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10

Reinsurance

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I. [10.1] INTRODUCTION AND OVERVIEW

Participants in reinsurance transactions have developed a highly specialized and, sometimes, arcane vocabulary to describe their dealings. However, as Judge Richard A. Posner noted, “Every esoteric term used by the reinsurance industry has a counterpart in ordinary English.” *Indiana Lumbermens Mutual Insurance Co. v. Reinsurance Results, Inc.*, 513 F.3d 652, 658 (7th Cir.), *aff’d*, 129 S.Ct. 249 (2008). Accordingly, any discussion of the reinsurance field should begin by defining the relevant terms.

A “reinsurance agreement” is “a promise by one insurance company to reimburse the original insurer should it be compelled to pay under the policy of direct insurance the insured who suffered the original loss.” *In re Liquidations of Reserve Insurance Co.*, 122 Ill.2d 555, 524 N.E.2d 538, 541, 120 Ill.Dec 508 (1988). In a typical reinsurance transaction: one insurer (the “ceding company” or “cedent”) “cedes” all or part of the risk relating to a policy, or a group of policies, to the reinsurer, also known as the “assuming company.” A portion of risk not ceded is “retained.” The reinsurer indemnifies the ceding company for any liability incurred that is covered by the reinsurance.

There are two kinds of reinsurance: (a) “facultative” reinsurance, in which the reinsurer assumes the risk on a single policy; or (b) “treaty” reinsurance, in which the reinsurer agrees to assume certain defined risks under many policies. Robert W. Strain, REINSURANCE, pp. 652, 664 (1980) (Strain). Reinsurance may be written on a pro rata basis, whereby the reinsurer agrees to indemnify the direct insurer for a proportional part of its losses under its policies, or on an excess of loss basis, whereby the reinsurer indemnifies the direct insurer against all or a portion of the amount of loss in excess of a specified retention. Strain, pp. 651, 660.

When a reinsurer purchases reinsurance for the risks it has assumed, the transaction is called a “retrocession.” Strain, p. 662. The ceding company is referred to as the “retrocedent,” and the assuming company is known as the “retrocessionaire.” *Id.*

Reinsurance agreements are contracts of indemnity, so that the assuming company’s obligation does not arise until the ceding company makes a payment under its direct insurance policy. *See Certain Underwriters at Lloyd’s, London v. Boeing Co.*, 385 Ill.App.3d 23, 895 N.E.2d 940, 954, 324 Ill.Dec. 225 (1st. Dist. 2008). In the absence of unusual circumstances, such as a “cut-through” clause whereby the assuming company expressly agrees to pay reinsurance proceeds directly to the ceding company’s policyholder, a “contract of re-insurance operates solely between the insurer and the re-insurer, and creates no privity whatever between the reinsurer and the person originally insured.” *People ex rel. Baylor v. Highway Ins. Co.*, 57 Ill.2d 590, 316 N.E.2d 633, 634 (1974), quoting *Vial v. Norwich Union Fire Ins. Society of Norwich, England*, 257 Ill. 355, 100 N.E. 929, 930 (1913).

Insurance companies may engage in reinsurance/retrocessional transactions for any number of reasons. The ceding company may wish to increase its capacity to assume direct risk by using reinsurance to pass off a portion of that risk to the assuming company. The ceding company, as well as the retrocedent, may use reinsurance to protect against rare, catastrophic losses.

Companies may employ reinsurance to diversify the risks they assume. Reinsurance thus serves to assist ceding companies, assuming companies, retrocedents, and retrocessionaires in stabilizing their underwriting results and increasing their surpluses.

Reinsurance has become an increasingly international business, with alien reinsurance companies accounting for approximately 60 percent of premiums ceded. Notwithstanding and as with direct insurance, the regulation of reinsurance remains vested primarily in the states because “[i]nsurers who negotiate and enter into reinsurance agreements do so from a substantially more equal bargaining position than do policyholders of direct insurance.” *In re Liquidation of Reserve Insurance Co.*, *supra*, 524 N.E.2d at 541. State regulators do not focus on consumer protection issues such as form filing, rate filing, and market conduct when regulating reinsurance. They instead concentrate on the effects a reinsurance transaction may have on the ceding company’s solvency. Although regulators in Illinois and elsewhere do engage in some direct regulation of reinsurers, they achieve their greatest impact on reinsurance transactions through indirect regulation.

