

**CHAPTER 163. REQUIREMENTS FOR FUNDS HELD AS SECURITY
FOR THE PAYMENT OF OBLIGATIONS OF UNLICENSED,
UNQUALIFIED REINSURERS**

- Sec.
- 163.1. Definitions.
- 163.2. Purpose.
- 163.3. Scope.
- 163.4. Funds held in trust.
- 163.5. General requirements for trust agreements.
- 163.6. Requirements for assets held in trust accounts.
- 163.7. Duties and responsibilities of trustees.
- 163.8. Resignation or removal of trustee.
- 163.9. Termination of trust agreements.
- 163.10. Permitted provision in trust agreements.
- 163.11. Requirements for provisions in reinsurance agreements entered into in conjunction with trust agreements.
- 163.12. Accounting in statutory financial statements for credit for reinsurance secured by trust agreements.
- 163.13. Existing trust agreements and underlying reinsurance agreements.
- 163.14. Letters of credit.
- 163.15. Requirements for letters of credit.
- 163.16. Provisions in reinsurance agreements entered into in conjunction with letters of credit.
- 163.17. Accounting in statutory financial statements for credit for reinsurance secured by letters of credit.
- 163.18. Existing letters of credit.
- 163.19. Actions or rights of the Commissioner.
- 163.20. Other security acceptable to the Commissioner.

Authority

The provisions of this Chapter 163 issued under sections 319—319.2 of The Insurance Company Law of 1921 (40 P.S. §§ 442—442.2), unless otherwise noted.

Source

The provisions of this Chapter 163 adopted January 17, 1997, effective January 18, 1997, 27 Pa.B. 295, unless otherwise noted.

Cross References

This chapter cited in 31 Pa. Code § 90j.5 (relating to exemptions); and 31 Pa. Code § 90j.7 (relating to requirements applicable to covered policies to obtain credit for reinsurance; opportunity for remediation).

§ 163.1. Definitions.

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise:

Act—The Insurance Company Law of 1921 (40 P.S. §§ 341—991.1718).

Association—Individuals, partnerships or associations of individuals, authorized to engage in the business of insurance in this Commonwealth as insurers on the Lloyds plan.

Beneficiary—The domestic ceding insurer, or domestic ceding insurers who are members of the same holding company system and are participating in a joint reinsurance pooling arrangement or other arrangement establishing the

respective rights of each ceding insurer within the same holding company system, for whose benefit a trust or letter of credit has been established and any successor of the beneficiary by operation of law. If a successor in interest to the named beneficiary is effectuated by the issuance of an order by a court of law, the successor beneficiary shall include and be limited to the court appointed domiciliary receiver, including a liquidator, rehabilitator or conservator.

Ceding insurer—An insurer that has transferred all or part of the insurance or reinsurance risk it has written to another insurer or reinsurer.

Commissioner—The Insurance Commissioner of the Commonwealth.

Credit for reinsurance—An increase in assets or reduction in liabilities for reinsurance in financial statements filed with the Department by domestic insurers in accordance with statutory insurance accounting principles.

Department—The Insurance Department of the Commonwealth.

Domestic—Incorporated or organized under the laws of the Commonwealth.

Exchange—Individuals, partnerships and corporations, authorized by the laws of the Commonwealth to exchange with each other inter-insurance or reciprocal insurance contracts.

Grantor—An unlicensed, unqualified reinsurer that has established a trust for the benefit of the beneficiary.

Insurer—A stock or mutual insurance company, including a title insurance company, association or exchange.

Qualified United States financial institution—

(i) An institution that meets the following qualifications:

(A) 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 a state thereof.

(B) Is regulated, supervised and examined by United States Federal or state authorities having regulatory authority over banks and trust companies.

(C) Has been determined by either the Commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners or a successor thereto to meet standards of financial condition and standing that are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the Commissioner.

(ii) For purposes of specifying those institutions that are eligible to act as a fiduciary of a trust, the term also means an institution that meets the following qualifications:

(A) 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.

(B) Is regulated, supervised and examined by Federal or State authorities having regulatory authority over banks and trust companies.

Trustee—A qualified United States financial institution as defined in section 319.1(g) of the act (40 P. S. § 442.1(g)).

Unlicensed, unqualified reinsurer—An assuming insurer which is neither:

(i) Licensed by the Department to transact insurance business in this Commonwealth.

(ii) Included on a list of qualified or certified reinsurers published and periodically reviewed by the Commissioner under section 319.1(a) of the act (40 P. S. § 442.1(a)).

Authority

The provisions of this § 163.1 amended under sections 206, 506, 1501 and 1502 of The Administrative Code of 1929 (71 P. S. §§ 66, 186, 411 and 412); and sections 319—319.2 of The Insurance Company Law of 1921 (40 P. S. § 442—442.2).

