DEPARTMENT OF ENERGY, LABOR, AND ECONOMIC GROWTH

OFFICE OF FINANCIAL AND INSURANCE REGULATION

CREDIT FOR REINSURANCE

(By authority conferred on the Commissioner of the Office of Financial and Insurance Regulation by sections 210 of 1956 PA 218, 1969 PA 306, and E.R.O. 2008-1, MCL 500.210, MCL 24.231 to MCL 24.233, MCL 445.2005)

R 500.1121 Credit for reinsurance; reinsurers maintaining multiple beneficiary trust funds

Rule 1. (1) The commissioner shall allow credit for reinsurance ceded by an insurer authorized to do business in this state to an assuming insurer not authorized to do business in this state that, as of the date of the ceding insurer's statutory financial statement, maintains a trust fund in an amount prescribed in section 1103 of Act No. 218 of the Public Acts of 1956, as amended, being § 500.1103 of the Michigan Compiled Laws, in a qualified United States financial institution for the payment of the valid claims of its United States policyholders and ceding insurers, their assigns, and successors in interest.

(2) The trust shall be established in a form approved by the commissioner and shall be in compliance with section 1103 of Act No. 218 of the Public Acts of 1956, as amended, being § 500.1103 of the Michigan Compiled Laws, and this rule. The trust instrument shall contain all of the following provisions:

(a) Contested claims shall be valid and enforceable out of funds in trust to the extent that they remain unsatisfied 30 days after entry of the final order of any court of competent jurisdiction in the United States.

(b) Legal title to the assets of the trust shall be vested in the trustees of the trust for the benefit of the grantor's United States policyholders and ceding insurers, their assigns, and successors in interest.

(c) The trust shall remain in effect for as long as the assuming insurer, or any member or former member of a group of assuming insurers, has outstanding obligations due under reinsurance agreements subject to the trust.

(d) An amendment to the trust shall not be effective unless reviewed and approved in advance by the commissioner.

History: 1996 AC.

R 500.1122 Requirements for single beneficiary trust agreements

Rule 2. (1) As used in this rule:

(a) "Beneficiary" means the entity for whose sole benefit the trust has been established and any successor of the beneficiary by operation of law, including, without limitation, any receiver, conservator, rehabilitator, or liquidator.

(b) "Grantor" means the entity that has established a trust for the sole benefit of the beneficiary. When a trust is established in conjunction with a reinsurance agreement, the grantor is the unlicensed assuming insurer.

(c) "Obligations, as used in subrule (13) of this rule, means any of the following:

(i) Reinsured losses and allocated loss expenses paid by the ceding company, but not recovered from the assuming insurer.

(ii) Reserves for reinsured losses reported and outstanding.

(iii) Reserves for reinsured losses incurred but not reported.

(iv) Reserves for allocated reinsured loss expenses and unearned premiums.

(2) Reinsurance trusts established under section 1105 of Act No. 218 of the Public Acts of 1956, as amended, being § 500.1105 of the Michigan Compiled Laws, shall comply with the requirements of R 500.1123 and this rule.

(3) The trust agreement shall be entered into between the beneficiary, the grantor, and a trustee. The trustee shall be a qualified United States financial institution.

(4) The trust agreement shall create a trust account into which assets shall be deposited.

(5) All assets in the trust account shall be held by the trustee at the trustee's office in the United States.

(6) The trust agreement shall provide for all of the following:

(a) The beneficiary shall have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice from the beneficiary to the trustee.

(b) Another statement or document shall not be required to be presented to withdraw assets, except that the beneficiary may be required to acknowledge receipt of withdrawn assets.

(c) The trust agreement shall not be subject to any conditions or qualifications outside of the trust agreement.

(d) The trust agreement shall not contain references to any other agreements or documents, except as provided for under subrule (12) of this rule.

(7) The trust agreement shall be established for the sole benefit of the beneficiary.

(8) The trust agreement shall require the trustee to do all of the following:

(a) Receive assets and hold all assets in a safe place.

(b) Determine that all assets are in a form that the beneficiary, or the trustee upon the direction of the beneficiary, may, when necessary, negotiate the assets without the consent of, or a signature from, the grantor or any other person or entity.

