

SENATE BILL 1540

By Norris

AN ACT to amend Tennessee Code Annotated, Title 56,  
Chapter 13, relative to captive insurance  
companies.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 56, Chapter 13, is amended by deleting Chapter 13 in its entirety and by substituting instead the following language as a new Chapter 13:

CHAPTER 13. TENNESSEE CAPTIVE INSURANCE COMPANY ACT

SUBCHAPTER 1. GENERAL PROVISIONS

**56-13-101.** Short Title - Purpose.

(a) This chapter shall be known and may be cited as the "Amended and Restated Tennessee Captive Insurance Act."

(b) The purpose of this chapter is to establish the procedures for the organization and regulation of the operations of captive insurance companies within this state and thereby promote the general welfare of the people of the state.

**56-13-102.** Definitions.

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

(1) "Affiliated company" means any company in the same corporate system as a parent, an industrial insured, or a member organization by virtue of common ownership, control, operation, or management.

(2) "Association" means any legal association of individuals, corporations, limited liability companies, partnerships, associations, or other entities, the member organizations of which or which does itself, whether or not in conjunction with some or all of the member organizations:

(A) Own, control, or hold with power to vote all of the outstanding voting securities of an association captive insurance company incorporated as a stock insurer; or

(B) Have complete voting control over an association captive insurance company incorporated as a mutual insurer; or

(C) Constitute all of the subscribers of an association captive insurance company formed as a reciprocal insurer; or

(D) Have complete voting control over an association captive insurance company formed as a limited liability company.

(3) "Association captive insurance company" means any company that insures risks of the member organizations of the association, and that also may insure the risks of affiliated companies of the member organizations and the risks of the association itself.

(4) "Captive insurance company" means any pure captive insurance company, association captive insurance company, sponsored captive insurance company, industrial insured captive insurance company, risk retention group, protected cell captive insurance company, incorporated cell captive insurance company, or special purpose financial captive insurance company formed or licensed under the provisions of this chapter. For purposes of this chapter, a branch captive insurance company shall be a pure captive insurance company with respect to operations in this state, unless otherwise permitted by the Commissioner.

(5) "Commissioner" means the Commissioner of the Department of Commerce and Insurance.

(6) "Controlled unaffiliated business" means any person:

(A) That is not in the corporate system of a parent and its affiliated companies in the case of a pure captive insurance company, or that is not in the corporate system of an industrial insured and its affiliated companies in the case of an industrial insured captive insurance company;

(B) That has an existing contractual relationship with a parent or one of its affiliated companies in the case of a pure captive insurance company, or with an industrial insured or one of its affiliated companies in the case of an industrial insured captive insurance company; and

(C) Whose risks are managed by a pure captive insurance company or an industrial insured captive insurance company, as applicable, in accordance with Section 56-13-117 of this title.

(7) “Excess workers’ compensation insurance” or “excess accident and health insurance” means, in the case of an employer that has insured or self-insured its workers’ compensation or accident and health insurance risks in accordance with applicable state or federal law, insurance in excess of a specified per-incident or aggregate limit established by the Commissioner.

(8) “Industrial insured” means an insured:

(A) Who procures the insurance of any risk or risks by use of the services of a full-time employee acting as an insurance manager or buyer;

(B) Whose aggregate annual premiums for insurance on all risks total at least \$25,000.00; and

(C) Who has at least 25 full-time employees.

(9) “Industrial insured captive insurance company” means any company that insures risks of the industrial insureds that comprise the industrial insured group, and that may insure the risks of the affiliated companies of the industrial insureds and the

risks of the controlled unaffiliated business of an industrial insured or its affiliated companies.

(10) "Industrial insured group" means any group of industrial insureds that collectively:

(A) Own, control, or hold with power to vote all of the outstanding voting securities of an industrial insured captive insurance company incorporated as a stock insurer;

(B) Have complete voting control over an industrial insured captive insurance company incorporated as a mutual insurer; or

(C) Constitute all of the subscribers of an industrial insured captive insurance company formed as a reciprocal insurer; or

(D) Have complete voting control over an industrial insured captive insurance company formed as a limited liability company.

(11) "Member organization" means any individual, corporation, limited liability company, partnership, association, or other entity that belongs to an association.

(12) "Mutual corporation" means a corporation organized without stockholders and includes a nonprofit corporation with members.

(13) "Parent" means a corporation, limited liability company, partnership, other entity, or individual that directly or indirectly owns, controls, or holds with power to vote more than 50 per centum of the outstanding voting:

(A) Securities of a pure captive insurance company organized as a stock corporation; or

(B) Membership interests of a pure captive insurance company organized as a nonprofit corporation; or

(C) Membership interests of a pure captive insurance company organized as a limited liability company.

(14) “Pure captive insurance company” means any company that insures risks of its parent and affiliated companies or controlled unaffiliated business.

(15) “Risk retention group” means a captive insurance company organized under the laws of this state pursuant to the Liability Risk Retention Act of 1986, 15 U.S.C. § 3901 et seq., as amended, as a stock or mutual corporation, a reciprocal or other limited liability entity.

(16) “Incorporated cell” means a protected cell of an incorporated cell captive insurance company that is organized as a corporation or other legal entity separate from the incorporated cell captive insurance company.

(17) “Incorporated cell captive insurance company” means a protected cell captive insurance company that is established as a corporation or other legal entity separate from its incorporated cells that are organized as separate legal entities.

**56-13-103.** Licensing; Authority

(a) Any captive insurance company, when permitted by its articles of association, charter, or other organizational document, may apply to the commissioner for a license to do any and all insurance comprised in Sections 56-2-201(2) and (4)-(7), 56-2-202, -203, and -204 of this title; provided, however, that:

(1) No pure captive insurance company may insure any risks other than those of its parent and affiliated companies or controlled unaffiliated business;

(2) No association captive insurance company may insure any risks other than those of its association, those of the member organizations of its association, and those of a member organization’s affiliated companies;

(3) No industrial insured captive insurance company may insure any risks other than those of the industrial insureds that comprise the industrial insured group, those of their affiliated companies, and those of the controlled unaffiliated business of an industrial insured or its affiliated companies;

(4) No risk retention group may insure any risks other than those of its members and owners;

(5) No captive insurance company may provide personal motor vehicle or homeowner's insurance coverage or any component thereof;

(6) No captive insurance company may accept or cede reinsurance except as provided in Section 56-13- of this title;

(7) Any captive insurance company may provide excess or stop loss accident and health insurance, unless prohibited by federal law or the laws of the state having jurisdiction over the transaction.

(8) No captive insurance company may provide workers' compensation insurance except to insureds and affiliates who may otherwise qualify as self-insureds under this title; and

(b) No captive insurance company shall do any insurance business in this state unless:

(1) It first obtains from the commissioner a license authorizing it to do insurance business in this state;

(2) Its board of directors or committee of managers or, in the case of a reciprocal insurer, its subscribers' advisory committee holds at least one meeting each year in this state;

(3) It maintains its principal place of business in this state; and

(4) It appoints a registered agent to accept service of process and to otherwise act on its behalf in this state; provided that whenever such registered agent cannot with reasonable diligence be found at the registered office of the captive insurance company, the secretary of state shall be an agent of such captive insurance company upon whom any process, notice, or demand may be served.

(c)

(1) Before receiving a license, a captive insurance company shall:

(A) file with the commissioner a certified copy of its organizational documents, a statement under oath of its president and secretary showing its financial condition, and any other statements or documents required by the commissioner; and

(B) submit to the commissioner for approval a description of the coverages, deductibles, coverage limits, and rates, together with such additional information as the commissioner may reasonably require. In the event of any subsequent material change in any item in such description, the captive insurance company shall submit to the commissioner for approval an appropriate revision and shall not offer any additional kinds of insurance until a revision of such description is approved by the commissioner. The captive insurance company shall inform the commissioner of any material change in rates within thirty (30) days of the adoption of such change.

(2) Each applicant captive insurance company shall also file with the commissioner evidence of the following:

(A) The amount and liquidity of its assets relative to the risks to be assumed;

(B) The adequacy of the expertise, experience, and character of the person or persons who will manage it;

(C) The overall soundness of its plan of operation;

(D) The adequacy of the loss prevention programs of its insureds;  
and

(E) Such other factors deemed relevant by the commissioner in ascertaining whether the proposed captive insurance company will be able to meet its policy obligations.

(3) Information submitted pursuant to this subsection shall be and remain confidential, and may not be made public by the commissioner or an employee or agent of the commissioner without the written consent of the company, except that:

(A) Such information may be discoverable by a party in a civil action or contested case to which the captive insurance company that submitted such information is a party, upon a showing by the party seeking to discover such information that:

(i) The information sought is relevant to and necessary for the furtherance of such action or case;

(ii) The information sought is unavailable from other non-confidential sources; and

(iii) A subpoena issued by a judicial or administrative officer of competent jurisdiction has been submitted to the

commissioner; provided, however, that the provisions of this subdivision (3) shall not apply to any risk retention group; and

(B) The Commissioner may, in the Commissioner's discretion, disclose such information to a public officer having jurisdiction over the regulation of insurance in another state, provided that:

(i) Such public official shall agree in writing to maintain the confidentiality of such information; and

(ii) The laws of the state in which such public official serves require such information to be and to remain confidential.

(d) Each captive insurance company shall pay to the commissioner a nonrefundable fee of \$1,000.00 for examining, investigating, and processing its application for license, and for issuing same, and the commissioner is authorized to retain legal, financial, and examination services from outside the department, the reasonable costs of which may be charged against the applicant. The provisions of Sections 56-1-401 through -420 of this title shall apply to examinations, investigations, and processing conducted under the authority of this section. In addition, each captive insurance company shall pay a license renewal fee for each year thereafter of \$1,000.00.

(e) If the Commissioner is satisfied that the documents and statements that such captive insurance company has filed comply with the provisions of this chapter, the Commissioner may grant a license authorizing it to do insurance business in this state until April 1 thereafter, which license may be renewed.

**56-13-104** Names of companies

No captive insurance company shall adopt a name that is the same, deceptively similar, or likely to be confused with or mistaken for any other existing business name registered in this state, nor any name calculated to mislead the public.

**56-13-105** 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.

(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 or an irrevocable letter of credit issued by a bank approved by the Commissioner.

**56-13-106** Dividends

No captive insurance company may pay a dividend out of, or other distribution with respect to, capital or surplus without the prior approval of the Commissioner. Approval of an ongoing plan for the payment of dividends or other distributions shall be conditioned upon the retention, at the time of each payment, of capital or surplus in excess of amounts specified by, or determined in accordance with formulas approved

by, the Commissioner. A captive insurance company may otherwise make such distributions as are in conformity with its purposes and approved by the Commissioner.

**56-13-107** Formation of Captive Insurance Companies in this State

(a) A pure captive insurance company may be incorporated as a stock insurer with its capital divided into shares and held by the stockholders, as a nonprofit corporation with one or more members, or as a manager-managed limited liability company.

