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INSURANCE BUSINESS & REGULATORY NEWS

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The Insurance Business and Regulatory Group was formed in 1990 by Robert B. Sullivan and is currently chaired by Steven L. Imber. The group concentrates on providing outstanding service and expertise to the insurance industry with respect to virtually any type of individual or entity subject to insurance regulation by the state insurance departments or enforcement actions by the state Attorneys General. For more information and a list of contacts within the group, see page 7.

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NAIC Changes Target Insurance Holding Company System

By Jeanie A. Botkin

Jeanie Botkin

In late 2010, the National Association of Insurance Commissioners (NAIC) adopted sweeping changes to the Insurance Holding Company System Regulatory Act and Insurance Holding Company System Model Regulation (Model Law and Regulation), the main goal of which was to give the state insurance departments broader authority to review the financial strength of the holding company system as a whole. The changes grant unprecedented power to the departments to require filings by non-insurance entities and the power to examine such entities for any evidence of a systemic risk that could ultimately affect an insurance company's financial strength. The concern that prompted such an expansion of authority stemmed from recent collapses of holding company systems that were due to issues largely unrelated to the insurers that happened to be a part of such systems.

Adoption of the Model Law and Regulation is required by the NAIC in order for states to receive accreditation. All states have adopted the Model Law and Regulation in some form. However, only three states so far have enacted legislation to implement the most recent changes to the Model Law. These three states include Rhode Island, Texas and West Virginia. At the time this article was written, seven states had introduced such legislation this year, including Florida, Illinois, Indiana, Kansas, Kentucky, Nebraska and Oklahoma. More states are expected to follow suit.

The discussion below sets forth some of the major changes to the Model Law. There are other changes not discussed below, such as the changes to the Form E Preacquisition Notice and the confidentiality provisions.

Form A Acquisition Statements

The revisions make it clear than any divestiture of a person's controlling interest in an insurer requires a filing at least 30 days prior to the transaction, and such divestiture must receive insurance department

approval prior to finalization. This simply codifies the practice by many in the industry who already filed a Form A on the basis that such a divestiture amounts to a change in control of the insurer. This filing will be confidential until the conclusion of the transaction, unless the department determines that maintaining such confidentiality interferes with enforcement.

Additionally, if more than one state must approve the Form A transaction (e.g., a domestic state and a commercial domiciliary) and each state requires a public hearing, the hearing may be held on a consolidated basis upon the request of the acquiring party. The commissioner of a state may opt out of a consolidated hearing. A hearing conducted on a consolidated basis must be public and held before the commissioners of the domiciliary states of the insurer(s). The commissioners may attend in person or by telecommunication.

Form B Registration Statements

The new Model Law gives the insurance department the authority to request financial statements from affiliates within an insurance holding company system, even those not directly regulated by the insurance department. Additionally, the Form B must now contain the following statements: (1) the board of directors oversees corporate governance and internal controls; and (2) the officers and senior management have approved, implemented and continue to maintain and monitor corporate governance and internal control procedures.

Form D Affiliated Transaction Filings

The revisions make it clear that amendments and modifications to affiliated agreements that were previously filed are required to be filed through another Form D filing. Some in the industry believed that only material amendments or modifications were required to be filed, contrary to the position of most insurance departments. The new Model Law, however, specifies that all amendments or modifications have to be filed as long as the original agreement was filed. Notice concerning such changes must include the reasons for the change and their financial impact on the insurer.

Additionally, the Model Law states that notice must be provided regarding the termination of affiliated agreements. Again, this is something most regulatory counsel advised clients to do anyway.

Form F Enterprise Risk Reports

The new Form F Enterprise Risk Report is perhaps the biggest change for holding company systems. A Form F is a new annual filing that must be made by the ultimate controlling person of the insurer. The timing of implementation of this new filing will vary by state.

The report must, to the best of the ultimate controlling person's knowledge and belief, identify the material risks within the insurance holding company system that could pose a risk to the insurer. An enterprise risk is defined as any event involving one or more affiliates that, if not promptly remedied, is "likely to have a material adverse effect upon the financial condition or liquidity" of the insurer or its system as a whole.