(c) Furnish to the grantor and the beneficiary a statement of all assets in the trust account upon its inception and at intervals not less frequent than the end of each calendar quarter.

(d) Notify the grantor and the beneficiary within 10 days of any deposits to, or withdrawals from, the trust account.

(e) Upon written demand of the beneficiary, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title, and interest in the assets held in the trust account to the beneficiary and deliver physical custody of the assets to the beneficiary.

(f) Not allow substitutions or withdrawals of assets from the trust account, except on written instructions from the beneficiary; however, the trustee may, without the consent of, but with notice to, the beneficiary, upon call or maturity of any trust asset, withdraw the asset upon the condition that the proceeds are paid into the trust account.

(9) The trust agreement shall provide that written notice of termination shall be delivered by the trustee to the beneficiary not less than 30 days, but not more than 45 days, before termination of the trust account.

(10) The trust agreement shall be made subject to and governed by the laws of the state in which the trust is established.

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

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

(13) Notwithstanding other provisions of this rule, when a trust agreement is established in conjunction with a reinsurance agreement covering risks other than life, annuities, and accident and health, where it is customary practice to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, for any of the following purposes:

(a) To pay or reimburse the ceding insurer for the assuming insurer's share under the specific reinsurance agreement regarding any losses and allocated loss expenses paid by the ceding insurer but not recovered from the assuming insurer or for unearned premiums due to the ceding insurer if not otherwise paid by the assuming insurer.

(b) To make payment to the assuming insurer of any amounts held in the trust account that are more than 102% of the actual amount required to fund the assuming insurer's obligations under the specific reinsurance agreement.

(c) Where the ceding insurer has received notification of termination of the trust account and where the assuming insurer's entire obligations under the specific reinsurance agreement remain unliquidated and undischarged 10 days before the termination date, to withdraw amounts equal to the obligations and deposit the amounts in a separate account apart from its general assets in the name of the ceding insurer in any qualified United States financial institution in trust for the uses and purposes specified in subdivisions (a) and (b) of this subrule as may remain executory after the withdrawal and for any period after the termination date.

(14) The trust agreement shall provide that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash (United States legal tender), certificates of deposit issued by a United States bank and payable in United States legal tender, and investments of the types permitted by chapter 9 of Act No. 218 of the Public Acts of 1956, as amended, being §§ 500.901 to 500.947 of the Michigan Compiled Laws, or any combination of cash, certificates of deposit, or investments, specified in this subrule, if the investments are issued by an entity that is not the parent, subsidiary, or affiliate of either the grantor or the beneficiary.

(15) The trust agreement may provide that the trustee may resign upon the delivery of a written notice of resignation which is effective not less than 90 days after receipt by the beneficiary and grantor of the notice and that the trustee may be removed by the grantor by the delivery, to the trustee and the beneficiary, of a written notice

of removal which is effective not less than 90 days after receipt by the trustee and the beneficiary of the notice. However, a resignation or removal is not effective until a successor trustee has been duly appointed and approved by the beneficiary and the grantor and all assets in the trust have been duly transferred to the new trustee.

(16) The grantor may have the full and unqualified right to vote any shares of stock in the trust account and to receive payments of any dividends or interest upon any shares of stock or obligations included in the trust account. The interest or dividends shall be either forwarded promptly upon receipt to the grantor or deposited in a separate account established in the grantor's name.

(17) The trustee may be given authority to invest and accept substitutions of any funds in the account if the investment or substitution is made with the prior approval of the beneficiary, unless the trust agreement specifies categories of investments acceptable to the beneficiary and authorizes the trustee to invest funds and to accept substitutions which the trustee determines are at least equal in market value to the assets withdrawn and which are consistent with the restrictions in subrule (14) of this rule.

(18) The trust agreement may provide that the beneficiary may at any time
designate a party to which all or part of the trust assets are to be
transferred.The transfer may be conditioned upon the trustee's receipt, either before the transfer or simultaneous with the transfer, of other specified assets.

(19) The trust agreement may provide that, upon termination of the trust account, all assets not previously withdrawn by the beneficiary shall, with the written approval by the beneficiary, he delivered over to the grantor.

History: 1996 AC.