(b) An association captive insurance company, an industrial insured captive insurance company, or a risk retention group may be:

(1) incorporated as a stock insurer with its capital divided into shares and held by the stockholders;

(2) incorporated as a mutual corporation;

(3) organized as a reciprocal insurer in accordance with chapter \_\_\_\_ of this title; or

(4) organized as a manager-managed limited liability company.

(c) A captive insurance company incorporated or organized in this state shall have not less than three incorporators or three organizers of whom not less than one shall be a resident of this state.

(d) In the case of a captive insurance company:

(1)

(A) formed as a corporation, before the articles of incorporation are transmitted to the secretary of state, the incorporators shall petition the Commissioner to issue a certificate setting forth the Commissioner's finding that the establishment and maintenance of the proposed

corporation will promote the general good of the state. In arriving at such a finding the commissioner shall consider:

(i) the character, reputation, financial standing and purposes of the incorporators;

(ii) the character, reputation, financial responsibility, insurance experience, and business qualifications of the officers and directors; and

(iii) such other aspects as the commissioner shall deem advisable.

(B) the articles of incorporation, such certificate, and the organization fee shall be transmitted to the secretary of state, who shall thereupon record both the articles of incorporation and the certificate.

(2) formed as a reciprocal insurer, the organizers shall petition the Commissioner to issue a certificate setting forth the commissioner's finding that the establishment and maintenance of the proposed association will promote the general good of the state. In arriving at such a finding the Commissioner shall consider the items set forth in subdivisions (1)(A)(i)-(iii) of this subsection.

(3) formed as a limited liability company, before the articles of organization are transmitted to the secretary of state, the organizers shall petition the commissioner to issue a certificate setting forth the Commissioner's finding that the establishment and maintenance of the proposed company will promote the general good of the state. In arriving at such a finding, the Commissioner shall consider the items set forth in subdivisions (1)(A)(i)-(iii) of this subsection.

(e) The capital stock of a captive insurance company incorporated as a stock insurer may be authorized with no par value.

(f) In the case of a captive insurance company:

(1) formed as a corporation, at least one of the members of the board of directors shall be a resident of this state;

(2) formed as a reciprocal insurer, at least one of the members of the subscribers' advisory committee shall be a resident of this state;

(3) formed as a limited liability company, at least one of the managers shall be a resident of this state.

(g) Other than captive insurance companies formed as limited liability companies or as nonprofit corporations, captive insurance companies formed as corporations under the provisions of this chapter shall have the privileges and be subject to the provisions of title 48 as well as the applicable provisions contained in this chapter. In the event of conflict between the provisions of said general corporation law and the provisions of this chapter, the latter shall control.

(h) Captive insurance companies formed under the provisions of this chapter:

(1) as limited liability companies shall have the privileges and be subject to the provisions of title 48 as well as the applicable provisions contained in this chapter. In the event of a conflict between the provisions of title 48 and the provisions of this chapter, the latter shall control; or

(2) as nonprofit corporations shall have the privileges and be subject to the provisions of title 48 as well as the applicable provisions contained in this chapter. In the event of conflict between the provisions of title 48 and the provisions of this chapter, the latter shall control.

(i) The provisions of this title 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 therein, except that:

(1) the Commissioner may, upon request of an insurer party to a merger authorized under this subsection, waive the requirement of \_\_\_\_ of this title;

(2) the Commissioner may waive the requirements for public notice and hearing or, in accordance with rules which the Commissioner may adopt addressing categories of transactions, modify the requirements for public notice and hearing. If a notice of public hearing is required, but no one requests a hearing ten days before the day set for the hearing, then the commissioner may cancel the hearing;

(3) the provisions of subsections \_\_\_\_ of this title shall not apply, and the Commissioner may waive or modify the requirement of subdivision \_\_\_\_ of this title, with respect to market value of a converted company as necessary or desirable to reflect applicable restrictions on ownership of companies formed under this chapter;

(4) an alien insurer may be a party to a merger authorized under this subsection; provided that the requirements for a merger between a captive insurance company and a foreign insurer under section \_\_\_\_ of this title shall apply to a merger between a captive insurance company and an alien insurer under this subsection. Such alien insurer shall be treated as a foreign insurer under section \_\_\_\_ and such other jurisdictions shall be the equivalent of a state for purposes of section \_\_\_\_; and

(5) the Commissioner may issue a certificate of general good to permit the formation of a captive insurance company that is established for the purpose

of consolidating or merging with or assuming existing insurance or reinsurance business from an existing licensed captive insurance company.

(j) Captive insurance companies formed as reciprocal insurers under the provisions of this chapter shall have the privileges and be subject to the provisions of chapter \_\_\_ of this title in addition to the applicable provisions of this chapter. In the event of a conflict between the provisions of chapter \_\_\_ and the provisions of this chapter, the latter shall control. To the extent a reciprocal insurer is made subject to other provisions of this title pursuant to chapter \_\_\_, such provisions shall not be applicable to a reciprocal insurer formed under this chapter unless such provisions are expressly made applicable to captive insurance companies under this chapter.

(k) The articles of incorporation or bylaws of a captive insurance company formed as a corporation may authorize a quorum of its board of directors to consist of no fewer than one-third of the fixed or prescribed number of directors.

(l) The subscribers' agreement or other organizing document of a captive insurance company formed as a reciprocal insurer may authorize a quorum of its subscribers' advisory committee to consist of no fewer than one-third of the number of its members.

(m) With the Commissioner's approval, a captive insurance company organized as a stock insurer may convert to a nonprofit corporation with one or more members by filing with the secretary of state an irrevocable election for such conversion, provided that:

(1) the irrevocable election shall certify that, at the time of the company's original organization and at all times thereafter, the company conducted its business in a manner not inconsistent with a nonprofit purpose; and

(2) at the time of the filing of its irrevocable election, the company shall file with both the commissioner and the secretary of state amended and restated articles of incorporation consistent with the provisions of this chapter and with Title 11B, duly authorized by the corporation.

(n) The following provisions of title 48 shall not apply to captive insurance companies that are nonprofit corporations:

(1) subsection \_\_\_ relating to the signing of articles of incorporation by directors;

(2) section \_\_\_ in the case of any merger in which a captive insurance company merges with and into a captive insurance company organized as a nonprofit corporation under title 48 where the latter is the surviving corporation.

(o) In the case of a captive insurance company formed as a limited liability company, a reciprocal insurance company or mutual insurance company, any proxy executed by the members, subscribers, and policyholders of each shall be valid if executed and transmitted in compliance with title 48.

**56-13-108. Reports and statements**

(a) Captive insurance companies shall not be required to make any annual report except as provided in this chapter.

(b) Prior to March 1 of each year, and prior to March 15 of each year in the case of pure captive insurance companies or industrial insured captive insurance companies, each captive insurance company shall submit to the commissioner a report of its financial condition, verified by oath of two of its executive officers. Each captive insurance company shall report using generally accepted accounting principles, unless the Commissioner requires, approves, or accepts the use of statutory accounting principles or other comprehensive basis of accounting, in each case with any

appropriate or necessary modifications or adaptations thereof required or approved or accepted by the Commissioner for the type of insurance and kinds of insurers to be reported upon, and as supplemented by additional information required by the Commissioner. Except as otherwise provided, each association captive insurance company and each risk retention group shall file its report in the form required by subsection \_\_\_ of this title, and each risk retention group shall comply with the requirements set forth in section \_\_\_ of this title. The Commissioner shall by rule propose the forms in which pure captive insurance companies and industrial insured captive insurance companies shall report. Subsection 56-13-103(c)(3) of this title shall apply to each report filed pursuant to this section, except that such subdivision shall not apply to reports filed by risk retention groups.

(c) Any pure captive insurance company or an industrial insured captive insurance company may make written application for filing the required report on a fiscal year-end. If an alternative reporting date is granted:

(1) the annual report is due 75 days after the fiscal year-end; and

(2) in order to provide sufficient detail to support the premium tax return, the pure captive insurance company or industrial insured captive insurance company shall file, prior to March 15 of each year for each calendar year-end, pages 1, 2, 3, and 5 of the "Captive Annual Statement; Pure or Industrial Insured," verified by oath of two of its executive officers.

**56-13-109** Examinations and investigations

(a) At least once in three years, and whenever the Commissioner determines it to be prudent, the Commissioner shall personally, or by some competent person appointed by the Commissioner, visit each captive insurance company and thoroughly inspect and examine its affairs to ascertain its financial condition, its ability to fulfill its

obligations and whether it has complied with the provisions of this chapter. The Commissioner may enlarge the aforesaid three-year period to five years, provided said captive insurance company is subject to a comprehensive annual audit during such period of a scope satisfactory to the Commissioner by independent auditors approved by the Commissioner. The expenses and charges of the examination shall be paid to the state by the company or companies examined and the Commissioner.

(b) The provisions of Section 56-1-401 through 420 of this title shall apply to examinations conducted under this section.

(c) All examination reports, preliminary examination reports or results, working papers, recorded information, documents and copies thereof produced by, obtained by or disclosed to the Commissioner or any other person in the course of an examination made under this section are confidential and are not subject to subpoena and may not be made public by the Commissioner or an employee or agent of the Commissioner without the written consent of the company, except to the extent provided in this subsection. Nothing in this subsection shall prevent the Commissioner from using such information in furtherance of the Commissioner's regulatory authority under this title. The Commissioner may, in the Commissioner's discretion, grant access to such information to public officers having jurisdiction over the regulation of insurance in any other state or country, or to law enforcement officers of this state or any other state or agency of the federal government at any time, so long as such officers receiving the information agree in writing to hold it in a manner consistent with this section.

**56-13-110.** Grounds and procedures for suspension or revocation of license

(a) The license of a captive insurance company may be suspended or revoked by the commissioner for any of the following reasons:

(1) Insolvency or impairment of capital or surplus;

(2) Failure to meet the requirements of Section 56-13-105 of this title;

(3) Refusal or failure to submit an annual report, as required by this chapter, or any other report or statement required by law or by lawful order of the commissioner;

(4) Failure to comply with the provisions of its own charter, bylaws or other organizational document;

(5) Failure to submit to or pay the cost of examination or any legal obligation relative thereto, as required by this chapter;

(6) Use of methods that, although not otherwise specifically prohibited by law, nevertheless render its operation detrimental or its condition unsound with respect to the public or to its policyholders; or

(7) Failure otherwise to comply with the laws of this state.

(b) If the Commissioner finds, upon examination, hearing, or other evidence, that any captive insurance company has violated any provision of subsection (a) of this section, the Commissioner may suspend or revoke such company's license if the Commissioner deems it in the best interest of the public and the policyholders of such captive insurance company, notwithstanding any other provision of this title.

**56-13-111.** Legal investments

(a) Except as may be otherwise authorized by the Commissioner, association captive insurance companies and risk retention groups shall comply with the investment requirements contained in Sections 56-3-401 through -409 of this title, as applicable. Notwithstanding any other provision of this title, the Commissioner may approve the use of alternative reliable methods of valuation and rating.