II. DIRECT REGULATION OF REINSURANCE

A. [10.2] Domestic Companies

Under §173(a) of the Illinois Insurance Code, 215 ILCS 5/173(a), a domestic insurance company may assume reinsurance of “any part or all of any risks of the kind which it is authorized to insure.” Domestic reinsurers must meet the same general requirements as direct insurers, including (1) corporate governance laws; (2) minimum capital, surplus, and reserves; (3) annual or more frequent submission of financial data to the Illinois Department of Insurance (IDI), including audited financial statements and risk-based capital reports; (4) kind and quality of investments; (5) on-site examinations; and (6) categories of risk insured. See Chapters 1 and 3 of this handbook.

Under recently enacted federal legislation, most reinsurers meeting the financial solvency requirements of their states of domicile will be free from financial solvency regulation by non-domiciliary states. Included within the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. No. 111-203, 124 Stat. 1376 (2010), is the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA), Title V, Subtitle B — State-Based Insurance Reform, §511, *et. seq.*

The NRRA provides that if a reinsurer’s state of domicile is accredited by the National Association of Insurance Commissioners (NAIC) or has financial solvency requirements similar to those necessary for NAIC accreditation, then that state alone will have responsibility for regulating the financial solvency of the reinsurer. NRRA §532(a) (codified at 15 U.S.C. §8222(a)). Although non-domiciliary states may request copies of financial statements the reinsurer provides to its domiciliary regulator, they may not require the reinsurer to provide any financial information in addition to that required by the domiciliary state. NRRA §532(b) (codified at 15 U.S.C. §8222(b)). A “reinsurer” is defined as an insurer to the extent that, in accordance with the laws of its state of domicile, it

- (i) is principally engaged in the business of reinsurance;**
- (ii) does not conduct significant amounts of direct insurance as a percentage of its net premiums; and**
- (iii) is not engaged in an ongoing basis in the business of soliciting direct insurance.**
NRRA §533(5) (codified at 15 U.S.C. §8223(5)).

The NRRA takes effect July 21, 2011. NRRA §512 (specifying expiration of a twelve-month period after enactment as the effective date (codified at 15 U.S.C. §8201 Note).

A domestic ceding company must establish and maintain a reinsurance committee with no fewer than three members, one of whom must belong to the company's board of directors. 215 ILCS 5/179b. The committee must review and approve all treaty reinsurance placements and review and approve guidelines for facultative placements, giving special attention to the reinsurers' financial strength and performance record. *Id.* The committee need not review and approve any reinsurance agreement for which the aggregate premium ceded in any one year is less than one percent of the company's annual gross written premium.

B. Foreign or Alien Reinsurers

1. [10.3] Authorized Foreign or Alien Reinsurers

Any insurance company may be authorized to transact all or any part of its business on the basis of reinsurance. 215 ILCS 5/5. If it chooses to do so, it will be required to meet the requirements for obtaining a certificate of authority. See 215 ILCS 5/111; Chapter 1 of this handbook. Certain other restrictions and requirements may also apply.

a. [10.4] Bulk Transfer Restrictions

A foreign or alien company that has received a certificate of authority may transfer its direct policy obligations under insurance contracts with Illinois policyholders, by reinsurance or otherwise, if the transferee company is authorized to transact in Illinois the type of insurance business transferred. 215 ILCS 5/113.1(1)(a).

