

**304.45-032 Board of directors of risk retention group -- Contracts with service provider -- Audit committee composed of independent directors -- Governance standards -- Code of business conduct and ethics -- Notification of noncompliance.**

- (1) (a)
    1. The board of directors of a risk retention group shall have a majority of independent directors.
    2. No director shall qualify as independent unless the board of directors affirmatively determines that the director has no material relationship with the risk retention group. Each risk retention group shall disclose these determinations to the commissioner at least annually.
    3. No director shall be deemed to have a material relationship with the risk retention group solely because the director is a direct or indirect owner or member of the risk retention group or is an officer, director, or employee of an owner or member of the risk retention group.
  - (b) If the risk retention group is a reciprocal insurer, then an attorney-in-fact shall be required to adhere to the same standards regarding independence of operation and governance as imposed on the risk retention group's board of directors pursuant to this section. Unless prohibited under state law, service providers of a reciprocal risk retention group shall contract with the risk retention group and not the attorney-in-fact.
  - (c) No person shall qualify as independent until one (1) year after the end of a material relationship. For material relationships established pursuant to KRS 304.45-020(9)(a), no person shall qualify as independent until one (1) year after the compensation or payment of any other item of value from the risk retention group or a consultant or service provider to the risk retention group falls below the threshold established in that subsection.
- (2) (a) No contract with a service provider that creates or results in a material relationship shall be entered into by a risk retention group unless the risk retention group has provided written notice to the commissioner of its intention to enter into the contract at least thirty (30) days prior to the execution of the contract and the commissioner has not disapproved the proposed contract within the notice period.
  - (b) The term of any material service provider contract with a risk retention group shall not exceed five (5) years.
  - (c) Any material service provider contract, or its renewal, shall require the approval of the majority of a risk retention group's independent directors. At any time, the risk retention group's board of directors has the right to terminate any service provider contract for cause after providing adequate notice as defined in the contract.
  - (d) For the purposes of this subsection, "service provider" includes:
    1. Captive managers;
    2. Auditors;
    3. Accountants;

4. Actuaries;
  5. Investment advisors;
  6. Lawyers other than defense counsel retained by the risk retention group to defend claims, unless the amount of fees paid to the defense counsel creates or results in a material relationship;
  7. Managing general underwriters; and
  8. Other parties responsible for underwriting, determining rates, collecting premiums, adjusting and settling claims, or preparing financial statements.
- (3) A risk retention group's board of directors shall adopt a written policy in its plan of operation that requires the board to:
- (a) Ensure that all owners of the risk retention group receive evidence of ownership interest;
  - (b) Develop a set of corporate governance standards applicable to the risk retention group that satisfies, at a minimum, the requirements of this section;
  - (c) Oversee the evaluation of the risk retention group's management, including but not limited to the performance of the captive manager, managing general underwriter, or other party or parties responsible for underwriting, determining rates, collecting premiums, adjusting or settling claims, or preparing financial statements;
  - (d) Review and approve the amount to be paid for all material service providers; and
  - (e) Review and approve, at least annually:
    1. The goals and objectives relevant to the risk retention group's compensation of officers and service providers;
    2. The officers' and service providers' performance in light of those goals and objectives; and
    3. The continued engagement of the officers and material service providers.
- (4) (a) A risk retention group shall have an audit committee composed of at least three (3) independent directors. Non-independent directors may participate in the activities of the audit committee if invited by the committee members, but cannot be members of the committee.
- (b) The audit committee shall have a written charter that defines the committee's purpose, which, at a minimum, shall include the following:
1. Assist board oversight of:
    - a. The integrity of the financial statements;
    - b. Compliance with legal and regulatory requirements; and
    - c. The qualification, independence, and performance of the independent auditor and actuary;
  2. Discuss the annual audited financial statements and the quarterly

- financial statements with management;
  3. Discuss the annual audited financial statements and, if advisable, the quarterly financial statements with its independent auditors;
  4. Discuss policies with respect to risk assessment and risk management;
  5. Meet separately and periodically, either directly or through a designated representative of the committee, with management and independent auditors;
  6. Review with the independent auditors any audit problems or difficulties and management's response;
  7. Set clear hiring policies regarding the hiring of employees or former employees of the independent auditor;
  8. Require external auditors to rotate the lead or coordinating audit partner having primary responsibility for the risk retention group's audit as well as the audit partner responsible for reviewing that audit so that neither individual performs audit services for more than five (5) consecutive fiscal years; and
  9. Report regularly to the board of directors.
- (c) The commissioner may waive the requirement to establish an audit committee composed of independent directors if the risk retention group demonstrates to the commissioner that:
1. It is impracticable to do so; and
  2. The risk retention group's board of directors is otherwise capable of accomplishing the purposes of an audit committee.
- (5) (a) The governance standards adopted by the board of directors pursuant to subsection (3)(b) of this section shall include:
1. The process by which the directors are elected by the owners;
  2. Director qualification standards;
  3. Director responsibilities;
  4. Director access to management and, as necessary and appropriate, independent advisors;
  5. Director compensation;
  6. Director orientation and continuing education;
  7. The policies and procedures for management succession;
  8. The policies and procedures for annual performance evaluation of the board; and
  9. A code of business conduct and ethics for directors, officers, and employees.
- (b) The board of directors shall make the governance standards required by this section available through electronic or other means and provide the information to the risk retention group's members upon request.
- (6) (a) The code of business conduct and ethics for directors, officers, and employees

required by subsection (5) of this section shall address the following topics:

1. Conflicts of interest;
  2. Matters covered under the corporate opportunities doctrine under the state of domicile;
  3. Confidentiality;
  4. Fair dealing;
  5. Protection and proper use of risk retention group assets;
  6. Compliance with all applicable laws, rules, and regulations; and
  7. Requiring the reporting of any illegal or unethical behavior which affects the operation of the risk retention group.
- (b) Any waivers of the code for directors or executive officers shall be promptly disclosed to the board of directors.
- (7) The captive manager, president, or chief executive officer of the risk retention group shall promptly notify the commissioner in writing if he or she becomes aware of any material noncompliance with any of the provisions of this section.

**Effective:** January 1, 2018

**History:** Created 2017 Ky. Acts ch. 16, sec. 1, effective January 1, 2018.