(b) No pure captive insurance company, industrial insured captive insurance company, protected cell captive insurance company, incorporated cell captive insurance

company, or special purpose financial captive insurance company shall be subject to any restrictions on allowable investments whatever; provided, however, that the Commissioner may prohibit or limit any investment that threatens the solvency or liquidity of any such company.

(c) No pure captive insurance company may make a loan to or an investment in its parent company or affiliates without prior written approval of the Commissioner, and any such loan or investment must be evidenced by documentation approved by the Commissioner. Loans of minimum capital and surplus funds required by Section 56-13-105 of this title are prohibited.

**56-13-112. Reinsurance**

(a) Any captive insurance company may provide reinsurance as authorized by this title on risks ceded by any other insurer.

(b) Any captive insurance company may take credit for the reinsurance of risks or portions of risks ceded to reinsurers complying with the provisions of this title.

(c) In addition to reinsurers authorized hereunder, a captive insurance company may take credit for the reinsurance of risks or portions of risks ceded to a pool, exchange or association acting as a reinsurer which has been authorized by the Commissioner. The Commissioner may require any other documents, financial information or other evidence that such a pool, exchange or association will be able to provide adequate security for its financial obligations. The Commissioner may deny authorization or impose any limitations on the activities of a reinsurance pool, exchange or association that, in the Commissioner's judgment, are necessary and proper to provide adequate security for the ceding captive insurance company and for the protection and consequent benefit of the public at large.

(d) For all purposes of this chapter, insurance by a captive insurance company of any workers' compensation or accident and health qualified self-insured plan of its parent and affiliates shall be deemed to be reinsurance.

**56-13-113.** Rating organizations; memberships; Guaranty Associations, etc.

(a) No captive insurance company shall be required to join a rating organization.

(b) No captive insurance company shall be permitted to join or contribute financially to any plan, pool, association, or guaranty or insolvency fund in this state, nor shall any such captive insurance company, or any insured or affiliate thereof, receive any benefit from any such plan, pool, association, or guaranty or insolvency fund for claims arising out of the operations of such captive insurance company.

**56-13-114.** Tax on premiums collected

(a) Each captive insurance company shall pay to the Commissioner of Revenue, on or prior to March 1 of each year, a tax at the rate of four tenths of one percent (0.4%) on the first 20 million dollars, and three tenths of one percent (0.3%) on each dollar thereafter on the direct premiums collected or contracted for on policies or contracts of insurance written by the captive insurance company during the year ending December 31 next preceding, after deducting from the direct premiums subject to the tax the amounts paid to policyholders as return premiums which shall include dividends on unabsorbed premiums or premium deposits returned or credited to policyholders; provided, however, that no tax shall be due or payable as to considerations received for annuity contracts.

(b) Each captive insurance company shall pay to the Commissioner of Revenue, on or prior to March 1 of each year, a tax at the rate of 225-thousandths of one percent (0.225%) on the first 20 million dollars of assumed reinsurance premium, and 150-thousandths of one percent (0.150%) on the next 20 million dollars, and 50-thousandths

of one percent (0.050%) on the next 20 million dollars, and 25-thousandths of one percent (0.025%) of each dollar thereafter. However, no reinsurance tax applies to premiums for risks or portions of risks that are subject to taxation on a direct basis pursuant to subsection (a) of this section. No reinsurance premium tax shall be payable in connection with the receipt of assets in exchange for the assumption of loss reserves and other liabilities of another insurer under common ownership and control if such transaction is part of a plan to discontinue the operations of such other insurer, and if the intent of the parties to such transaction is to renew or maintain such business with the captive insurance company.

(c) The annual minimum aggregate tax to be paid by a captive insurance company calculated under subsections (a) and (b) of this section shall be \$5,000.00, and the annual maximum aggregate tax shall be \$100,000.00. The maximum aggregate tax to be paid by a sponsored captive insurance company shall apply to each protected cell only and not to the sponsored captive insurance company as a whole. If a captive insurance company is a special purpose financial captive organized and licensed under subchapter 4 of this chapter and if such captive insurance company is subject to subsection (e) of this section as a captive insurance company under common ownership and control with one or more other captive insurance companies (collectively, the “consolidated group”), the premium tax calculated with respect to the consolidated group under subsections (a) and (b) of this section shall be allocated to each member of the consolidated group in the same proportion that the premium allocable to such member bears to the total premium of all members. The consolidated group shall pay an aggregate premium tax equal to the greater of the sum of the premium tax allocated to the members and \$5,000.00; provided:

(1) If the total of premium tax allocated to all members of a consolidated group that are special purpose financial captives (as defined in Section 56-13-402 of this chapter) exceeds \$100,000.00, the total premium tax allocated to such members shall be \$100,000.00; and

(2) If the total of premium tax allocated to all members of the consolidated group that are not special purpose financial captive insurance companies exceeds \$100,000.00, the total of premium tax allocated to such members shall be \$100,000.00.

(d) The tax provided for in this section shall constitute all taxes collectible under the laws of this state from any captive insurance company, and no other occupation tax or other taxes shall be levied or collected from any captive insurance company by the state or any county, city, or municipality within this state, except ad valorem taxes on real and personal property used in the production of income.

(e) Annually, the first \$100,000 of the premium tax revenues collected pursuant to this section, and 10 percent of any such premium tax revenues collected in excess of \$100,000, shall be transferred to the Department of Commerce and Insurance for the regulation of captive insurance companies under this chapter.

(f) The tax provided for in this section shall be calculated on an annual basis, notwithstanding policies or contracts of insurance or contracts of reinsurance issued on a multiyear basis. In the case of multiyear policies or contracts, the premium shall be prorated for purposes of determining the tax under this section.

**56-13-115. Rules and regulations**

The Commissioner may adopt and from time to time amend such rules relating to captive insurance companies as are necessary to enable the commissioner to carry out the provisions of this chapter.

**56-13-116. Applicable Laws**

No provisions of this title, other than those contained in this chapter or contained in specific references contained in this chapter, shall apply to captive insurance companies. Risk retention groups shall have the privileges and be subject to the provisions of chapter \_\_\_ of this title in addition to the applicable provisions of this chapter.

**56-13-117. Rules for controlled unaffiliated business**

The Commissioner may adopt rules establishing standards to ensure that a parent or its affiliated company, or an industrial insured or its affiliated company, is able to exercise control of the risk management function of any controlled unaffiliated business to be insured by a pure captive insurance company or an industrial insured captive insurance company, respectively; provided, however, that, until such time as rules under this section are adopted, the Commissioner may approve the coverage of such risks by a pure captive insurance company or an industrial insured captive insurance company.

**56-13-118. Captive insurance regulatory and supervision fund**

There is hereby created a fund to be known as the captive insurance regulatory and supervision fund for the purpose of providing the financial means for the Commissioner to administer this chapter and for reasonable expenses incurred in promoting the captive insurance industry in this state. The transfer of the premium tax under this chapter and all fees and assessments received by the department pursuant to the administration of these chapters shall be credited to this fund.

**56-13-119. Insolvency**

Except as otherwise provided in this chapter, the terms and conditions set forth in chapter \_\_\_ of this title shall apply in full to captive insurance companies formed or licensed under this chapter.

**SUBCHAPTER 2. SPONSORED CAPTIVE INSURANCE COMPANIES**

**56-13-201. Formation**

(a) One or more sponsors may form a sponsored captive insurance company under this chapter. In addition to the general provisions of this chapter, the provisions of this subchapter shall apply to sponsored captive insurance companies.

(b) A sponsored captive insurance company shall be incorporated as a stock insurer with its capital divided into shares and held by the stockholders, as a mutual corporation, as a nonprofit corporation with one or more members, or as a manager-managed limited liability company.

**56-13-202. Definitions**

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

(1) "Participant" means an entity as defined in Section 56-13-206 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.

(2) "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.

(3) "Protected cell" means a separate account established by a sponsored captive insurance company formed or licensed under the provisions of this chapter, in which an identified pool of assets and liabilities are segregated and insulated by means of this chapter from the remainder of the protected cell company's assets and liabilities in accordance with the terms of one or more participant contracts to fund the liability of

the protected cell captive insurance company with respect to the participants as set forth in the participant contracts.

(4) "Protected cell assets" means all assets, contract rights, and general intangibles identified with and attributable to a specific protected cell of a protected cell company.

(5) "Protected cell captive insurance company" means any captive insurance company:

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

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

(c) that insures the risks of separate participants through 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 protected cell captive insurance company's general account.

(6) "Protected cell liabilities" means all liabilities and other obligations identified with and attributed to a specific protected cell of a protected cell company.

(7) "Sponsor" means any entity that meets the requirements of Section 56-13-205 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.

(8) "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.

**56-13-203.** Supplemental application materials

In addition to the information required by Sections 56-13-103(c)(1) and (2) of this title, each applicant-sponsored captive insurance company shall file with the Commissioner the following:

(1) materials demonstrating how the applicant will account for the loss and expense experience of each protected cell at a level of detail found to be sufficient by the Commissioner, and how it will report such experience to the Commissioner;

(2) a statement acknowledging that all financial records of the sponsored captive insurance company, including records pertaining to any protected cells, shall be made available for inspection or examination by the Commissioner or the Commissioner's designated agent;

(3) all contracts or sample contracts between the sponsored captive insurance company and any participants; and

(4) evidence that expenses shall be allocated to each protected cell in a fair and equitable manner.

**56-13-204.** 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, which may be incorporated or unincorporated, to insure risks of one or more participants, subject to the following conditions:

(1)

(A) A protected cell company may establish one or more protected cells with the prior written approval of the Commissioner of a plan of operation or amendments submitted by the protected cell company with respect to each protected cell.

(B) Upon the written approval of the Commissioner of the plan of operation that must include but is not limited to the specific business objectives and investment guidelines of the protected cell, the protected cell company in accordance with the approved plan of operation may attribute to the protected cell insurance obligations with respect to its insurance business.

(C) A protected cell shall have its own distinct name or designation that must include the words "protected cell" or "incorporated cell."

(D) The protected cell company shall transfer all assets attributable to a protected cell to one or more separately established and identified protected cell accounts bearing the name or designation of that protected cell. Protected cell assets must be held in the protected cell accounts for the purpose of satisfying the obligations of that protected cell.

(E) An incorporated protected cell may be organized and operated in any form of business organization authorized by the Commissioner. Each incorporated protected cell of a protected cell captive insurer shall be treated as a captive insurer for purposes of this chapter. Unless otherwise permitted by the articles of incorporation or other organizational document of a protected cell

captive insurer, each incorporated protected cell of the protected cell captive insurer must have the same directors, secretary, and registered office as the protected cell captive insurer.

(F) All attributions of assets and liabilities between a protected cell and the general account must be in accordance with the plan of operation and participant contracts approved by the Commissioner. No other attribution of assets or liabilities may be made by a protected cell company between the protected cell company's general account and its protected cells. Any attribution of assets and liabilities between the general account and a protected cell must be in cash or in readily marketable securities with established market values.