Specifically, the Form F must disclose, *inter alia*, any material developments regarding strategy, internal audit findings, compliance or risk management affecting the holding company system; developments in various investigations, regulatory activities or litigation that may have a significant impact on the system; the business plan of the system and summarized strategies for the next 12 months; identification of holding company system capital resources and material distribution patterns; identification of any negative movement or discussions with rating agencies which may have caused or may cause potential negative movement in credit ratings and individual insurer financial strength ratings assessments of the holding company system; information on corporate or parental guarantees throughout the system and the expected source of liquidity should such guarantees be called upon; and identification of any material activity or development of the system that, in the opinion of senior management, could adversely affect the system.

All new acquirers of an insurance company following the enactment of this change to the Model Law will likely understand this requirement. At the time of an acquisition of an insurance company, the acquirer must agree to make this annual filing and must acknowledge that, upon request, it will provide information that the department has determined is necessary to evaluate enterprise risk. However, current owners of an insurance company will likely be surprised by this new requirement, particularly foreign owners that are not accustomed to the current amount of regulation of insurers in the U.S. Regulatory counsel may have a tough time during the next few years working with some owners to provide the information required in the new Form F.

Examinations

The new Model Law gives the department the power to examine affiliates of the insurer. The purpose would be to ascertain the financial condition of the insurer and to investigate any potential enterprise risk to the insurer by the ultimate controlling person or any other person or entity within the insurance holding company system or the entire system on a consolidated basis. If the regulators exercise this power, this again, will likely be quite a shock to some owners, especially those in countries in which insurance companies are not regulated to the extent they are in the U.S.

Supervisory Colleges

A new section has been added to the Model Law providing authority to commissioners to create and/or participate in a supervisory college. A supervisory college is made up of state, federal and international regulators of a particular insurer that has international operations. The regulators assess the business strategy, financial position, legal and regulatory position, risk exposure, risk management, and governance processes that apply to the insurer and its affiliates. In conjunction with coordinating regulatory activities, the supervisory college may also establish a crisis management plan in the event such a plan is needed.

The above are just some of the major changes to the Model Law. For additional information regarding these and other changes, please contact Jeanie Botkin at (816) 360-4110 or by email at jbotkin@polsinelli.com. ■

Delaware Series LLC Captive Insurance Programs

By Zachary R. Dyer

Delaware has traditionally been the preeminent and innovative jurisdiction for U.S. businesses to incorporate. In recent years, a concerted effort between the Offices of the Governor, the Secretary of State and the Insurance Commissioner of the State of Delaware, along with a collaboration of industry experts, resulted in the modernization of the Delaware Revised Captive Insurance Company Act. The combination of Delaware's highly-regarded business and corporate law with the features of the state's captive insurance provisions offers advantages such as increased flexibility and enhanced certainty. Accordingly, Delaware has become one of the most attractive jurisdictions for captive insurance companies.


Zach Dyer

Delaware was the first to adopt a provision authorizing the series limited liability company (LLC) entity in 1996. A series LLC is very similar to an ordinary LLC, since it is a separate legal entity. However, unlike an ordinary LLC, a series LLC acts like a sponsor or core LLC under which it has the ability to partition its assets, debts, obligations, liabilities and rights among distinct series business units or SBUs. Each SBU acts as a cell in that it maintains assets and liabilities separate and distinct from those held by other SBUs. Each SBU may have a different business purpose and different rights, powers and duties with respect to the assets held within that unit. The debts, obligations and liabilities incurred by each SBU are enforceable only against that SBU. Each SBU will also be treated as a separate taxpayer for federal income tax purposes.

In early 2010, the Delaware Department of Insurance (Department) licensed the first series LLC captive insurance company. Under Delaware law, it is classified as a "Special Purpose Captive Insurance Company," and this classification gives the Delaware Commissioner of Insurance the authority to license captives that do not otherwise fit within the definition of any particular type of captive. Further, the Commissioner is granted by statute the authority to exempt a Special Purpose Captive Insurance Company from any of the existing captive insurance laws and regulations, in order to appropriately allow for creativity and mechanisms for implementing new or novel captive insurance programs, including the utilization of the series LLC structure.