If the proposed transferee company is not subject to regulation by the Illinois Department of Insurance or the administrative requirements of the Illinois Insurance Code, the transferring company must give 30 days' prior written notice to each policyholder to be transferred, stating that the insurance contract and the company's liabilities thereunder are to be transferred to a specified insurer. 215 ILCS 5/113.1(1)(b). The unauthorized transferee company must make and maintain a special deposit with the Director of the Illinois Department of Insurance (IDI) for the protection and benefit of all Illinois policyholders of such unauthorized company, in assets acceptable to the Director and having a fair market value not less than the required statutory reserves for the Illinois insurance business to be transferred. 215 ILCS 5/113.1(1)(c).

b. [10.5] Port of Entry Requirements

An alien company may use Illinois as a state of entry to transact insurance in the United States by obtaining a certificate of authority and maintaining a deposit of assets. 215 ILCS 5/60a(1). The deposited assets — known as “trusteed assets” — must be held in trust for the benefit of policyholders in the United States, in an amount at least equal to the sum of its minimum capital and surplus, and the amount of its liabilities to policyholders, net of reinsurance for which credit is allowed (see §§10.11 – 10.16 below), as reflected in its most recent financial statement on file with the Director of the Illinois Department of Insurance, minus the sum of

(i) the amount of all of its general state deposits (including all interest accrued and due and payable to the holder of the deposit), (ii) the amount of its special state deposits (including all interest accrued and due and payable to the holder of the deposit), (iii) the amount of its reinsurance recoverable on paid losses (where such reinsurance is the type for which credit would be allowed Pursuant to Article XI), (iv) the amounts of its notes and bills receivable, taken for premiums; (v) with respect to a company authorized to write [casualty, fidelity, surety or fire and marine insurance], the amount of its agents’ balances and uncollected premiums; and (vi) the amount of its funds held by or deposited with reinsureds. 215 ILCS 5/60b(1).

The trusteed assets must meet certain specified investment requirements imposed on domestic companies by the Illinois Insurance Code. See 215 ILCS 5/60b(2).

The trust agreement must provide as follows:

1. Legal title to the trusteed assets will be held by the trustee for the benefit of the alien company’s United States policyholders.
2. The trustee may be substituted, subject to the Director’s approval.
3. The trust fund must be segregated from all other assets.
4. The trustee must maintain a record sufficient to identify the assets of the trust.
5. Withdrawals from the trust will be made only as provided in the relevant provision of the Illinois Insurance Code. 215 ILCS 5/60c.

See also 215 ILCS 5/60d (governing withdrawals of trusteed assets). An alien company qualifying to use Illinois as its state of entry will be considered a domestic company and, as such, will be subject to all applicable provisions of the Illinois Insurance Code. 215 ILCS 5/60a(2).

2. [10.6] Unauthorized Foreign or Alien Reinsurers

A foreign or alien company may transact reinsurance in Illinois without obtaining a certificate of authority. 215 ILCS 5/121(1), 5/121-2.02. However, an unauthorized foreign or alien company

that transacts reinsurance business in Illinois is subject to substituted service of process and, further, may be required to post security before filing a pleading in a suit or arbitration. 215 ILCS 5/123.

a. [10.7] Substitute Service of Process

Substitute service of process may be effected on any unauthorized foreign or alien company, which, by mail or otherwise, (1) issues or delivers a contract of reinsurance to residents of Illinois or to corporations authorized to do business in Illinois; (2) solicits applications for such contracts; (3) collects reinsurance premiums, membership fees, assessments or other considerations for such contracts; or (4) otherwise transacts business. 215 ILCS 5/123(2). By such conduct, the foreign or alien reinsurer is deemed to have appointed the Director of the Illinois Department of Insurance as attorney for service of process, in any action or proceeding against it, arising out of the contract of reinsurance. *Id.*

Service on the unauthorized foreign or alien reinsurer is effected by delivering a copy of the process to the Director and paying the prescribed fee. The Director must maintain a record of all such process so served. Within ten days of serving the Director, the plaintiff's attorney must send a notice of the service and copy of the process via certified or registered mail to the defendant's last known principal place of business. On or before the return date of the process or within such further time as the court may allow, the plaintiff's attorney must file the defendant's receipt and the affidavit of compliance of the plaintiff's attorney with the Insurance Code's substitute service provisions with the clerk of the court in which the action is pending. 215 ILCS 5/123(3).