(2) The creation of a protected cell does not create, with respect to that protected cell, a legal person separate from the protected cell company unless the protected cell is an incorporated cell. Amounts attributed to a protected cell under this chapter, including assets transferred to a protected cell account, are owned by the protected cell and the protected cell company may not be, or may not hold itself out to be, a trustee with respect to those protected cell assets of that protected cell account. Notwithstanding the provisions of this subsection, the protected cell company may allow for a security interest to attach to protected cell assets or a protected cell account when in favor of a creditor of the protected cell and otherwise allowed under applicable law.

(3) This chapter may not be construed to prohibit the protected cell company from contracting with or arranging for an investment advisor, commodity trading advisor, or other third party to manage the protected cell assets of a protected cell, if all remuneration, expenses, and other compensation of the third party advisor or manager are payable from the protected cell assets of that protected cell and not from the

protected cell assets of other protected cells or the assets of the protected cell company's general account.

(4) A protected cell company shall establish administrative and accounting procedures necessary to properly identify the one or more protected cells of the protected cell company and the protected cell assets and protected cell liabilities attributable to the protected cells. The directors of a protected cell company shall keep protected cell assets and protected cell liabilities:

(A) separate and separately identifiable from the assets and liabilities of the protected cell company's general account and;

(B) attributable to one protected cell separate and separately identifiable from protected cell assets and protected cell liabilities attributable to other protected cells.

(C) If this the provisions of this subsection (4) are violated, the remedy of tracing is applicable to protected cell assets when commingled with protected cell assets of other protected cells or the assets of the protected cell company's general account. The remedy of tracing must not be construed as an exclusive remedy.

(5) When establishing a protected cell, the protected cell company shall attribute to the protected cell assets a value at least equal to the reserves and other insurance liabilities attributed to that protected cell.

(6) Each protected cell shall be accounted for separately on the books and records of the sponsored captive insurance company to reflect the financial condition and results of operations of such protected cell, net income or loss, dividends or other distributions to participants, and such other factors as may be provided in the participant contract or required by the Commissioner.

(7) The assets of a protected cell shall not be chargeable with liabilities arising out of any other insurance business the sponsored captive insurance company may conduct.

(8) No sale, exchange, or other transfer of assets may be made by such sponsored captive insurance company between or among any of its protected cells without the consent of such protected cells.

(9) No sale, exchange, transfer of assets, dividend, or distribution may be made from a protected cell to a sponsor or participant without the Commissioner's approval and in no event shall such approval be given if the sale, exchange, transfer, dividend or distribution would result in insolvency or impairment with respect to a protected cell;

(10) All attributions of assets and liabilities to the protected cells and the general account shall be in accordance with the plan of operation approved by the Commissioner. No other attribution of assets or liabilities may be made by a sponsored captive insurance company between its general account and any protected cell or between any protected cells. The sponsored captive insurance company shall attribute all insurance obligations, assets, and liabilities relating to a reinsurance contract entered into with respect to a protected cell to such protected cell. The performance under such reinsurance contract and any tax benefits, losses, refunds, or credits allocated pursuant to a tax allocation agreement to which the sponsored captive insurance company is a party, including any payments made by or due to be made to the sponsored captive insurance company pursuant to the terms of such agreement, shall reflect the insurance obligations, assets, and liabilities relating to the reinsurance contract that are attributed to such protected cell;

(11) 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.

(12) 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.

(13) Each sponsored captive insurance company shall annually file with the Commissioner such financial reports as the commissioner shall require, which shall include, without limitation, accounting statements detailing the financial experience of each protected cell.

(14) 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.

(15) 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.

(16) The business written by a sponsored captive, with respect to each cell, shall be:

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

(B) reinsured by a reinsurer authorized or approved by the this state; or

(C) 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 amount of security provided shall be no less than the reserves associated with those liabilities which are neither fronted nor reinsured, including reserves for losses, allocated loss adjustment expenses, incurred but not reported losses and unearned premiums for business written through the participant's protected cell. 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.

(17) Notwithstanding the provisions of this title or other laws of this state, and in addition to the provisions of Section 56-13-208 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.

**56-13-205. Qualification of sponsors**

A sponsor of a sponsored captive insurance company shall be an insurer licensed under the laws of any state, a reinsurer authorized or approved under the laws of any state, a captive insurance company formed or licensed under this chapter, a broker-dealer registered in this state, a financial institution or holding company as defined under the laws of this state, including any affiliate or subsidiary of such financial institution holding company, or any other person approved by the Commissioner in the exercise of his or her discretion, after finding that the approval of a person as a sponsor is not inconsistent with the purposes of this chapter. A risk retention group shall not be either a sponsor or a participant of a sponsored captive insurance company.

**56-13-206.** Participants in sponsored captive insurance companies

(a) Associations, corporations, limited liability companies, partnerships, trusts, and other business entities may be participants in any sponsored captive insurance company formed or licensed under this chapter.

(b) A sponsor may be a participant in a sponsored captive insurance company.

(c) A participant need not be a shareholder of the sponsored captive insurance company or any affiliate thereof.

(d) A participant shall insure only its own risks through a sponsored captive insurance company.

**56-13-207.** Investments by sponsored captive insurance companies

Notwithstanding the provisions of Section 56-13-204 of this title, the assets of two or more protected cells may be combined for purposes of investment, and such combination shall not be construed as defeating the segregation of such assets for accounting or other purposes. Sponsored captive insurance companies shall comply with the investment requirements contained in Sections 56-13-401 through 409 of this title, as applicable; provided, however, that compliance with such investment requirements shall be waived for sponsored captive insurance

companies to the extent that credit for reinsurance ceded to reinsurers is allowed pursuant to Section 56-13-112 of this title or to the extent otherwise deemed reasonable and appropriate by the Commissioner. Notwithstanding any other provision of this title, the Commissioner may approve the use of alternative reliable methods of valuation and rating.

**56-13-208. Delinquency**

(a) Except as otherwise provided in this section, the provisions of chapter 9 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 9 of this title:

(1) 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) 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.

**SUBCHAPTER 3. BRANCH CAPTIVE INSURANCE COMPANIES**

**56-13-301. Establishment of a Branch Captive**

(a) A branch captive may be established in this state in accordance with the provisions of this chapter to write in this state any insurance or reinsurance either of the employee benefit business of its parent and affiliated companies that is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended, or any insurance or reinsurance permitted to be written by captive insurance companies pursuant to this chapter. In addition to the general provisions of this chapter, the provisions of this subchapter shall apply to branch captive insurance companies.

(b) No branch captive insurance company shall do any insurance business in this state unless it maintains the principal place of business for its branch operations in this state.

**56-13-302. Definitions**

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

(1) "Alien captive insurance company" means any insurance company formed to write insurance business for its parents and affiliates and licensed pursuant to the laws of an alien jurisdiction which imposes statutory or regulatory standards in a form acceptable to the Commissioner on companies transacting the business of insurance in such jurisdiction.

(2) "Branch business" means any insurance business transacted by a branch captive insurance company in this state.

(3) "Branch captive insurance company" means any alien captive insurance company licensed by the Commissioner to transact the business of insurance in this state through a business unit with a principal place of business in this state.

(4) "Branch operations" means any business operations of a branch captive insurance company in this state.

**56-13-303. Security Required**

(a) No branch captive insurance company shall be issued a license unless it shall possess and thereafter maintain, as security for the payment of liabilities attributable to the branch operations:

(1) an amount equal to the amount set forth in this chapter as the minimum capital requirement for a pure captive; and in addition

(2) reserves on such insurance policies or such reinsurance contracts as may be issued or assumed by the branch captive insurance company through its

branch operations, including reserves for losses, allocated loss adjustment expenses, incurred but not reported losses, and unearned premiums with regard to business written through the branch operations; provided, however, the Commissioner may permit a branch captive insurance company to credit against any such reserve requirement any security for loss reserves that the branch captive insurance company may post with a ceding insurer or that may be posted by a reinsurer with the branch captive insurance company, in either case so long as such security remains posted.

(b) Subject to the prior approval of the Commissioner, the amounts required in subsection (a) of this section may be held in the form of:

(1) a trust formed under a trust agreement and funded by assets acceptable to the commissioner;

(2) an irrevocable letter of credit issued or confirmed by a bank approved by the Commissioner;

(3) with respect to the amounts required in subdivision (a)(1) of this section only, cash on deposit with the Commissioner; or

(4) any combination thereof.

**56-13-304. Certificate of General Good**

In the case of a captive insurance company licensed as a branch captive, the alien captive insurance company shall petition the Commissioner to issue a certificate setting forth the Commissioner's finding that, after considering the character, reputation, financial responsibility, insurance experience, and business qualifications of the officers and directors of the alien captive insurance company, the licensing and maintenance of the branch operations will promote the general good of the state. The alien captive insurance company may register to do business in this state after the Commissioner's certificate is issued.

**56-13-305. Branch Captive Reports**

Prior to March 1 of each year, or with the approval of the Commissioner within 60 days after its fiscal year-end, a branch captive insurance company shall file with the Commissioner a copy of all reports and statements required to be filed under the laws of the jurisdiction in which the alien captive insurance company is formed, verified by oath of two of its executive officers. If the Commissioner is satisfied that the annual report filed by the alien captive insurance company in its domiciliary jurisdiction provides adequate information concerning the financial condition of the alien captive insurance company, the Commissioner may waive the requirement for completion of the captive annual statement for business written in the alien jurisdiction.

**56-13-306. Examination of Branch Captives**

(a) The examination of a branch captive insurance company pursuant to Section 56-13-109 of this title shall be of branch business and branch operations only, so long as the branch captive insurance company provides annually to the Commissioner a certificate of compliance, or its equivalent, issued by or filed with the licensing authority of the jurisdiction in which the branch captive insurance company is formed, and demonstrates to the Commissioner's satisfaction that it is operating in sound financial condition in accordance with all applicable laws and regulations of such jurisdiction.

(b) As a condition of licensure, the alien captive insurance company shall grant authority to the Commissioner for examination of the affairs of the alien captive insurance company in the jurisdiction in which the alien captive insurance company is formed.

**56-13-307. Taxation of Branch Captives**

In the case of a branch captive insurance company, the tax provided for in Section 56-13-114 of this title shall apply only to the branch business of such company.

**SUBCHAPTER 4. SPECIAL PURPOSE FINANCIAL CAPTIVES**

**56-13-401. Purpose**

This article provides for the creation of Special Purpose Financial Captives (SPFCs) exclusively to facilitate the securitization of one or more risks, as a means of accessing alternative sources of capital and achieving the benefits of securitization. SPFCs are created for the limited purpose of entering into SPFC contracts and insurance securitization transactions and into related agreements to facilitate the accomplishment and execution of those transactions. The creation of SPFCs is intended to achieve greater efficiencies in structuring and executing insurance securitizations, to diversify and broaden for insurers to sources of capital, to facilitate access for many insurers to insurance securitization and capital markets financing technology, and to further the economic development and expand the interest of this state through its captive insurance program.

**56-13-402. Definitions**

For purposes of this article:

(1) "Administrative Law Court" means that agency and court of record created pursuant to the provisions of \_\_\_\_.

(2) "Affiliated company" means a company in the same corporate system as a parent, by virtue of common ownership, control, operation, or management.

