of Insurance, (502) 564-6082, **[Russell.Coy@ky.gov](mailto:Russell.Coy@ky.gov)**.

/s/ Sharon P. Clark  
Sharon P. Clark, Commissioner  
Kentucky Department of Insurance  
On this 22nd day of March, 2011

## **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 another lesser percentage as required in the discretion of the Commissioner; and
- B. Credit for reinsurance will be permitted if the reinsurer complies with KRS 304.5-130, KRS 304.5-140, KRS 304.5-150 and 806 KAR 5:025; 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 a minimum policyholder 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 captive manager or risk retention group licensed as a captive insurer shall file annually, on or before June 30, or at the request of the Commissioner or if the captive manager or risk retention group thinks it appropriate to file more often, 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) The affiliated 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.
- 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 60 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 are effective as of January 1, 2011 and 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. "Commissioner" refers to the commissioner of the Commonwealth of Kentucky.

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**Acknowledgement Form**

\_\_\_\_\_, (a captive Risk Retention Group) hereby acknowledges, understands, accepts, and agrees to comply with the Holding Company Act, Reinsurance Intermediaries Act, Limits of Risk statute, and the Reinsurance Guidelines as provided in Bulletin 2011-02.

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(signature of President)

Date: \_\_\_\_\_