Process may also be served on any person within Illinois who, in Illinois on behalf of the unauthorized foreign or alien reinsurer, (1) solicits reinsurance; (2) makes, issues, or delivers any contracts of reinsurance; (3) collects or receives any consideration for reinsurance; or (4) in any manner aids or assists in any of the foregoing activities. 215 ILCS 5/123(4). Within ten days of serving any such person, the plaintiff's attorney must send a notice of the service and copy of the process, via certified or registered mail, to the defendant's last known principal place of business. On or before the return date of the process or within such further time as the court may allow, the plaintiff's attorney must file (1) the defendant's receipt and (2) the plaintiff's attorney's affidavit of compliance with the Illinois Insurance Code's substitute service provisions with the clerk of the court in which the action on is pending. *Id.*

b. [10.8] Prejudgment Security

Before filing a responsive pleading in any action, proceeding, or arbitration brought against it, an unauthorized foreign or alien reinsurer must

1. deposit cash or securities, or file a satisfactory bond, with the clerk of the court in the jurisdiction in which the action, proceeding, or arbitration is pending, in an amount to be fixed by the court sufficient to secure the payment of any final judgment that may be rendered in such action, proceeding, or arbitration; or

2. if the unauthorized company continues to issue new contracts of reinsurance, procure a certificate of authority to transact the business of insurance in Illinois. 215 ILCS 5/123(5).

These requirements do not prevent the unauthorized company from moving to quash service on the grounds that it has not transacted insurance business in Illinois. *Id.* The court has discretion to postpone the compliance with the prejudgment security provisions. *Id.*

c. [10.9] Attorneys' Fees and Interest

In any action against an unauthorized foreign or alien company on a contract of reinsurance issued or delivered in Illinois to an Illinois resident or to a corporation authorized to do business in Illinois, if the defendant has failed for 30 days after demand prior to the commencement of the action to make payment in accordance with the terms of the contract, and it appears to the court that such refusal was vexatious and without reasonable cause, the court may allow to the plaintiff a reasonable attorney's fee and include such fee in any judgment that may be rendered in such action. Such fee will not exceed 12.5 percent of the amount that the court or jury finds the plaintiff is entitled to recover against the insurer. Failure of a company to defend any such action is deemed prima facie evidence that its failure to make payment was vexatious and without reasonable cause. 215 ILCS 5/123(6).

III. [10.10] INDIRECT REGULATION OF REINSURANCE

As noted in §10.1 above, regulators in Illinois and elsewhere achieve their greatest impact on reinsurance transactions through a system of indirect regulation, which focuses on the effect the reinsurance arrangement may have on the financial solvency of the ceding company. The principal value of reinsurance to ceding companies is that it enables them to claim statutory credit for the reinsurance (*i.e.*, to claim cessions as assets or as deductions from liabilities on their annual financial statements).

The regulators exercise control over reinsurance transactions by limiting the circumstances under which their domestic ceding companies can claim such statutory credit for their reinsurance arrangements. Thus, while it is perfectly legal for a foreign or alien company to transact reinsurance in Illinois without obtaining a certificate of authority (215 ILCS 5/121-2.01), an Illinois domiciled ceding company cannot claim statutory credit for its cessions on its financial statements unless the assuming company meets statutory criteria and the agreement itself contains certain required terms, which are set forth below.

Recent federal legislation confirms that the ceding company's state of domicile has primacy in determining whether to grant statutory credit for the reinsurance transaction. The Nonadmitted and Reinsurance Reform Act of 2010 (see §10.2 above) provides that if a state grants statutory credit for the domestic insurer's ceded risk, then no other state may deny such credit, provided that the domiciliary state is accredited by the National Association of Insurance Commissioners or has financial solvency requirements similar to those necessary for NAIC accreditation. NRRA §531(a) (codified at 15 U.S.C. §8221(a)).

A. [10.11] Credit for Reinsurance

The relevant provisions of the Illinois Insurance Code are based on the National Association of Insurance Commissioners Model Credit for Reinsurance Law. Illinois allows credit to domestic ceding companies if the assuming reinsurer (1) is licensed in Illinois, or (2) is accredited by the Illinois Department of Insurance, or (3) maintains a trust fund, or (4) secures its obligations with authorized collateral. 215 ILCS 5/173.1.