(3) "Contested case" means a proceeding in which the legal rights, duties, obligations, or privileges of a party are required by law to be determined by the Administrative Law Court after an opportunity for hearing.

(4) "Control" including the terms "controlling", "controlled by", and "under common control with" means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or non-management services, or otherwise, unless the power is the result of an official

position with or corporate office held by the person. Control must be presumed to exist if a person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing ten percent (10%) or more of the voting securities of another person. This presumption may be rebutted by a showing that control does not exist. Notwithstanding other provisions of this item, for purposes of this article, the fact that an SPFC exclusively provides reinsurance to a ceding insurer under an SPFC contract is not by itself sufficient grounds for a finding that the SPFC and ceding insurer are under common control.

(5) “Counterparty” means an SPFC’s parent or affiliated company, as ceding insurer to the SPFC contract, or subject to the prior approval of the Commissioner, a non-affiliated company.

(6) “Fair value” means:

(a) as to cash, the amount of it; and

(b) as to an asset other than cash:

(i) the amount at which that asset could be bought or sold in a current transaction between arms-length, willing parties;

(ii) the quoted mid-market price for the asset in active markets must be used if available; and

(iii) if quoted mid-market prices are not available, a value determined using the best information available considering values of similar assets and other valuation methods, such as present value of future cash flows, historical value of the same or similar assets, or comparison to values of other asset classes, the value of which have been historically related to the subject asset.

(7) “Insolvency” or “insolvent” means that the SPFC or one or more of its protected cells is unable to pay its obligations when they are due, unless those obligations are the subject of a bona fide dispute, or the Commissioner previously has established by order other criteria for determining the solvency of the SPFC or one or more of its protected cells, in which case the SPFC is insolvent if it fails to meet that criteria.

(8) “Insurance securitization” means a package of related risk transfer instruments, capital market offerings, and facilitating administrative agreements by which proceeds are obtained by an SPFC directly or indirectly through the issuance of securities, which complies with applicable securities law, and which proceeds are held in trust pursuant to the provisions of this chapter to secure the obligations of the SPFC under one or more SPFC contracts with a counterparty, where investment risk to the holders of these securities is contingent upon the obligations of the SPFC to the counterparty under the SPFC contract in accordance with the transaction terms.

(9) “Management” means the board of directors, managing board, or other individual or individuals vested with overall responsibility for the management of the affairs of the SPFC, including the election and appointment of officers or other of those agents to act on behalf of the SPFC.

(10) “Organizational document” means the SPFC’s Articles of Incorporation, Articles of Organization, Bylaws, Operating Agreement, or other foundational documents that establish the SPFC as a legal entity or prescribes its existence.

(11) “Parent” means any corporation, limited liability company, partnership, or individual that directly or indirectly owns, controls, or holds with power to vote more than fifty percent (50%) of the outstanding voting securities of an SPFC.

(12) “Permitted investments” means those investments that meet the qualifications pursuant to Section 56-13-3--.

(13) “Protected cell” means a separate account established and maintained by an SPFC for one SPFC contract and the accompanying insurance securitization with a counterparty.

(14) “Qualified United States financial institution” means, for purposes of meeting the requirements of a trustee as specified in Section 56-13-3--, a financial institution that is eligible to act as a fiduciary of a trust, and is:

(a) organized or, in the case of a United States branch or agency office of a foreign banking organization, is licensed under the laws of the United States or any state of the United States; and

(b) regulated, supervised, and examined by federal or state authorities having regulatory authority over banks and trust companies.

(14) “Securities” means those different types of debt obligations, equity, surplus certificates, surplus notes, funding agreements, derivatives, and other legal forms of financial instruments.

(15) “SPFC” or “Special Purpose Financial Captive” means a captive insurance company that has received a certificate of authority from the Commissioner for the limited purposes provided for in this chapter.

(16) “SPFC contract” means a contract between the SPFC and the counterparty pursuant to which the SPFC agrees to provide insurance or reinsurance protection to the counterparty for risks associated with the counterparty’s insurance or reinsurance business.

(17) “SPFC securities” means the securities issued by a SPFC.

(18) “Surplus note” means an unsecured subordinated debt obligation deemed to be a surplus certificate under this title and otherwise possessing characteristics consistent with paragraph 3 of the Statement of Statutory Accounting Principals No. 41, as amended, National Association of Insurance Commissioners (NAIC).

(19) “Third party” means a person unrelated to an SPFC or its counterparty, or both, that has been aggrieved by a decision of a director regarding that SPFC or its activities.

**56-13-403.** Relation to other provisions in Title 56

(A) No provisions of this title, other than those specifically referenced in this subchapter, shall apply to an SPFC, and those provisions apply only as modified by this subchapter. If a conflict occurs between a provision of this title and a provision of this subchapter, the latter shall control.

(B) The director, by rule, regulation, or order, may exempt an SPFC or its protected cells, on a case-by-case basis, from provisions of this chapter that he or she determines to be inappropriate given the nature of the risks to be insured.

**56-13-404.** License to Transact Business in this State; Contents of Application; Fees;  
Foreign Corporations

(A) An SPFC, when permitted by its organizational documents, may apply to the director for a license to transact insurance or reinsurance business as authorized by this article. An SPFC only may insure or reinsure the risks of its counterparty.

Notwithstanding another provision of this article, an SPFC may purchase reinsurance to cede the risks assumed under the SPFC contract as approved by the Commissioner.

(B) To transact business in this state an SPFC shall:

(1) obtain from the Commissioner a license authorizing it to conduct insurance or reinsurance business, or both, in this state;

(2) hold at least one management meeting each year in this state;

(3) maintain its principal place of business in this state;

(4) appoint a resident registered agent to accept service of process and to otherwise act on its behalf in this state. If the registered agent, with reasonable diligence, is not found at the registered office of the SPFC, the Commissioner must be an agent of the SPFC upon whom any process, notice, or demand may be served;

(5) provide such documentation of the insurance securitization as requested by the Commissioner immediately upon closing of the transaction, including:

(a) an opinion of legal counsel with respect to compliance with this subchapter and any other applicable laws as of the effective date of the transaction; and

(b) a statement under oath of its president and secretary showing its financial condition; and

(6) provide a complete set of the documentation of the insurance securitization to the Commissioner immediately following closing of the transaction.

(C) A complete SPFC application must include the following:

(1) a certified copy of its organizational documents; and

(2) evidence of:

(a) the amount and liquidity of its assets relative to the risks to be assumed;

(b) the adequacy of the expertise, experience, and character of the person or persons who manage it;

(c) the overall soundness of its plan of operation;

(d) other factors considered relevant by the Commissioner in ascertaining whether the proposed SPFC is able to meet its policy obligations; and

(e) the applicant SPFC's financial condition, including the source and form of the minimum capitalization to be contributed to the SPFC.

(3) A plan of operation, consisting of a description of or statement of intent with respect to the contemplated insurance securitization, the SPFC contract, and related transactions, which must include:

(a) draft documentation or, at the discretion of the Commissioner, a written summary of all material agreements that are entered into to effectuate the SPFC contract and, before effecting such, the insurance securitization, to include the names of the counterparty, the nature of the risks being assumed, the proposed use of protected cells, if any, and the maximum amounts, purpose, and nature and the interrelationships of the various transactions required to effectuate the insurance securitization;

(b) the source and form of additional capitalization to be contributed to the SPFC;

(c) the proposed investment strategy of the SPFC;

(d) a description of the underwriting, reporting, and claims payment methods by which losses covered by the SPFC contract are reported, accounted for, and settled; and

(e) a pro forma balance sheet and income statement illustrating various stress case scenarios for the performance of the SPFC under the SPFC contract.

(4) Biographical affidavits in NAIC format of all of the prospective SPFC's officers and directors, providing their legal names, any names under which they have or are conducting their affairs, and any other biographical information as the Commissioner may request.

(5) An affidavit from the applicant SPFC verifying:

(a) the applicant SPFC meets the provisions of this article;

(b) the applicant SPFC operates only pursuant to the provisions in this article;

(c) the applicant SPFC's investment strategy reflects and takes into account the liquidity of assets and the reasonable preservation, administration, and asset management of such assets relative to the risks associated with the SPFC contract and the insurance securitization transaction;

(d) the securities proposed to be issued are valid legal obligations that are either properly registered with the Commissioner or constitute an exempt security or form part of an exempt transaction; and

(e) unless otherwise exempted by the Commissioner, the trust agreement, the trusts holding assets that secure the obligations of the SPFC under the SPFC contract, and the SPFC contract with the counterparty in connection with the contemplated insurance securitization are structured pursuant to the provisions in this subchapter.

(6) Any other statements or documents required by the Commissioner to evaluate and complete the licensing of the SPFC.

(D) In addition to the information required by subsection (C), and to the provisions of Section 56-13-408, if a protected cell is used, an applicant SPFC shall file with the Commissioner:

(1) a business plan demonstrating how the applicant accounts for the loss and expense experience of each protected cell at a level of detail found to be sufficient by the Commissioner, and how it reports the experience to the Commissioner;

(2) a statement acknowledging that all financial records of the SPFC, including records pertaining to any protected cells, must be made available for inspection or examination by the Commissioner;

(3) all contracts or sample contracts between the SPFC and any counterparty, related to each protected cell; and

(4) a description of the expenses allocated to each protected cell.

(E) Information submitted pursuant to this subsection is confidential.

(F) Section 56-13-109 applies to examinations, investigations, and processing conducted pursuant to the authority of this subchapter.

(G) To transact insurance or reinsurance business in this State, an SPFC shall pay to the Department of Commerce and Insurance:

(1) a nonrefundable fee of one thousand dollars (\$1,000.00) for processing its application for license. In addition, the Commissioner may retain legal, financial, and examination services from outside the Department of Commerce and Insurance to examine and investigate the application, the reasonable cost of which may be charged against the applicant. The Commissioner also may use internal resources to examine and investigate the application based upon an hourly rate for the services performed or the usual

and customary fee charged by the financial services industry for similar work subject to a minimum fee of twelve thousand dollars (\$12,000.00), six thousand dollars (\$6,000.00) of which is payable upon filing of the application and the remainder upon licensure;

(2) a license fee for the year of registration of three hundred dollars (\$300.00) and an annual renewal fee of five hundred dollars (\$500.00);

(3) an annual review fee of three thousand dollars (\$3,000.00) or, if higher, the actual cost as determined by the Commissioner; and

(4) premium taxes as required by this chapter.

(H) The Commissioner may grant a license authorizing the SPFC to transact insurance or reinsurance business as a SPFC in this State until the end of each calendar year, at which time the license may be renewed, upon finding that the:

(1) proposed plan of operation provides a reasonable and expected successful operation;

(2) terms of the SPFC contract and related transactions comply with this subchapter;

(3) the proposed plan of operation is not hazardous to any counterparty;

(4) the commissioner of the state of domicile of each counterparty has notified the Commissioner in writing or otherwise provided assurance satisfactory to the Commissioner that it has approved or not disapproved the transaction; and

(5) the certificate of authority authorizing the SPFC to transact business is limited only to the insurance or reinsurance activities that the SPFC is allowed to conduct pursuant to this subchapter.