Source

The provisions of this § 163.1 amended May 24, 2013, effective June 24, 2013, 43 Pa.B. 2819. Immediately preceding text appears at serial pages (224501) to (224503).

Cross References

This section cited in 31 Pa. Code § 163.19 (relating to actions or rights of the Commissioner).

§ 163.2. Purpose.

Section 319.1(b) of the act (40 P. S. § 442.1(b)) establishes conditions whereby a domestic ceding insurer may be allowed to take credit for reinsurance when the assuming reinsurer is an unlicensed, unqualified reinsurer. This chapter establishes minimum requirements for trust agreements, letters of credit and other forms of acceptable security for which credit will be allowed for reinsurance ceded to unlicensed, unqualified reinsurers.

§ 163.3. Scope.

This chapter applies to licensed domestic insurers subject to section 319.1(b) of the act (40 P. S. § 442.1(b)) relating to credit for collateralized reinsurance with unlicensed, unqualified reinsurers.

§ 163.4. Funds held in trust.

Trust agreements established for funds held on behalf of a domestic ceding insurer as security for the payment of the obligations of an unlicensed, unqualified reinsurer shall comply with section 319.1(b)—(e) of the act (40 P. S. § 442.1(b)—(e)) and this chapter.

§ 163.5. General requirements for trust agreements.

(a) A trust agreement shall be entered into between the beneficiary, the grantor and a trustee.

(b) A trust agreement shall be established for the sole benefit of the beneficiary.

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

(d) A trust agreement may not be subject to any conditions or qualifications outside of the trust agreement.

(e) A trust agreement may not be conditioned upon any other agreements or documents, except for the reinsurance agreement for which the trust agreement is established.

(f) A trust agreement may not transfer liability from the trustee for the trustee's own negligence, willful misconduct or lack of good faith.

(g) A trust agreement shall create a trust account into which the assets shall be deposited.

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

(i) A trust agreement shall prohibit the grantor from terminating the trust agreement on the basis of the insolvency of the beneficiary.

§ 163.6. Requirements for assets held in trust accounts.

(a) Assets in the trust account shall be in the form of security permitted by section 319.1(b) of the act (40 P. S. § 442.1(b)) and shall be valued at current fair market value.

(b) A trust agreement shall permit substitution or withdrawal of assets from the trust account only as provided by the following:

(1) Within 6 months of the date the trust account is funded, no substitution or withdrawal of assets may occur except on written instructions from the beneficiary for each individual substitution or withdrawal at the time the substitution or withdrawal is executed.

(2) After 6 months from the date the trust account is funded, no substitution or withdrawal of assets may occur except in accordance with prior written instructions from the beneficiary listing specific types of permitted substitutions or withdrawals of assets that the trustee determines are at least equal in market value to the assets withdrawn and that are in the form permitted by section 319.1(b) of the act and subsection (a); except that, if a substitution or withdrawal of assets, together with other substitutions or withdrawals made within the preceding 12 months, exceeds 50% of the total fair market value of the assets as of the first day of the first month within the preceding 12-month period, the substitution or withdrawal shall be made only on written instructions from the beneficiary for each individual substitution or withdrawal at the time the substitution or withdrawal is executed.

(c) The restrictions on substitutions of assets set forth in subsection (b) do not apply to the substitution of assets that have been designated as Class One or Class Two by the Securities Valuation Office (SVO) of the National Association of Insurance Commissioners if the substitution results in the deposit of SVO designated Class One or Class Two securities that are at least equal in fair market value to the assets withdrawn.

(d) Upon call or maturity of a trust asset, the trustee may withdraw the asset without the consent of the beneficiary, if the trustee provides notice to the ben-

eficiary, liquidates or redeems the assets, and the proceeds are paid into the trust account no later than 5 days after the liquidation or redemption of the assets.

(e) A trust agreement shall permit the beneficiary to have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice of the withdrawal from the beneficiary to the trustee.

(f) No statement or document other than the written notice by the beneficiary to the trustee under subsection (e) shall be required to be presented by the beneficiary to withdraw assets, except that the beneficiary may be required to acknowledge receipt of withdrawn assets.

Cross References

This section cited in 31 Pa. Code § 163.7 (relating to duties and responsibilities of trustees).

§ 163.7. Duties and responsibilities of trustees.

A trust agreement shall require the trustee to:

(1) Receive and hold the assets in a safe place at an office of the trustee in the United States.

(2) Determine that the assets are in a form so that the beneficiary, or the trustee upon direction by the beneficiary, may negotiate the assets without consent or signature from the grantor or another person.

(3) Furnish to the grantor and the beneficiary a statement of the assets in the trust account upon the inception of the account and at the end of each calendar quarter.

