

**CHAPTER 125****(SB 171)**

AN ACT relating to reinsurance.

*Be it enacted by the General Assembly of the Commonwealth of Kentucky:*

Section 1. KRS 304.5-140 is amended to read as follows:

- (1) (a) For the purposes of subsection (3)(c) of this section, a "qualified United States financial institution" means an institution that:
  1. Is organized or, in the case of a United States office of a foreign banking organization, licensed under the laws of the United States or any state thereof;
  2. Is regulated, supervised, and examined by the United States federal or state authorities having regulatory authority over banks and trust companies; and
  3. Has been determined by the commissioner, or the Securities Valuation Office of the National Association of Insurance Commissioners, to meet the standards of financial condition and standing considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.
- (b) A "qualified United States financial institution" means, for purposes of those provisions of this section specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:
  1. Is organized or, in the case of a United States branch or agency office of a foreign banking organization, licensed under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and
  2. Is regulated, supervised, and examined by federal or state authorities having regulatory authority over banks and trust companies.
- (2) Credit for reinsurance shall be allowed a ceding insurer as either an asset or a deduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of paragraphs (a), (b), (c), (d), or (e) of this subsection. If meeting the requirements of paragraphs (c) or (d) of this subsection, the requirements of paragraph (f) of this subsection shall also be met.
  - (a) Credit shall be allowed when the reinsurance is ceded to an assuming insurer which is authorized to transact insurance or reinsurance in Kentucky.
  - (b) Credit shall be allowed when the reinsurance is ceded to an assuming insurer which is accredited as a reinsurer in Kentucky. An accredited reinsurer is one which:
    1. Files with the commissioner evidence of its submission to Kentucky's jurisdiction;
    2. Submits to Kentucky's authority to examine its books and records;
    3. Is licensed to transact insurance or reinsurance in at least one (1) state, or in the case of a United States branch of an alien assuming insurer, is entered through and licensed to transact insurance or reinsurance in at least one (1) state;

4. Files annually with the commissioner a copy of its annual statement filed with the insurance regulatory official of its state of domicile and a copy of its most recent audited financial statement, and either:
    - a. Maintains a surplus as regards policyholders in an amount which is not less than twenty million dollars (\$20,000,000) and whose accreditation has not been denied by the commissioner within ninety (90) days of its submission; or
    - b. Maintains a surplus as regards policyholders in an amount less than twenty million dollars (\$20,000,000) and whose accreditation has been approved by the commissioner.
  5. Credit shall not be allowed a ceding insurer under this paragraph if the assuming insurer's accreditation has been revoked by the commissioner after notice and hearing.
- (c) Credit shall be allowed when the reinsurance is ceded to an assuming insurer which is domiciled and licensed in or, in the case of a United States branch of an alien assuming insurer, is entered through a state which employs standards regarding credit for reinsurance substantially similar to those applicable under this section and the assuming insurer or United States branch of an alien insurer:
1. Maintains a surplus as regards policyholders in an amount not less than twenty million dollars (\$20,000,000); and
  2. Submits to the authority of the commissioner to examine its books and records.

However, subparagraph 1. of this paragraph shall not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system.

- (d) 1. Credit shall be allowed when the reinsurance is ceded to an assuming insurer which maintains a trust fund in a qualified United States financial institution for the payment of valid claims of its United States policyholders and ceding insurers, their assigns, and successors in interest. The assuming insurer shall report annually to the commissioner information substantially the same as that required to be reported on the National Association of Insurance Commissioners annual statement form by authorized insurers to enable the commissioner to determine the sufficiency of the trust fund. In the case of a single assuming insurer, the trust fund shall consist of a trustee account representing the assuming insurer's liabilities attributable to business written in the United States and, in addition, the assuming insurer shall maintain a trustee surplus of not less than twenty million dollars (\$20,000,000). In the case of a group including incorporated and individual unincorporated underwriters, the trust shall consist of a trustee account representing the group's liabilities attributable to business written in the United States; and, in addition, the group shall maintain a trustee surplus of which one hundred million dollars (\$100,000,000) shall be held jointly for the benefit of United States ceding insurers of any member of the group, the incorporated members of which group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of solvency regulation and control by the group's domiciliary regulator as are the unincorporated members; and the group shall make available

to the commissioner an annual certification of the solvency of each underwriter by the group's domiciliary insurance regulatory official and its independent public accountants.