R 500.1123 Conditions applicable to a reinsurance agreement in conjunction with a single beneficiary trust agreement

Rule 3. (1) A reinsurance agreement that is entered into in conjunction with a trust agreement and the establishment of a trust account under section 500.1105 of Act No. 218 of the Public Acts of 1956, as amended, being § 500.1105 of the Michigan Compiled Laws, may contain any of the following provisions:

(a) A requirement that the assuming insurer enter into a trust agreement, establish a trust account for the benefit of the ceding insurer, and specify what the agreement is to cover.

(b) A stipulation that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash (United States legal tender), certificates of deposit issued by a United States bank and payable in United States legal tender, and investments of the types permitted by chapter 9 of Act No. 218 of the Public Acts of 1956, as amended, being §§ 500.901 to 947 of the Michigan Compiled Laws, or any combination of cash, certificates of deposit, or investments specified in this subrule, if the investments are issued by an entity that is not the parent, subsidiary, or affiliate of either the grantor or the beneficiary. The reinsurance agreement may further specify the types of investments to be deposited. If a trust agreement is entered into in conjunction with a reinsurance agreement covering risks other than life, annuities, and accident and health, then the trust agreement may contain the provisions required by this paragraph instead of including the provisions in the reinsurance agreement.

(c) A requirement that the assuming insurer, before depositing assets with the trustee, execute assignments or endorsements in blank or transfer legal title to the trustee of all shares, obligations, or any other assets requiring assignments, so that the ceding insurer, or the trustee upon the direction of the ceding insurer, may, if necessary, negotiate the assets without the consent or signature from the assuming insurer or any other entity.

(d) A requirement that all settlements of account between the ceding insurer and the assuming insurer be made in cash or its equivalent.

(e) A stipulation that the assuming insurer and the ceding insurer agree that the assets in the trust account established pursuant to the provisions of the reinsurance agreement may be withdrawn by the ceding insurer at any time, notwithstanding any other provisions in the reinsurance agreement, and shall be used and applied by the ceding insurer or its successors in interest by operation of law, including, without limitation, any liquidator, rehabilitator, receiver, or conservator of the insurer, without diminution because of insolvency on the part of the ceding insurer or the assuming insurer, only for the following purposes:

(i) To reimburse the ceding insurer for the assuming insurer's share of premiums returned to the owners of policies reinsured under the reinsurance agreement because of cancellation of the policies.

(ii) To reimburse the ceding insurer for the assuming insurer's share of surrenders and benefits or losses paid by the ceding insurer pursuant to the provisions of the policies reinsured under the reinsurance agreement.

(iii) To fund an account with the ceding insurer in an amount at least equal to the deduction for reinsurance ceded from the ceding insurer's liabilities for policies ceded under the agreement. The account shall include, but not be limited to, amounts for all of the following:

(A) Policy reserves.

(B) Claims and losses incurred, including losses incurred but not reported.

(C) Loss adjustment expenses.

(D) Unearned premium reserves.

(iv) To pay any other amounts the ceding insurer claims are due under the reinsurance agreement.

(2) The reinsurance agreement may also do any of the following:

(a) Give the assuming insurer the right to seek approval from the ceding insurer to withdraw from the trust account all or any part of the trust assets and transfer the assets to the assuming insurer, if either of the following provisions is satisfied:

(i) The assuming insurer shall, at the time of withdrawal, replace the withdrawn assets with other qualified assets that have a market value equal to the market value of the assets withdrawn so as to maintain, at all times, the deposit in the required amount.

(ii) After withdrawal and transfer, the market value of the trust account is not less than 102% of the required amount. The ceding insurer shall not unreasonably or arbitrarily withhold its approval.

(b) Provide for the return of any amount withdrawn in excess of the actual amounts required under subrule (1)(e)(i), (ii), and (iii) of this rule, or, for purposes of subrule (1)(e)(iv) of this rule, any amounts that are subsequently determined not to be due.

(c) Provide for interest payments, at a rate that is not more than the prime rate of interest, on the amounts held pursuant to subrule (1)(e)(iii) of this rule.

(d) Permit the award by any arbitration panel or court of competent jurisdiction of any of the following:

(i) Interest at a rate different from that provided in subdivision (c) of this subrule.