(4) Notify the grantor and the beneficiary within 10 days of any deposits to or withdrawals from the trust account; except as provided in § 163.6(b) (relating to requirements for assets held in trust accounts).

(5) Upon written demand of the beneficiary, immediately take the 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.

§ 163.8. Resignation or removal of trustee.

This section applies if the resignation or removal of a trustee does not result in the termination of the trust agreement under § 163.9 (relating to termination of trust agreements):

(1) The trustee may resign upon delivery of a written notice of resignation, effective no later than 90 days after notice to the beneficiary and grantor.

(2) The trustee may be removed by the grantor by delivery to the trustee and the beneficiary of a written notice of removal, effective no later than 90 days after notice to the trustee and the beneficiary.

(3) The resignation or removal of the trustee may not be effective until the following requirements have been met:

(i) A successor trustee has been appointed and approved by the beneficiary and the grantor.

(ii) A trust agreement has been executed by the successor trustee which complies with section 319.1(b)—(e) of the act (40 P. S. § 442.1(b)—(e)) and this chapter.

(iii) The possession of, and title to, all assets in the trust have been transferred to the new trustee.

§ 163.9. Termination of trust agreements.

(a) The trustee shall deliver written notification of termination to the beneficiary at least 30 days, but not more than 45 days, prior to termination of the trust account.

(b) Upon termination of the trust account, assets not previously withdrawn by the beneficiary may not be delivered to the grantor except with the written approval of the beneficiary.

Cross References

This section cited in 31 Pa. Code § 163.8 (relating to resignation or removal of trustee).

§ 163.10. Permitted provision in trust agreements.

The grantor may have the full and unqualified right to vote any shares of stock in the trust account and to receive from time to time payments of any dividends or interest upon any shares of stock or obligations included in the trust account.

§ 163.11. Requirements for provisions in reinsurance agreements entered into in conjunction with trust agreements.

When a reinsurance agreement is entered into in conjunction with a trust agreement and the establishment of a trust account, either the reinsurance agreement or the trust agreement shall contain provisions that:

(1) Require the reinsurer to enter into a trust agreement and to establish a trust account for the benefit of the reinsured.

(2) Specify what recoverables and reserves, or both, the agreement is to cover.

(3) Require the reinsurer, prior to depositing assets with the trustee, to execute assignments or endorsements in blank, or transfer legal title to the trustee of all shares, obligations or other assets requiring assignments so that the ceding insurer, or the trustee upon the direction of the ceding insurer, may negotiate these assets without consent or signature from the reinsurer or any other entity.

(4) Require that all settlements of account between the ceding insurer and the reinsurer be made in cash or its equivalent.

§ 163.12. Accounting in statutory financial statements for credit for reinsurance secured by trust agreements.

(a) A trust agreement established in compliance with this chapter may be used by a domestic ceding insurer to take credit for reinsurance ceded to an unlicensed, unqualified reinsurer in a financial statement required to be filed with the Department if the trust agreement is executed and the trust account is established and funded on or before the date on which the domestic ceding insurer files the financial statement.

(b) Credit for reinsurance shall be allowed for reinsurance ceded to an unlicensed, unqualified reinsurer only if the trust account is established in compliance with this chapter. The credit may not exceed the lesser of the current fair market value of assets available to be withdrawn from the trust account or the specific obligations under the reinsurance agreement that the trust account was established to secure.

§ 163.13. Existing trust agreements and underlying reinsurance agreements.

Domestic ceding insurers may continue to take credit for reinsurance ceded to unlicensed, unqualified reinsurers under reinsurance agreements with underlying trust agreements when both the reinsurance agreements and the underlying trust agreements were executed prior to January 18, 1997, if the reinsurance agreements and trust agreements were executed in compliance with applicable State laws and regulations in existence immediately preceding January 18, 1997, until January 19, 1998, after which no credit will be allowed until the reinsurance agreements and underlying trust agreements are brought into compliance with this chapter.

§ 163.14. Letters of credit.

Letters of credit held by or on behalf of a domestic ceding insurer as security for the payment of the obligations of an unlicensed, unqualified reinsurer under a reinsurance agreement shall meet the requirements of section 319.1(b)—(e) of the act (40 P. S. § 442.1(b)—(e)) and this chapter.

§ 163.15. Requirements for letters of credit.

- (a) A letter of credit shall:
- (1) Be clean, irrevocable, unconditional and evergreen as provided under section 319.1(b)(3)(i) of the act (40 P. S. § 442.1(b)(3)(i)).
 - (2) Contain an issue date and date of expiration with a term of at least 1 year.
 - (3) Contain an evergreen clause which prevents the expiration of the letter of credit without due notice from the issuer and provides for at least 30 days notice prior to expiration date or nonrenewal.