(I) In evaluating the expectation of a successful operation, the Commissioner shall consider, among other factors, whether the proposed SPFC and its management

are of known good character and reasonably believed not to be affiliated, directly or indirectly, through ownership, control, management, reinsurance transactions, or other insurance or business relations, with a person known to have been involved in the improper manipulation of assets, accounts, or reinsurance.

(J) A foreign or alien corporation or limited liability company, upon approval of the Commissioner, may become a domestic SPFC by complying with all of the provisions of this subchapter and by filing with the secretary of state its organizational documents, together with appropriate amendments to it, as may be adopted pursuant to the provisions of this subchapter to bring these organizational documents into compliance with this subchapter. After this is accomplished, the foreign or alien corporation or limited liability company is entitled to the necessary or appropriate certificates or licenses to transact business as a SPFC in this state and is subject to the authority and jurisdiction of this state. In connection with this redomestication, the Commissioner may waive any requirements for public hearings. It is not necessary for a corporation or limited liability company redomesticating into this state to merge, consolidate, transfer assets, or otherwise engage in another reorganization, other than as specified in this section.

**56-13-405.** Organization requirements; privileges and restrictions

(A) An SPFC may be established as a stock corporation, limited liability company, mutual, partnership, or other form of organization approved by the Commissioner.

(B) The SPFC's organizational documents must limit the SPFC's authority to transact the business of insurance or reinsurance to those activities the SPFC conducts to accomplish its purpose as expressed in this subchapter.

(C) The SPFC may not adopt a name that is the same as, deceptively similar to, or likely to be confused with or mistaken for another existing business name registered in this state.

(D) An SPFC may not have fewer than three incorporators or organizers of whom not fewer than two must be residents of this state.

(E) Before transmitting its organizational documents to the secretary of state, the incorporators or organizers shall petition the Commissioner to issue a certificate setting forth a finding that the establishment and maintenance of the proposed SPFC promotes the general good of this state. In arriving at this finding the Commissioner may consider:

(1) the character, reputation, financial standing, and purposes of the incorporators or organizers;

(2) the character, reputation, financial responsibility, insurance experience, and business qualifications of the officers, directors, partners, members, manager, or organizers, as applicable;

(3) other aspects as the Commissioner considers advisable.

(F) The organizational documents, the certificate issued pursuant to subsection (E), and the required organization fees must be transmitted to the secretary of state, who shall record the relevant organizational documents and forward all documents to the Department of Commerce and Insurance..

(G) At least one of the members of the management of the SPFC must be a resident of this State.

(H) An SPFC formed pursuant to the provisions of this subchapter has the privileges of and is subject to all other provisions of the Tennessee Code, applicable to its formation, as well as the applicable provisions contained in this subchapter. If a

conflict occurs between a provision of the applicable law and a provision of this subchapter, the latter controls.

**56-13-406. Capitalization**

(A) An SPFC initially shall possess and after that maintain minimum capitalization of not less than two hundred and fifty thousand dollars (\$250,000.00). All of the minimum initial capitalization must be in cash. All other funds of the SPFC in excess of its minimum initial capitalization must be in the form of cash, cash equivalent, or securities invested as approved by the Commissioner.

(B) Additional capitalization for the SPFC must be determined, if so required, by the Commissioner after giving due consideration to the SPFC's business plan, feasibility study, pro-formas, and the nature of the risks being insured or reinsured, which may be prescribed in formulas approved by the Commissioner.

**56-13-407. Authorized contracts**

(A) An SPFC may insure only the risks of a counterparty.

(B) An SPFC may not issue a contract for assumption of risk or indemnification of loss other than an SPFC contract. However, the SPFC may cede risks assumed through an SPFC contract to third party reinsurers through the purchase of reinsurance or retrocession protection on terms approved by the Commissioner.

(C) An SPFC may enter into contracts and conduct other commercial activities related or incidental to and necessary to fulfill the purposes of the SPFC contract, insurance securitization, and this subchapter. Those activities may include, but are not limited to: entering into SPFC contracts; issuing securities of the SPFC in accordance with applicable securities law; complying with the terms of these contracts or securities; entering into trust, swap, tax, administration, reimbursement, or fiscal agent transactions; or complying with trust indenture, reinsurance, or retrocession, and other agreements

necessary or incidental to effectuate an insurance securitization in compliance with this article or the plan of operation approved by the Commissioner.

(D)

(1) An SPFC may discount its reserves at discount rates as approved by the Commissioner.

(2) An SPFC shall file annually an actuarial opinion on reserves provided by an approved independent actuary.

**56-13-408. Protected cells**

(A) This section and Section 56-13-409 provide a basis for the creation and use of protected cells by an SPFC as a means of accessing alternative sources of capital, lowering formation and administrative expenses, and generally making insurance securitizations more efficient. If a conflict occurs between any other provision of Chapter 13, Title 56 and either this section or Section 56-13-409, this section and Section 56-13-409 shall control.

(B) An SPFC may establish and maintain one or more protected cells with prior written approval of the Commissioner and subject to compliance with the applicable provisions of this subchapter and the following conditions:

(1) a protected cell must be established only for the purpose of insuring or reinsuring risks of one or more SPFC contracts with a counterparty with the intent of facilitating an insurance securitization;

(2) each protected cell must be accounted for separately on the books and records of the SPFC to reflect the financial condition and results of operations of the protected cell, net income or loss, dividends, or other distributions to the counterparty for the SPFC contract with each cell, and other factors as may be provided in the SPFC contract, insurance securitization

transaction documents, plan of operation, or business plan, or as required by the Commissioner;

(3) amounts attributed to a protected cell under this subchapter, including assets transferred to a protected cell account, are owned by the SPFC, and the SPFC may not be, or may not hold itself out to be, a trustee with respect to those protected cell assets of that protected cell account;

(4) all attributions of assets and liabilities between a protected cell and the general account must be in accordance with the plan of operation approved by the Commissioner. No other attribution of assets or liabilities may be made by an SPFC between the SPFC's general account and its protected cell or cells. The SPFC shall attribute all insurance obligations, assets, and liabilities relating to an SPFC contract and the related insurance securitization transaction, including any securities issued by the SPFC as part of the insurance securitization, to a particular protected cell. The rights, benefits, obligations, and liabilities of any securities attributable to that protected cell and the performance under an SPFC contract and the related securitization transaction and any tax benefits, losses, refunds, or credits allocated, or any of them, at any point in time pursuant to a tax allocation agreement between the SPFC and the SPFC's counterparty, parent, or company or group company, or any of them, in common control with them, as the case may be, including any payments made by or due to be made to the SPFC pursuant to the terms of the agreement, must reflect the insurance obligations, assets, and liabilities relating to the SPFC contract and the insurance securitization transaction that are attributed to a particular protected cell;

(5) the assets of a protected cell must not be chargeable with liabilities arising out of an SPFC contract related to or associated with another protected cell. However, one or more SPFC contracts may be attributed to a protected cell so long as those SPFC contracts are intended to be, and ultimately are, part of a single securitization transaction;

(6) a sale, an exchange, or another transfer of assets may not be made by the SPFC between or among any of its protected cells without the consent of the Commissioner, counterparty, and each protected cell;

(7) except as otherwise contemplated in the SPFC contract or related insurance securitization transaction documents, or both, a sale, an exchange, a transfer of assets, a dividend, or a distribution may not be made from a protected cell to a counterparty or parent without the Commissioner's approval and may not be approved if the sale, exchange, transfer, dividend, or distribution would result in insolvency or impairment with respect to a protected cell; and

(8) an SPFC may pay interest or repay principal, or both, and make distributions or repayments in respect of any securities attributed to a particular protected cell from assets or cash flows relating to or emerging from the SPFC contract and the insurance securitization transactions that are attributable to that particular protected cell in accordance with the provisions of this subchapter or as otherwise approved by the Commissioner.

(C) An SPFC contract with or attributable to a protected cell does not take effect without the Commissioner's prior written approval, and the addition of each new protected cell constitutes a change in the business plan requiring the Commissioner's prior written approval. The Commissioner may retain legal, financial, and examination services from outside the Department of Commerce and Insurance to examine and

investigate the application for a protected cell, the reasonable cost of which may be charged against the applicant, or the Commissioner may use internal resources to examine and investigate the application, the reasonable cost of which may be charged against the applicant, or both.

(D) An SPFC utilizing protected cells initially shall possess minimum capitalization separate and apart from the capitalization of its protected cell or cells in an amount determined by the Commissioner after giving due consideration of the SPFC's business plan, feasibility study, and pro-formas, including the nature of the risks to be insured or reinsured. For purposes of determining the capitalization of each protected cell, an SPFC initially shall capitalize and after that time maintain capitalization in each protected cell in the amount and manner required for a SPFC in Section 56-13-406.

(E) The establishment of one or more protected cells alone does not constitute, and may not be deemed to be, a fraudulent conveyance, an intent by the SPFC to defraud creditors, or the carrying out of business by the SPFC for any other fraudulent purpose.

**56-13-409. Effect of Creation of Protected Cell; Naming; Management of Assets**

(A)

(1) The creation of a protected cell does not create, with respect to that protected cell, a legal person separate from the SPFC.

(2) Notwithstanding the provision of item (1), a protected cell must have its own distinct name or designation that includes the words "protected cell". The SPFC shall transfer all assets attributable to the protected cell to one or more separately established and identified protected cell accounts bearing the name or designation of that protected cell.

(3) Although it is not a separate legal person, the property of an SPFC in a protected cell is subject to orders of a court by name as it would have been if the protected cell were a separate legal person.

(4) The property of an SPFC in a protected cell must be served in its own name with process in all civil actions or proceedings involving or relating to the activities of that protected cell or a breach by the SPFC of a duty to the protected cell or to a counterparty to a transaction linked or attributed to it by serving the SPFC.

(5) A protected cell exists only at the pleasure of the SPFC. At the cessation of business of a protected cell in accordance with the plan approved by the Commissioner, the SPFC voluntarily shall close out the protected cell account.

(B) Nothing in this section may be construed to prohibit a SPFC from contracting with, or arranging for, an investment advisor, commodity trading advisor, or other third party to manage the assets of a protected cell, if all remuneration, expenses, and other compensation of the third party advisor or manager are payable from the assets of that protected cell and not from the assets of other protected cells or the assets of the SPFC's general account, unless approved by the Commissioner.

(C) Creditors with respect to a protected cell are not entitled to have recourse against the protected cell assets of other protected cells or the assets of the SPFC's general account. If an obligation of an SPFC relates only to the general account, the obligation of the SPFC extends only to that creditor, with respect to that obligation, and is entitled to have recourse only to the assets of the SPFC's general account.