2. In the case of a group of incorporated insurers under common administration which complies with the filing requirements contained in subparagraph 1. of this paragraph, and which is under the supervision of the Department of Trade and Industry of the United Kingdom and submits to the commissioner's authority to examine its books and records and bears the expense of the estimation, and which has aggregate policyholders' surplus of ten billion dollars (\$10,000,000,000), the trust shall be in an amount equal to the group's several liabilities attributable to business written in the United States plus the group shall maintain a joint trusteed surplus of which one hundred million dollars (\$100,000,000) shall be held jointly for the benefit of United States ceding insurers of any member of the group, and each member of the group shall make available to the commissioner an annual certification of the member's solvency by the member's domiciliary insurance regulatory official and its independent public accountant.
  3. The trust shall be established in a form approved by the commissioner. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the United States. The trust shall vest legal title to its assets in the trustees of the trust for its United States policyholders and ceding insurers, their assigns, and successors in interest. The trust and the assuming insurer shall be subject to examination as determined by the commissioner. The trust shall remain in effect for as long as the assuming insurer shall have outstanding obligations due under the reinsurance agreements subject to the trust.
  4. No later than February 28 of each year, the trustees of the trust shall report to the commissioner in writing setting forth the balance of the trust and listing the trust's investments at the preceding year end and shall certify the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the next following December 31.
- (e) Credit shall be allowed when the reinsurance is ceded to an assuming insurer not meeting the requirements of paragraphs (a), (b), (c), or (d) of this subsection, but only with respect to the insurance of risks located in jurisdictions where such reinsurance is required by applicable law or regulation of that jurisdiction or reinsurance ceded to a residual market mechanism reinsurance association, or the members thereof, created pursuant to law or which has been voluntarily created as such by its members with the approval of the commissioner.
- (f) If the assuming insurer is not authorized or accredited to transact insurance or reinsurance in Kentucky, the credit permitted by paragraphs (c) and (d) of this subsection shall not be allowed unless the assuming insurer agrees in the reinsurance agreements:
1. That in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance agreement, the assuming insurer, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, shall comply with all

requirements necessary to give the court jurisdiction, and shall abide by the final decision of the court or of any appellate court in the event of an appeal; and

2. To designate the Secretary of State or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit, or proceeding instituted by or on behalf of the ceding insurer.

This paragraph is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if this obligation is created in the agreement.

- (3) A reduction from liability for the reinsurance ceded by an insurer to an assuming insurer not meeting the requirements of subsection (2) of this section shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer and the reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer, or, in the case of a trust, held in a qualified United States financial institution. This security may be in the form of:
  - (a) Cash;
  - (b) Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners and qualifying as admitted assets;
  - (c) Clean, irrevocable, unconditional letters of credit issued or confirmed by a qualified United States financial institution no later than December 31 in respect of the year for which filing is being made, and in the possession of the ceding insurer on or before the filing date of its annual statement. Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance, or confirmation, shall, notwithstanding the issuing, or confirming, institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification, or amendment, whichever first occurs; or
  - (d) Any other form of security acceptable to the commissioner.
- (4) Cession of bulk reinsurance by a domestic insurer is subject to KRS 304.24-420.
- (5) (a) Credit shall be allowed as an asset or as a deduction from liability, to any ceding insurer for reinsurance ceded to an assuming insurer qualified therefor under subsections (2), (3), or (4) of this section, except that no such credit shall be allowed unless the reinsurance ***contract provides, in substance, that in the event of the insolvency of the ceding insurer, the reinsurance shall be***~~is~~ ***payable under a contract reinsured*** by the assuming insurer on the basis of ***reported claims allowed by the liquidation court,***~~the liability of the ceding insurer under the contracts reinsured~~ without diminution because of the insolvency of the ceding insurer. ***Such payments shall be made directly to the ceding insurer or to its domiciliary liquidator except:***
  1. ***Where the contract or other written agreement specifically provides another payee of such reinsurance in the event of the insolvency of the ceding insurer;***  
***or***

2. *Where the assuming insurer, with the consent of the direct insured, has assumed such policy obligations of the ceding insurer as direct obligations of the assuming insurer to the payees under such policies and in substitution for the obligations of the ceding insurer to such payees.*

(b) *The reinsurance agreement may provide that the domiciliary liquidator of an insolvent ceding insurer shall give written notice to the assuming insurer of the pendency of a claim against such ceding insurer on the contract reinsured within a reasonable time after such claim is filed in the liquidation proceeding. During the pendency of such claim, any assuming insurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated, any defenses which it deems available to the ceding insurer or its liquidator. Such expense may be filed as a claim against the insolvent ceding insurer to the extent of a proportionate share of the benefit which may accrue to the ceding insurer solely as a result of the defense undertaken by the assuming insurer. Where two (2) or more assuming insurers are involved in the same claim and a majority in interest elect to interpose a defense to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance agreement as though such expense had been incurred by the ceding insurer.*

- (6) Upon request of the commissioner an insurer shall promptly inform the commissioner in writing of the cancellation or any other material change of any of its reinsurance treaties or arrangements.
- (7) Subsections (1) to (3) of this section shall apply to all cessions after July 14, 1992, under reinsurance agreements which have had an inception, anniversary, or renewal date not less than six (6) months after July 14, 1992.