The series LLC captive was initially developed as a solution to the premium tax problem associated with a sponsored (or protected cell) captive. Delaware's protected cell captive statute imposes a premium tax (including an annual minimum premium tax of $5,000) on each cell captive; however, the series LLC captive applies the premium tax at the core LLC level instead of at the individual SBU

level, while still maintaining separate assets and liabilities within each SBU like the protected cell companies. In addition to the premium tax efficiencies, the series LLC captive allows for efficiencies from the sharing of other administrative and service provider expenses. A series LLC captive may also be designed for simpler administration than a protected cell captive. For example, one annual meeting of a single board of managers could satisfy the minimum governance requirements of the core LLC, as well as its SBUs.

The following is a highlight of some of the financial requirements (which are aggregated at the core LLC level):

- As a Special Purpose Captive Insurance Company, the core LLC will be required to maintain a minimum capital and surplus of at least $250,000, which could be increased if the core LLC is going to participate in the risk.
- Each SBU will be required to have its own minimum and capital surplus in an amount that is determined by the Department based on the lines of coverage, pro forma financial projections and the recommendation of the Department's actuaries.
- Application and processing fee of $3,200 and an annual fee of $300.
- Premium tax on direct business in the amount of two-tenths of 1 percent subject to an annual maximum of $125,000. Premium tax on assumed reinsurance in the amount of one-tenth of 1 percent subject to an annual maximum of $75,000. The minimum annual aggregate premium tax is $5,000.

We are very excited to see the captive market pushing down from the Fortune 500 to the middle market. The Delaware series LLC captive is uniquely positioned to allow small and mid-size groups the opportunity to come together in one captive in order to enhance alternative risk financing mechanisms, while at the same time protecting their assets from the debts and obligations of others.

For additional information on this topic, you may contact Zach Dyer at (816) 360-4352 or zdyer@polsinelli.com. ■

State Spotlights

Members of Polsinelli Shughart's Insurance Business and Regulatory Law Group track major insurance developments across the country and offer insights impacting our industry in the following states.

Arizona Spotlight

By Christina Geremia and John F. Barwell

Two Arizona trial courts recently held that a Medicare Advantage (MA) plan lien is unenforceable. These decisions mirror a long progeny of federal decisions reaching the same result.

In *Pradia v. Recovery Management Systems* (Maricopa County Cause No. CV2011-014963)(Jan. 25, 2012), the Arizona Superior Court considered whether federal Medicare law preempted Arizona law and provided a private right of action to enforce the MA plan lien. The court, relying on *Ferlazzo v. 18th Ave. Hardware, Inc.*, 33 Misc. 3d 421, 423-26, 929 N.Y.S.2d 690, 692-94 (Sup. Ct. 2011), held that the MA plan's right of reimbursement "stemmed from a private contract made with the enrollee," and not federal law. Further, because Arizona's anti-subrogation doctrine, as articulated in *Allstate Ins. Co. v. Druke*, 118 Ariz. 301, 304, 576 P.2d 489, 492 (1978), prohibits the assignment of a personal injury claim, the MA lien was held to be unenforceable under state law.

This ruling mirrors the decision in *Parra v. Pacificare Arizona*, 2011 WL 1119736 (D. Ariz., March 28, 2011), and provides a compelling argument that an MA plan lien is not enforceable in Arizona. While both cases will surely be appealed, if upheld, in addition to the lien being unenforceable, MA plan cases would not be subject to the recently enacted Medicare reporting requirements, and settlements of MA plan cases would not be subject to Medicare set aside consideration.

Tina Geremia has national experience on Medicare Lien laws. If you need assistance in this area, please contact her at (602) 650-2344 or cgeremia@polsinelli.com.

Illinois Spotlight

By Justin T. Liby

Governor Pat Quinn appointed Andrew Boron as Director of the Illinois Department of Insurance (Department), filling the vacancy left by Michael McRaith who was appointed in 2011 to be the first Director of the Federal Insurance Office. Mr. Boron has a bachelor's degree from the University of Wisconsin and a juris doctorate from Chicago-Kent College of Law. He most recently worked as a Vice President and Counsel for the ACE Group and started his career at CNA Financial Corp. in government relations.