(D) The assets of the protected cell may not be used to pay expenses or claims other than those attributable to the protected cell. Protected cell assets are available

only to the SPFC contract counterparty and other creditors of the SPFC that are creditors only with respect to that protected cell and, accordingly, are entitled, in conformity with this article, to have recourse to the protected cell assets attributable to that protected cell and absolutely are protected from the creditors of the SPFC that are not creditors with respect to that protected cell and who, accordingly, are not entitled to have recourse to the protected cell assets attributable to that protected cell. If an obligation of a SPFC to a person or counterparty arises from an SPFC contract or related insurance securitization transaction, or is otherwise incurred, with respect to a protected cell:

(1) that obligation of the SPFC extends only to the protected cell assets attributable to that protected cell, and the person or counterparty, with respect to that obligation, is entitled to have recourse only to the protected cell assets attributable to that protected cell; and

(2) that obligation of the SPFC does not extend to the protected cell assets of another protected cell or the assets of the SPFC's general account, and that person, with respect to that obligation, is not entitled to have recourse to the protected cell assets of another protected cell or the assets of the SPFC's general account. The SPFC's capitalization held separate and apart from the capitalization of its protected cell or cells must be available at all times to pay expenses of or claims against the SPFC and may not be used to pay expenses or claims attributable to any protected cell.

(E) Notwithstanding another provision of law, an SPFC may allow for a security interest in accordance with applicable law to attach to protected cell assets or a protected cell account when in favor of a creditor of the protected cell or to facilitate the insurance securitization, including, without limitation, the issuance of the SPFC contract,

to the extent those protected cell assets are not required at all times to support the risk, but without otherwise affecting the discharge of liabilities under the SPFC contract, or as otherwise approved by the Commissioner.

(F) An SPFC shall establish administrative and accounting procedures necessary to properly identify the one or more protected cells of the SPFC and the protected cell assets and protected cell liabilities to each protected cell. The directors of an SPFC shall keep protected cell assets and protected cell liabilities:

(1) separate and separately identifiable from the assets and liabilities of the SPFC's general account; and

(2) attributable to one protected cell separate and separately identifiable from protected cell assets and protected cell liabilities attributable to other protected cells.

(G) All contracts or other documentation reflecting protected cell liabilities clearly must indicate that only the protected cell assets are available for the satisfaction of those protected cell liabilities. In all SPFC insurance securitizations involving a protected cell, the contracts or other documentation effecting the transaction must contain provisions identifying the protected cell to which the transaction is attributed. In addition, the contracts or other documentation clearly must disclose that the assets of that protected cell, and only those assets, are available to pay the obligations of that protected cell. Notwithstanding the provisions of this subsection and subject to the provisions of this subchapter and other applicable law or regulations, the failure to include this language in the contracts or other documentation may not be used as the sole basis by creditors, insureds or reinsureds, insurers or reinsurers, or other claimants to circumvent the provisions of this section.

(H) An SPFC with protected cells annually shall file with the Department of Commerce and Insurance accounting statements and financial reports required by this subchapter, which, among other things, must:

(1) detail the financial experience of each protected cell and the SPFC separately; and

(2) provide the combined financial experience of the SPFC and all protected cells.

(I) An SPFC with protected cells shall notify the Commissioner in writing within ten business days of a protected cell becoming insolvent.

**56-13-410. Issuance of Securities**

(A) An SPFC may issue securities, including surplus notes and other forms of financial instruments, subject to and in accordance with applicable law, its approved plan of operation, and its organizational documents.

(B) An SPFC, in connection with the issuance of securities, may enter into and perform all of its obligations under any required contracts to facilitate the issuance of these securities.

(C) Subject to the approval of the Commissioner, an SPFC may lawfully:

(1) account for the proceeds of surplus notes as surplus and not as debt for purposes of statutory accounting;

(2) submit for prior approval of the Commissioner periodic written requests for payments of interest on and repayments of principal of surplus notes.

(D) Surplus notes issued by an SPFC constitute surplus.

(E) The Commissioner, without otherwise prejudicing the Commissioner's authority, may approve formulas for an ongoing plan of interest payments or principal

repayments, or both, to provide guidance in connection with his ongoing reviews of requests to approve the payments on and principal repayments of the surplus notes.

(F) The obligation to repay principal or interest, or both, on the securities issued by the SPFC must reflect the risk associated with the obligations of the SPFC to the counterparty under the SPFC contract.

**56-13-411. Swap Agreements and Other Forms of Asset Management Agreements**

An SPFC may enter into swap agreements, or other forms of asset management agreements, including guaranteed investment contracts, or other transactions that have the objective of leveling timing differences in funding of up-front or ongoing transaction expenses or managing asset, credit, or interest rate risk of the investments in the trust to ensure that the investments are sufficient to assure payment or repayment of the securities, and related interest or principal payments, issued pursuant to a SPFC insurance securitization transaction or the obligations of the SPFC under the SPFC contract.

**56-13-412. Authority to enter into Contracts; Contents**

(A) An SPFC, at any given time, may enter into and effectuate a SPFC contract with a counterparty, provided that the SPFC contract obligates the SPFC to indemnify the counterparty for losses and that contingent obligations of the SPFC under the SPFC contract are securitized through a SPFC insurance securitization and are funded and secured with assets held in trust for the benefit of the counterparty pursuant to the provisions of this article pursuant to agreements contemplated by this article and invested in a manner that meet the criteria as provided in Section 56-13-414.

(B) An SPFC may enter into agreements with affiliated companies and third parties and conduct business necessary to fulfill its obligations and administrative duties incidental to the insurance securitization and the SPFC contract. The agreements may include management and administrative services agreements and other allocation and

cost sharing agreements, or swap and asset management agreements, or both, or agreements for other contemplated types of transactions provided in Section 56-13-411.

(C) An SPFC contract must contain provisions that:

(1) require the SPFC to enter into a trust agreement specifying what recoverables or reserves, or both, the agreement is to cover and to establish a trust account for the benefit of the counterparty;

(2) stipulate that assets deposited in the trust account must be valued according to their current fair value and must consist only of permitted investments;

(3) require the SPFC, before depositing assets with the trustee, to execute assignments, endorsements in blank, or to transfer legal title to the trustee of all shares, obligations, or any other assets requiring assignments, in order that the counterparty, or the trustee upon the direction of the counterparty, may negotiate whenever necessary the assets without consent or signature from the SPFC or another entity;

(4) require that all settlements of account between the counterparty and the SPFC be made in cash or its equivalent; and

(5) stipulate that the SPFC and the counterparty agree that the assets in the trust account, established pursuant to the provisions of the SPFC contract, may be withdrawn by the counterparty at any time, notwithstanding any other provisions in the SPFC contract, and must be utilized and applied by the counterparty or any successor by operation of law of the counterparty, including any liquidator, rehabilitator, receiver, or conservator of the counterparty, without diminution because of insolvency on the part of the counterparty or the SPFC, only for the following purposes:

(a) to transfer all of the assets into one or more trust accounts for the benefit of the counterparty pursuant to and in accordance with the terms of the SPFC contract and in compliance with the provisions of this article; and

(b) to pay any other incurred and paid amounts that the counterparty claims are due pursuant to and under the terms of the SPFC contract and in compliance with this subchapter.

(D)

(1) The SPFC contract may contain provisions that give the SPFC the right to seek approval from the counterparty to withdraw from the trust all or part of the assets, or income from them, contained in the trust and to transfer the assets to the SPFC, provided that:

(a) at the time of the withdrawal, the SPFC shall replace the withdrawn assets, excluding any income withdrawn, with other qualified assets having a fair value equal to the fair value of the assets withdrawn and that meet the provisions of Section 56-13-415; and

(b) after the withdrawals and transfer, the fair value of the assets in trust securing the obligations of the SPFC under the SPFC contract is no less than an amount needed to satisfy the funded requirement of the SPFC contract.

(2) The counterparty must be the sole judge as to the application of these provisions but may not unreasonably or arbitrarily withhold its approval.

**56-13-413.** Securities issued by SPFC as Insurance Contract; Underwriters or Selling Agents as Insurance Producers

Securities issued by a SPFC pursuant to an insurance securitization may not be considered to be insurance or reinsurance contracts. An investor in these securities or a holder of these securities, by sole means of this investment or holding, may not be considered to be transacting the business of insurance in this state. The underwriter's placement or selling agents and their partners, directors, officers, members, managers, employees, agents, representatives, and advisors involved in an insurance securitization pursuant to this subchapter may not be considered to be insurance producers or brokers or conducting business as an insurance or reinsurance company or agency, brokerage, intermediary, advisory, or consulting business only by virtue of their activities in connection with them.

**56-13-414. Requirements and Guidelines for Asset Management**

In fulfilling its function, the SPFC shall adhere to the following requirements and, to the extent of its powers, shall ensure that contracts obligating other parties to perform certain functions incident to its operations are substantively and materially consistent with the following requirements and guidelines:

(1) The assets of a SPFC must be preserved and administered by or on behalf of the SPFC to satisfy the liabilities and obligations of the SPFC incident to the insurance securitization and other related agreements.

(2) Assets held by a SPFC in trust must be valued at their fair value.

(3) The proceeds from the sale of securities pursuant to the insurance securitization must be deposited with the trustee to the extent required to secure its obligations under the SPFC contract as provided by this article and must be held or invested by the trustee pursuant to the provisions of Section 56-13-415 and the asset management agreement, if any, filed with the Department of Commerce and Insurance.

(4) Assets of the SPFC, other than those held in trust for the counterparty, and income on trust assets received by the SPFC, may be used to pay interest or other

consideration on any securities or outstanding debt or other obligation of the SPFC, and nothing in this article may be construed or interpreted to prevent an SPFC from entering into a swap agreement or other asset management transaction that has the effect of hedging or guaranteeing the fixed or floating interest rate returns paid on the assets in trust or required for the securities issued by the SPFC generated from or other consideration or payment flows in the transaction.

(5) In the SPFC insurance securitization, the contracts or other relating documentation must contain provisions identifying the SPFC.

(6) Unless otherwise approved by the Commissioner, an SPFC may not:

(a) issue or otherwise administer primary insurance policies;

(b) enter into an SPFC contract with a person that is not licensed or otherwise authorized to transact the business of insurance or reinsurance in at least its state or country of domicile;

(c) assume or retain exposure to insurance or reinsurance losses for its own account that is not funded by proceeds from an SPFC securitization that meets the provisions of this article. However, the SPFC may wholly or partially reinsure or retrocede the risks assumed to a third party reinsurer on terms approved by the Commissioner.

(7) An SPFC may not:

(a) have any direct obligation to the policyholders or reinsureds of the counterparty;

(b) lend or otherwise invest, or place in custody, trust, or under management any of its assets with, or to borrow money or receive a loan from, other than by issuance of the securities pursuant to an insurance securitization, or advance from, anyone convicted of a felony, anyone who is untrustworthy or of

known bad character, or anyone convicted of a criminal offense involving the conversion or misappropriation of fiduciary funds or insurance accounts, theft, deceit, fraud, misrepresentation, or corruption.

**56-13-415.** Trust Agreements for Assets Held in Trust or Pledged to Secure Obligations

(A) Assets of the SPFC held in trust to secure obligations under the SPFC contract must at all times be held in:

- (1) cash and cash equivalents;
- (2) securities listed by the securities Valuation Office of the NAIC and qualifying as admitted assets under statutory accounting convention in its state of domicile; or
- (3) another form of security acceptable to the Commissioner.