Section 2. KRS 304.33-330 is amended to read as follows:

- (1) Set-offs allowed in general. Mutual debt or mutual credits between the insurer and another person in connection with any action or proceeding under this subtitle shall be set off and the balance only shall be allowed or paid, except as provided in subsection (2) of this section.
- (2) Exceptions. No set-off or counterclaim shall be allowed in favor of any person where:
- The obligation of the insurer to the person would not at the date of the filing of a petition for liquidation entitle him to share as a claimant in the assets of the insurer;
  - The obligation of the insurer to the person was purchased by or transferred to the person with a view to its being used as a set-off;
  - The obligation of the person is to pay an assessment levied against the members or subscribers of the insurer, or is to pay a balance upon a subscription to the capital stock of the insurer, or is in any other way in the nature of a capital contribution; or
  - The obligation of the person is to pay earned premiums to the insurer. However, *the provisions of this paragraph shall only apply to reinsurance contracts entered into prior to the effective date of this Act*~~[nothing in this subsection shall restrict the right of a person to set off premium due to or from the insurer pursuant to a reinsurance contract in any delinquency proceeding commenced against an insurer after July 15, 1996].~~

Section 3. KRS 304.33-350 is amended to read as follows:

The amount recoverable by the liquidator from a reinsurer shall not be reduced as a result of delinquency proceedings ***unless the reinsurance contract provides, in substance, that in the event of the insolvency of the ceding insurer the reinsurance shall be payable under a contract reinsured by the assuming insurer on the basis of reported claims allowed by the liquidation court, without diminution because of the insolvency of the ceding insurer. Such payments shall be made directly to the ceding insurer or to its domiciliary liquidator, except:***

- (1) ***Where the contract or other written agreement specifically provides another payee of such reinsurance in the event of the insolvency of the ceding insurer; or***
- (2) ***Where the assuming insurer, with the consent of the direct insured, has assumed such policy obligations of the ceding insurer as direct obligations of the assuming insurer to the payees under such policies and in substitution for the obligations of the ceding insurer to such payees***~~[, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor shall not diminish the reinsurer's obligation to the insurer's estate except when the reinsurance contract provided for direct coverage of an individual named insured and the payment was made in discharge of that obligation].~~

Section 4. KRS 304.33-380 is amended to read as follows:

- (1) Claims contingent on judgments. The claim of a third party which is contingent only on his first obtaining a judgment against the insured shall be considered and allowed as if there were no such contingency.
- (2) Claims under terminated policies. Any claim that would have become absolute if there had been no termination of coverage under KRS 304.33-120, and which was not covered by insurance acquired to replace the terminated coverage, shall be allowed as if the coverage had remained in effect, unless at least ten (10) days before the insured event occurred either the claimant had actual notice of the termination or notice was mailed to him as prescribed by subsection (1) of KRS 304.33-250, or subsection (1) of KRS 304.33-260. If allowed, the claim shall share in distributions under subsection (9) of KRS 304.33-430.
- (3) Other contingent claims. A claim may be allowed even if contingent, if it is filed in accordance with subsection (2) of KRS 304.33-360. It may be allowed and may participate in all dividends declared after it is filed, to the extent that it does not prejudice the orderly administration of the liquidation.
- (4) Immature claims. Claims that are due except for the passage of time shall be treated as absolute claims are treated, except that where justice requires the court may order them discounted at the legal rate of interest.
- (5) (a) ***Nothing in this section or any other section in this subtitle shall be construed as authorizing the receiver, or any other entity, to compel payment from a reinsurer on the basis of estimated incurred but not reported losses or outstanding reserves.***  
 (b) ***Notwithstanding the provisions of this section or any other section of this subtitle to the contrary, the liquidator may negotiate a voluntary commutation and release of all obligations arising from reinsurance contracts or other agreements.***

SECTION 5. A NEW SECTION OF SUBTITLE 5 OF KRS CHAPTER 304 IS CREATED TO READ AS FOLLOWS:

- (1) *An authorized insurer may reinsure its risks, or any part of its risks, in any insurer authorized to do business in this state, in any other state of the United States, or in the District of Columbia, or in any alien insurer.*
- (2) *An authorized insurer may reinsure an insurer eligible for export pursuant to Subtitle 10 of KRS Chapter 304, in whole or in part, as to property and casualty insurance policies which principally contemplate performance in Kentucky or as to such policies the principal subjects of risk of which are located in Kentucky.*
- (3) *The provisions of this section shall apply to reinsurance agreements which have had an inception, anniversary, or renewal date on or after January 1, 2005.*

**Approved April 9, 2004**