Shortly after being appointed as the Illinois Insurance Director, Mr. Boron announced a multi-state settlement agreement with Prudential Insurance Company of America and its affiliates with respect to the use of the Social Security Administration's records (the so-called "Death Master File") to identify life insurance beneficiaries. Under the agreement, Prudential agreed to pay $17 million as a national settlement and to overhaul its systems to find beneficiaries and turn unclaimed life insurance money over to the states. Illinois was one of the lead states for the multi-state examination, which also included California, Florida, Pennsylvania, New Hampshire, New Jersey and North Dakota. State insurance regulators have been investigating allegations that life insurers use the Death Master File to cut off annuity payments, but do not use the information to identify life insurance beneficiaries.

House Bill 1698 was signed into law on June 28, 2011, and represents a significant reform of the Illinois workers' compensation system. Among many other provisions, the new act requires the Department to provide annual reports regarding the Illinois workers' compensation market to the General Assembly, Governor and the Chairman of the Workers' Compensation Commission no later than April 1 beginning in 2012. On February 29, 2012, the Department issued a data call via Bulletin 2012-01 to all licensed workers' compensation insurers in order to facilitate the first report. The deadline for responding to the data call was April 1, 2012.

Effective January 1, 2012, several mandated benefits became effective with respect to accident and health policies. House Bill 1191 mandates that routine patient medical care must be provided under group accident and health insurance policies to patients participating in qualified clinical cancer trials, if that routine medical care would otherwise be covered. Senate Bill 673 requires group health insurers to offer $500 worth of optional tobacco cessation program coverage for persons age 18 or older. Additional premium may be charged for the coverage, which is also subject to the insurer's standard of insurability. House Bill 2249 expands mandatory coverage for diabetes self-management training to include certain education programs that allow the patient to maintain A1c levels. Finally, House Bill 1825 mandates that all individual or group accident and health policies providing coverage for oral cancer medications and intravenous cancer medications cover oral medications at the same benefit cost as intravenous medications.

Also effective January 1, 2012, a new limited lines insurance producer license was put in place under House Bill 1284 for retailers that sell insurance to cover the repair or replacement of portable electronic devices. In addition to the licensing provisions, the bill imposes regulations regarding the coverage and sale practices of portable electronics insurance.

House Bill 1193 revised the laws concerning health insurance recoupments effective January 1, 2012. The bill changes the information required to be displayed on the remittance advice or written document containing the insurer's demand for recoupment or offset and sets the time limit for insurance companies to request recoupment from health care providers at 18 months, subject to certain exceptions. Health care providers have 60 days following receipt of the remittance advice to appeal a recoupment or offset.

Kansas Spotlight

By Jennifer L. Osborn

In *McGuire v. American Family Mut. Ins. Co.*, 2011 WL 4000819, Docket No. 10-3226 (10th Cir. (Kan.) Sept. 9, 2011), the United States Court of Appeals for the Tenth Circuit ruled that the Kansas anti-rebating statute categorically prohibits an agent from paying insurance premiums on behalf of an insured, regardless of the agent's subjective intent when making the payments. The agent had allegedly paid the difference in insurance premiums between the original quote to his customer and the amount that underwriting ultimately charged his customer. The *McGuire* Court stated:

> Indeed, the Kansas legislature considers rebating such serious misconduct it ensures insurance agents who engage in such conduct are mandatorily subject to cease and desist orders and possibly subject to monetary fines and/or suspension or revocation of their agent's licenses. *See* Kan. Stat. Ann. §§ 40–2407 and 40–4909. These statutes provide no statutory exemption premised on the agent's subjective intent in paying an insured's premium, no matter how innocent or laudable such intent may be. *See State v. JC Sports Bar, Inc.*, 253 Kan. 815, 861 P.2d 1334, 1339 (1993) (holding the legislature may forbid the doing of an act without regard to intent or knowledge, and stating it is incumbent on the courts to give such a statute effect, although the intent of the actor may have been innocent).

Id. at *9.

The Kansas Insurance Department has made changes to two regulations. On February 17, 2012, following a public hearing, K.A.R. 40-4-42c dealing with external review organizations was amended. The amendment was intended to clarify to whom notice must be given about providing additional information for an external review organization to consider when reviewing denials of coverage for experimental or medically unnecessary procedures. The amendment also specified that external review organizations must forward copies of any additional information provided to the insurer or its designee.