(ii) Court or arbitration costs.

(iii) Attorney fees.

(iv) Any other reasonable expenses.

(3) A trust agreement that is in compliance with the provisions of R 500.1122 and this rule may be used to reduce any liability for reinsurance ceded to an unauthorized assuming insurer in financial statements required to be filed with the commissioner if established on or before the date of filing of the financial statement of the ceding insurer. Further, the amount of the reduction for the existence of an acceptable trust account may be up to the current fair market value of acceptable assets available to be withdrawn from the trust account at that time, but the reduction shall not be more than the specific obligations under the reinsurance agreement that the trust account was established to secure.

(4) Notwithstanding the effective date of this rule, any trust agreement or underlying reinsurance agreement in existence before July 1, 1996, will continue to be acceptable until June 30, 1997, at which time the agreements will have to be in full compliance with this rule for the trust agreement to be acceptable.

(5) The failure of any trust agreement to specifically identify the beneficiary as defined R 500.1122(1)(a) shall not be construed to affect any actions or rights that the commissioner may take or possess pursuant to the provisions of the laws of this state.

History: 1996 AC.

R 500.1124 Requirements for letters of credit.

Rule 4. (1) A letter of credit used to reduce any liability for reinsurance ceded to an unauthorized reinsurer under section 1105 of 1956 PA 218, MCL 500.1105, shall be clean, irrevocable, unconditional, and issued or confirmed by a qualified United States financial institution which is not affiliated with either the ceding insurer or the assuming insurer. The letter of credit shall contain an issue date and date of expiration and shall stipulate that the beneficiary need only draw a sight draft under the letter of credit and present it to obtain funds. The letter of credit shall also indicate that it is not subject to any condition or qualifications outside of the letter of credit. In addition, the letter of credit itself shall not contain reference to any other agreements, documents, or entities, except as provided in subrule (9)(a) of this rule. As used in this rule, "beneficiary" means the insurer for whose benefit the letter of credit has been established and any successor of the named beneficiary by operation of law, including, without limitation, any receiver, conservator, rehabilitator, or liquidator.

(2) The heading of the letter of credit may include a boxed section that contains the name of the applicant and other appropriate notations to provide a reference for the letter of credit. The boxed section shall be clearly marked to indicate that the information is for internal identification purposes only.

(3) The letter of credit shall contain a statement to the effect that the obligation of the qualified United States financial institution under the letter of credit is not contingent upon reimbursement with respect thereto.

(4) The term of the letter of credit shall be for at least 1 year and shall contain an "evergreen clause" that prevents the expiration of the letter of credit without due notice from the issuer. The evergreen clause shall provide for a period of not less than 30 days' notice before the expiration date or nonrenewal of the letter of credit.

(5) The letter of credit shall state whether it is subject to and governed by the laws of this state, publication 600 of the uniform customs and practice for documentary credits of the international chamber of commerce, or the international standby practices 98 of the international chamber of commerce; and all drafts drawn thereunder shall be presentable at an office in the United States of a qualified United States financial institution.

(6) If the letter of credit is made subject to the uniform customs and practice for documentary credits of the international chamber of commerce (publication 600), then the letter of credit shall specifically address and make provision for an extension of time to draw against the letter of credit if 1 or more of the occurrences specified in article 36 of publication 600 occur.

(7) The letter of credit shall be issued or confirmed by a qualified United States financial institution authorized to issue letters of credit pursuant to section 1101 1956 PA 218, MCL 500.1101.

(8) If the letter of credit is issued by a qualified United States financial institution authorized to issue letters of credit, other than a qualified United States financial institution as described in subrule (7) of this rule, then both of the following additional requirements shall be met:

(a) The issuing qualified United States financial institution shall formally designate the confirming qualified United States financial institution as its agent for the receipt and payment of the drafts.

(b) An evergreen clause shall provide for 30 days' notice before the expiration date or nonrenewal of the letter of credit.

History: 1996 AC; 2011 AACS.

R 500.1125 Conditions applicable to reinsurance agreement in conjunction with letter of credit

Rule 5. (1) A reinsurance agreement in conjunction with which a letter of credit is obtained may contain any of the following provisions:

(a) A requirement that the assuming insurer provide letters of credit to the ceding insurer and specify what they are to cover.