(B) Assets of the SPFC that are pledged to secure obligations of the SPFC to a counterparty under an SPFC contract must be held in trust and administered by a qualified United States financial institution. The qualified United States financial institution does not control, is not controlled by, or is not under common control with, the SPFC or the counterparty.

(C) The agreement governing this trust must create one or more trust accounts into which all pledged assets must be deposited and held until distributed in accordance with the trust agreement. The pledged assets must be held by the trustee at one of the trustee's offices or branch offices in the United States and may be held in certificated or electronic form.

(D) The provisions for withdrawal by the counterparty of assets from the trust must be clean and unconditional, subject only to the following requirements:

- (1) the counterparty has the right to withdraw assets from the trust account at any time, without notice to the SPFC, subject only to written notice to

the trustee from the counterparty that funds in the amount requested are due and payable by the SPFC, pursuant to the terms of the SPFC contract.

(2) a statement or document does not need to be presented in order to withdraw assets, except the counterparty may be required to acknowledge receipt of withdrawn assets;

(3) the trust agreement must indicate that it is not subject to any conditions or qualifications outside of the trust agreement;

(4) the trust agreement must not contain references to any other agreements or documents.

(E) The trust agreement must be established for the sole use and benefit of the counterparty at least to the full extent of the obligations of the SPFC to the counterparty under the SPFC contract. If there is more than one counterparty, or more than one SPFC contract with the same counterparty, a separate trust agreement must be entered into with the counterparty and a separate trust account must be maintained for each SPFC contract with the counterparty, unless otherwise approved by the director.

(F) The trust agreement must provide for the trustee to:

(1) receive assets and hold all assets in a safe place;

(2) determine that all assets are in a form that the counterparty or the trustee, upon direction by the counterparty, may negotiate, whenever necessary, the assets, without consent or signature from the SPFC or another person or entity;

(3) furnish to the SPFC, the Commissioner, and the counterparty a statement of all assets in the trust account reported at fair value upon its inception and at intervals no less frequent than the end of each calendar quarter;

(4) notify the SPFC and the counterparty, within ten days, of any deposits to or withdrawals from the trust account;

(5) upon written demand of the counterparty, immediately take the necessary steps to transfer absolutely and unequivocally all right, title, and interest in the assets held in the trust account to the counterparty and deliver physical custody of the assets to the counterparty; and

(6) allow no substitutions or withdrawals of assets from the trust account, except pursuant to the trust agreement or SPFC contract, or as otherwise permitted by the counterparty.

(G) The trust agreement must provide that at least thirty days, but not more than forty-five days, before termination of the trust account, written notification of termination must be delivered by the trustee to the counterparty with a copy of the notice provided to the Commissioner.

(H) In addition to the requirements for the trust as provided in this article, the trust agreement may be made subject to and governed by the laws of any state. The state must be disclosed in the plan of operation filed with and approved by the Commissioner.

(I) The trust agreement must prohibit invasion of the trust corpus for the purpose of paying compensation to, or reimbursing the expenses of, the trustee.

(J) The trust agreement must provide that the trustee must be liable for its own negligence, willful misconduct, or lack of good faith.

(K)

(1) Notwithstanding the provisions of subsection (D)(3) and (4), when a trust agreement is established in conjunction with an SPFC contract, then the trust agreement or SPFC contract, or both, may provide that the counterparty

shall undertake to use and apply any amounts drawn upon the trust account, without diminution because of the insolvency of the counterparty or the SPFC, only for one or more of the following purposes:

(a) to pay or reimburse the counterparty for payment of the SPFC's share of premiums to be returned to owners of counterparty's policies covered under the SPFC contract on account of cancellations of the policies under the counterparties policies;

(b) to pay or reimburse the counterparty for payment of the SPFC's share of surrenders, benefits, losses, or other benefits covered and payable pursuant to the provisions of the SPFC contract;

(c) to fund an account with the counterparty in an amount to secure the credit or reduction from liability for reinsurance coverage provided under the SPFC contract; or

(d) to pay any other amounts the counterparty claims are legally and properly due under the SPFC contract.

(2) Any assets deposited into an account of the counterparty pursuant to subitem (c) of item (1) or withdrawn by the counterparty pursuant to subitem (d) of item (1) and any interest or other earnings on them, must be held by the counterparty in trust and separate and apart from any general assets of the counterparty, for the sole purpose of funding the payments and reimbursements of the SPFC contract described in subitems (a) through (d) of item (1).

(3) The counterparty shall return to the SPFC amounts withdrawn under subitems (a) through (d) of item (1) in excess of actual amounts required under subitems (a) through (c) of item (1), and in excess of the amounts subsequently determined to be due under subitem (d) of item (1), plus interest at a rate not in

excess of the prime rate for the amounts held pursuant to subitem (c) of item (1) unless a higher rate of interest has been awarded by a panel of arbitration, and any net costs or expenses, including attorneys' fees, awarded by a panel of arbitration.

(4) If the counterparty has received notification of termination of the trust account, and where the SPFC's entire obligations secured under the specific SPFC contract remain unliquidated and undischarged ten days before the termination date, to withdraw amounts equal to the obligations and deposit the amounts in a separate account, in the name of the counterparty, in a qualified United States financial institution, separate and apart from the counterparty's general assets, to the extent the obligations or liabilities have not been funded by the SPFC, in trust only for those uses and purposes specified in subitem (a) of item (1) as may remain executory after the withdrawal and for any period after the termination date until discharged.

**56-13-416. Payment of Dividends**

(A) An SPFC may not declare or pay dividends in any form to its owners other than in accordance with the insurance securitization transaction agreements, and in no extent shall the dividends decrease the capital of the SPFC below two hundred fifty thousand dollars (\$250,000.00), and, after giving effect to the dividends, the assets of the SPFC, including assets held in trust pursuant to the terms of the insurance securitization, must be sufficient to satisfy the Commissioner that it can meet its obligations. Approval by the Commissioner of an ongoing plan for the payment of dividends or other distribution by a SPFC must be conditioned upon the retention, at the time of each payment, of capital or surplus equal to or in excess of amounts specified

by, or determined in accordance with formulas approved for the SPFC by the Commissioner.

(B) The dividends may be declared by the management of the SPFC if the dividends do not violate the provisions of this article or jeopardize the fulfillment of the obligations of the SPFC or the trustee pursuant to the SPFC insurance securitization agreements, the SPFC contract, or any related transaction and other provisions of this subchapter.

**56-13-417. Material Changes of SPFC'S Plan; Filing of Audit and Statement of Operations; Examination of Records**

(A) Any material change of the SPFC's plan of operation, whether or not through a SPFC protected cell, shall require prior approval of the Commissioner, provided however:

(1) if initially approved in the plan of operation, securities subsequently issued to continue the securitization activities of the SPFC either during or after expiration, redemption, or satisfaction, of all of these, of part or all of the securities issued pursuant to initial insurance securitization transactions may not be considered a material change; or

(2) a change and substitution in a counterparty to a swap transaction for an existing insurance securitization as allowed pursuant to the provisions of this article may not be considered a material change if the replacement swap counterparty carries a similar or higher rating to its predecessor with two or more nationally recognized rating agencies, or both.

(B) No later than five months after the fiscal year end of the SPFC, the SPFC shall file with the Commissioner an audit by a certified public accounting firm of the financial statements of the SPFC and the trust accounts.

(C) Each SPFC shall file by March first, a statement of operations, using either generally accepted accounting principles or, if approved or required by the director, statutory accounting principles with useful or necessary modifications or adaptations required or approved or accepted by the Commissioner for the type of insurance and kinds of insurers to be reported upon, and as supplemented by additional information required by the Commissioner. The statement of operations must include a statement of income, a balance sheet, and may include a detailed listing of invested assets, including identification of assets held in trust to secure the obligations of the SPFC under the SPFC contract. The SPFC also may include with the filing risk based capital calculations and other adjusted capital calculations to assist the Commissioner with evaluating the levels of the surplus of the SPFC for the year ending on December thirty-first of the previous year. The statements must be prepared on forms required by the Commissioner. In addition the Commissioner may require the filing of performance assessments of the SPFC contract.

(D) An SPFC shall maintain its records in this state and shall make its records available for examination by the Commissioner at any time. The SPFC shall keep its books and records in such manner that its financial condition, affairs, and operations can be ascertained and so that the Commissioner may readily verify its financial statements and determine its compliance with this subchapter.

(E) All original books, records, documents, accounts, and vouchers must be preserved and kept available in this state for the purpose of examination and until authority to destroy or otherwise dispose of the records is secured from the Commissioner. The original records, however, may be kept and maintained outside this state if, according to a plan adopted by the management of the SPFC and approved by

the Commissioner, it maintains suitable records instead of it. The books or records may be photographed, reproduced on film, or stored and reproduced electronically.

**56-13-418.** Expiration of Authority Granted by Commissioner on Cessation of Business

(A) At the cessation of business of a SPFC following termination or cancellation of a SPFC contract and the redemption of any related securities issued in connection with them, the authority granted by the Commissioner expires or, in the case of retiring and surviving protected cells, is modified, and the SPFC is no longer authorized to conduct activities unless and until a new or modified license is issued pursuant to a new filing pursuant to the provisions hereof or as agreed by the Commissioner.

**56-13-419.** Conditions for SPFC Contract being Granted Credit for Reinsurance

An SPFC contract meeting the provisions of this subchapter must be granted credit for reinsurance treatment or otherwise qualifies as an asset or a reduction from liability for reinsurance ceded by a domestic insurer to an SPFC as an assuming insurer pursuant to the provisions of Section 56-13-112 for the benefit of the counterparty, provided and only to the extent:

(1) of the fair market value of the assets held in trust for, or irrevocable letters of credit issued by a bank chartered by this state or a member bank of the Federal Reserve System or as approved by the Commissioner, for the benefit of the counterparty under the SPFC contract;

(2) the assets are held in trust pursuant to the provisions of this subchapter;

(3) the assets are administered in the manner and pursuant to arrangements as provided in this subchapter; and

(4) the assets are held or invested in one or more of the forms allowed in Section 56-13-415.

**56-13-420.** Delinquency

(a) Except as otherwise provided in this section, the provisions of chapter 9 of this title shall apply in full to an SPFC.

(b) Upon any order of supervision, rehabilitation, or liquidation of an SPFC, the receiver shall manage the assets and liabilities of the SPFC pursuant to the provisions of this subchapter.

(c) Notwithstanding the provisions of chapter 9 of this title:

(1) 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) an SPFC's capital and surplus shall at all times be available to pay any expenses of or claims against the SPFC.

**56-13-421. Promulgation of Regulations**

The director may promulgate regulations necessary to effectuate the purposes of this subchapter. Regulations promulgated pursuant to this section shall not affect a SPFC insurance securitization in effect at the time of the promulgation.

SECTION 2. This act shall take effect upon becoming a law, the public welfare requiring it.