Additionally, K.A.R. 40-5-7 was revoked effective February 10, 2012. The original regulation merely mirrored a statutory provision of the Uniform Consumer Credit Code that related to property insurance. However, that statute was subsequently amended. As a result, the regulation became inconsistent with the law. The Kansas Insurance Department determined there was no need to have a regulation that mirrored a statutory provision, so it elected to revoke the regulation, rather than amend it.

Missouri Spotlight

By Richard S. Brownlee

Our insurance practice group has recently identified a significant trend in the Missouri Department of Insurance, Financial Institutions and Professional Registration (DIFP) Market Conduct Section.

The DIFP is undertaking a series of targeted market conduct exams directed at companies with a significant book of workers' compensation business. The focus appears to be on the discrepancy in reported amounts of premium between the filed Missouri Annual Report and the amount of premium reported to the Workers' Compensation Second Injury Fund. Significant differences in these two sums may be due to discounts, although that issue is presently unresolved. These involve important legal issues regarding back premiums due, interest and penalties. It also appears these may involve important statute of limitation questions for the "look back" period.

Additionally, a significant workers compensation decision was reached in *Gunter v. KCP&L* (Case No. 10CA-CV01079) (on appeal *State ex. rel KCP&L v. The Honorable Jacqueline Cook*) (WD 73462) (Mo. App. En Banc. Sept. 13, 2011). The Missouri Court of Appeals, En Banc, held that employers can have liability for occupational disease under the Workers Compensation Act without benefit of the exclusive remedy. The plaintiff's claims in a civil action for occupational disease arising from exposure to toxic chemicals in his employment were determined not be subject to the Act's exclusivity provisions because they did not arise out of an "accident" as the term is defined in the statute.

The court acknowledged that occupational disease claims have been historically treated as exclusive, but held that the 2005 amendment changed the Act materially in a way to prevent relying on historical interpretation. Those material changes were (1) the institution of strict construction, (2) changes in the definition of accident, (3) the bifurcation of accident and occupational disease, and (4) the express abrogation of prior case law. The court then said that just because an injury is compensable under the Act does not mean that the Act's remedy is exclusive. Admitting that such a result is a substantial departure from prior law, the court stated that it is not an absurd or illogical result, which would merit court interference. This is a significant, adverse decision for all workers' compensation insurers covering employers of employees that might be exposed to toxic substances in the workplace. ■

Insurance Business and Regulatory Law

With decades of experience assisting the insurance industry with corporate transactions and various compliance and regulatory issues across the country, the Insurance Business and Regulatory Group at Polsinelli Shughart PC has the experience to provide outstanding services to this industry. With several former state insurance department attorneys, including two who served as General Counsel, and five attorneys who were former in-house counsel to various insurance organizations, our attorneys understand the unique needs of our insurance clients on matters involving state insurance departments, state Attorneys General, and other state and federal regulatory agencies.

We routinely handle business and regulatory issues, such as:

- Serving as national outside counsel for various property and casualty insurers, workers' compensation insurers, life and health insurers, third-party administrators and discount medical plan organizations.
- Conducting corporate mergers and acquisitions.
- Making holding company transaction and other related regulatory filings.
- Completing complex national and multi-state regulatory and compliance research.
- Filing Uniform Certificate of Authority Applications, including Primary, Expansion and Corporate Amendment Applications.
- Conducting national and multi-state licensing and compliance projects for third party administrators, agencies, adjusters and discount medical plan organizations.
- Assisting with market conduct examinations and financial examinations, including a multi-state market conduct examination involving 50 states.
- Assisting with insurance company corporate governance requirements, including the Model Audit Rule, and development of appropriate committee charters, conflict of interest statements, codes of conduct and ethics statements, record retention and destruction policies; whistle blower policies, and others.
- Serving as the Deputy Receiver or General Counsel to the Deputy Receiver with respect to insurance company receiverships.
- Forming captive insurers and risk retention groups and assisting with their ongoing compliance and business issues.

Clients include insurance companies, insurance brokers and agencies, third-party administrators, discount medical plan organizations and associations – virtually any individual or entity subject to regulation by state insurance departments, state Attorneys General or other state agencies. The Insurance Business and Regulatory Group has the depth to provide quality and responsive legal services to regulated entities in the insurance industry with respect to all of their business and regulatory needs. ■

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