(b) A stipulation that the assuming insurer and ceding insurer agree that the letter of credit provided by the assuming insurer pursuant to the provisions of the reinsurance agreement may be drawn upon at any time, notwithstanding any other provisions in the agreement, and shall be utilized by the ceding insurer or its successors in interest only for 1 or more of the following reasons:

(i) To reimburse the ceding insurer for the assuming insurer's share of premiums returned to the owners of policies reinsured under the reinsurance agreement on account of cancellations of the policies.

(ii) To reimburse the ceding insurer for the assuming insurer's share of surrenders and benefits or losses paid by the ceding insurer under the terms and provisions of the policies reinsured under the reinsurance agreement.

(iii) To fund an account with the ceding insurer in an amount at least equal to the deduction, for reinsurance ceded, from the ceding insurer's liabilities for policies ceded under the agreement. The account shall include, but not be limited to, amounts for all of the following:

(A) Policy reserves.

(B) Claims and losses incurred, including losses incurred but not reported.

(C) Loss adjustment expenses.

(D) Unearned premium reserves.

(iv) To pay any other amounts the ceding insurer claims are due under the reinsurance agreement.

(c) A requirement that all of the provisions of this subrule shall be applied without diminution because of insolvency on the part of the ceding insurer or assuming insurer.

(2) Nothing contained in subrule (1) of this rule shall preclude the ceding insurer and assuming insurer from providing for either of the following:

(a) An interest payment, at a rate not more than the prime rate of interest, on the amounts held pursuant to subrule (1)(b)(iii) of this rule.

(b) The return of any amounts drawn down on the letters of credit in excess of the actual amounts required for subrule (1)(b) of this rule, or, for purposes of subrule (1)(b)(iv) of this rule, any amounts that are subsequently determined not to be due.

(3) When a letter of credit is obtained in conjunction with a reinsurance agreement covering risks other than life, annuities and health, where it is customary practice to provide a letter of credit for a specific purpose, then the reinsurance agreement may, in place of subrule (1)(b) of this rule, require that the parties enter into a trust agreement which may be incorporated into the reinsurance agreement or which may be a separate document.

(4) A letter of credit may not be used to reduce any liability for reinsurance ceded to an unauthorized assuming insurer in financial statements required to be filed with the commissioner, unless an acceptable letter of credit that names the filing ceding insurer as beneficiary has been issued on or before the date of filing of the financial statement. Further, the reduction for the letter of credit may be up to the amount available under the letter of credit, but not more than the specific obligation under the reinsurance agreement that the letter of credit was intended to secure.

History: 1996 AC.

R 500.1126 Other security

Rule 6. A ceding insurer may take credit for unencumbered funds withheld by the ceding insurer in the United States subject to withdrawal solely by the ceding insurer and under its exclusive control.

History: 1996 AC.

R 500.1127 Reinsurance contract

Rule 7. Credit will not be granted to a ceding insurer for reinsurance effected with assuming insurers meeting the requirements of section 1103 or 1105 of Act No. 218 of the Public Acts of 1956, as amended, being § 500.1103 or § 500.1105 of the Michigan Compiled Laws, after the effective date of these rules, unless the reinsurance agreement includes both of the following:

(a) Contains an insolvency clause acceptable to the commissioner.

(b) Includes a provision whereby the assuming insurer, if an unauthorized assuming insurer, has agreed to submit to the jurisdiction of an alternative dispute resolution panel or court of competent jurisdiction within the United States, has agreed to comply with all requirements necessary to give the court or panel jurisdiction, has designated an agent upon whom service of process may be served, and has agreed to abide by the final decision of the court or panel or any appellate court on appeal.

History: 1996 AC.

R 500.1128 Contracts affected

Rule 8. All new and renewal reinsurance transactions entered into on or after July 1, 1996, shall conform to the requirements of these rules if credit is to be given to the ceding insurer for the reinsurance.

History: 1996 AC.

R 500.1129 Rescission

Rule 9. R 500.402 of the Michigan Administrative Code, appearing on pages 422 and 423 of the 1982 Annual Supplement to the 1979 Michigan Administrative Code, is rescinded.

History: 1996 AC.