- (4) Stipulate that the beneficiary need only draw a sight draft under the letter of credit and present it to obtain funds and that no other document need be presented.
 - (5) Indicate that it is not subject to any condition or qualifications outside of the letter of credit.
 - (6) Be conditioned upon no other agreement, document or entity, except for the reinsurance agreement for which the letter of credit is issued.
 - (7) Include a clearly marked section which indicates that it contains information for internal identification purposes only and which contains the name of the applicant and other appropriate notations to provide a reference for the letter of credit.
 - (8) Contain a statement to the effect that the obligation of the qualified United States financial institution, as defined in section 319.1(g) of the act, under the letter of credit is in no way contingent upon reimbursement of the issuer by the applicant with respect thereto.
 - (9) Contain a statement that the letter of credit is subject to and governed by the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 500 or subsequent updates) and the laws of the Commonwealth, and drafts drawn thereunder shall be presentable at an office of a qualified United States financial institution.
 - (10) Contain a provision for an extension of time to draw against the letter of credit in the event that one or more of the occurrences specified in Article 17 of Publication 500 (or subsequent updates) occur.
- (b) A letter of credit shall be issued or confirmed by a qualified United States financial institution authorized to issue letters of credit under section 319.1(g)(1) of the act.
 - (c) A letter of credit may be issued by a qualified United States financial institution authorized to issue letters of credit under section 319.1(g)(2) of the act if the following conditions are met:
 - (1) The letter of credit is confirmed by a qualified United States financial institution authorized to issue letters of credit under section 319.1(g)(1) of the act.
 - (2) The issuing qualified United States financial institution formally designates the confirming qualified United States financial institution as its agent for the receipt and payment of the drafts.
 - (3) The letter of credit meets other requirements of this chapter relating to letters of credit.

§ 163.16. Provisions in reinsurance agreements entered into in conjunction with letters of credit.

When a reinsurance agreement is entered into in conjunction with a letter of credit, either the reinsurance agreement or an ancillary agreement thereto shall contain provisions that:

- (1) Require the reinsurer to provide letters of credit to the ceding insurer.
- (2) Specify what recoverables and reserves are covered by the letter of credit.
- (3) Specify that notice of nonrenewal of the letter of credit is a reason that the ceding insurer may draw down the full amount of the letter of credit.

§ 163.17. Accounting in statutory financial statements for credit for reinsurance secured by letters of credit.

(a) A letter of credit may not be used by a domestic ceding insurer to take credit for reinsurance ceded to an unlicensed, unqualified reinsurer unless the letter of credit has been issued with the domestic ceding insurer listed as a beneficiary and is in compliance with section 319.1 of the act (40 P. S. § 442.1) and this chapter.

(b) Credit for reinsurance secured by a letter of credit shall be allowed in an amount not exceeding the lesser of the amount of the letter of credit or the specific obligations under the reinsurance agreement which the letter of credit was issued to secure.

§ 163.18. Existing letters of credit.

Domestic ceding insurers may continue to take credit for reinsurance secured by letters of credit where both the reinsurance agreements and underlying letters of credit were executed prior to January 18, 1997, if the reinsurance agreements and letters of credit were in compliance with applicable State laws and regulations in existence immediately preceding January 18, 1997, until January 19, 1998, or the renewal date of the letter of credit, whichever time is less, after which no credit will be allowed until the reinsurance agreements and letters of credit are brought into compliance with this chapter.

§ 163.19. Actions or rights of the Commissioner.

The failure of a trust agreement or letter of credit to specifically identify the beneficiary as defined in § 163.1 (relating to definitions) to include a court appointed domiciliary receiver may not be construed to prevent the Commissioner from becoming the successor of the beneficiary as a court appointed domiciliary receiver or to otherwise affect any rights which the Commissioner may possess under the laws and regulations of the Commonwealth.

§ 163.20. Other security acceptable to the Commissioner.

(a) A domestic ceding insurer may take credit for reinsurance for funds or letters of credit provided by a noninsurer parent corporation of the ceding insurer if the requirements of section 319.1(b)(4) of the act (40 P. S. § 442.1(b)(4)) are met, as follows:

- (1) The funds or letters of credit are held subject to withdrawal by, and under the control of, the ceding insurer.

(2) The type, amount and form of the funds or letters of credit receive the prior approval of the Commissioner.

(b) A domestic ceding insurer may take credit for unencumbered funds deposited with or withheld by the ceding insurer in the United States if the funds are subject to withdrawal, transfer or substitution solely by the domestic ceding insurer, are under the exclusive control of the domestic ceding insurer, and are in the form of cash or securities as identified in section 319.1(b)(1) and (2) of the act.

[Next page is 165-1.]