1. [10.12] Licensed Reinsurers

Credit is allowed for cessions to an assuming reinsurer that is (a) authorized in Illinois to insure the types of insurance ceded and (b) has at least \$5 million in capital and surplus. 215 ILCS 5/173.1(1)(A); 50 Ill.Admin. Code §1104.20.

2. [10.13] Accredited Reinsurers

An accredited reinsurer is one (a) that agrees to submit to the state's jurisdiction, (b) that submits to Illinois' authority to examine its books and records, (c) that is licensed in at least one state, (d) that files the annual statement that it must file in its domiciliary state and a copy of its most recent audited financial statement, (e) that maintains at least a \$20 million surplus, and (f) whose accreditation has been approved by the Director of the Illinois Department of Insurance. 215 ILCS 5/173.1(1)(B); 50 Ill.Admin. Code §1104.30.

3. [10.14] Unlicensed or Unaccredited Reinsurers Maintaining Multiple Beneficiary Trusts

A domestic insurer is allowed to claim statutory credit on its financial statements for cessions to unlicensed and unaccredited reinsurers if the reinsurer submits to Illinois' authority to examine its books and records, maintains a trust fund in a qualified financial institution in the amount of its gross U.S. liabilities, and also meets one of the following requirements:

- a. A single assuming insurer must maintain a trusted surplus of \$20 million.
- b. A group of unincorporated underwriters must maintain a trusted surplus of \$100 million held for the benefit of U.S. ceding companies and make available to the Director of the Illinois Department of Insurance annual certifications by the group's domiciliary regulator and its independent public accountants of the solvency of each underwriter member of the group (the "Lloyd's Provision").
- c. A group of incorporated reinsurers under common administration with aggregate policyholders' surplus of \$10 billion must have three years' seasoning, maintain a joint trusted surplus of which \$100 million is held for U.S. ceding companies, and make available to the Director annual certifications by the group's domiciliary regulator and its independent public accountants of the solvency of each member of the group (the "ILU Provision"). 215 ILCS 5/173.1(1)(C); 50 Ill.Admin. Code §1104.40.

4. [10.15] Unauthorized Reinsurers Providing Collateral

A domestic ceding company can obtain statutory credit for cessions to a reinsurer not meeting the foregoing requirements listed in §10.14 above to the extent the reinsurer provides collateral for its obligations. Such credit cannot exceed the amount of funds held by or on behalf of the ceding company. The security must be held in the United States under the control of the cedent or in trust for the cedent in a qualified financial institution. Security may take the form of (a) cash; (b) securities acceptable to the National Association of Insurance Commissioners Securities Valuation Office; (c) a clean, irrevocable, evergreen letter of credit; or (d) any other form of security acceptable to the Director of the Illinois Department of Insurance. 215 ILCS 5/173.1(2); 50 Ill.Admin. Code §1104.60. The regulations specify the required terms of the trust agreement and letter of credit. See 50 Ill.Admin. Code §1104.70 (specifying trust agreement terms); 50 Ill.Admin. Code §1104.80 (specifying letter of credit requirements).

5. [10.16] Credit for Funds Withheld

A domestic ceding company can also obtain statutory credit for cessions to a reinsurer not meeting the requirements of 215 ILCS 5/173.1(1) in the amount of unencumbered funds it withholds in the United States under its exclusive control. Such funds must be subject to withdrawal solely by the ceding company. 50 Ill.Admin. Code §1104.90.

B. [10.17] Required Terms

Because reinsurance agreements are usually negotiated by sophisticated parties on relatively even footing, the parties are largely free to negotiate any terms they see fit. Reinsurance has often been provided on the basis of an abbreviated contract, called a “slip.” See *Sphere Drake Insurance Ltd. v. American General Life Insurance Co.*, 376 F.3d 664 (7th Cir. 2004). However, if the ceding company wishes to take statutory credit for its reinsurance, the agreement must contain a number of provisions.

The Nonadmitted and Reinsurance Reform Act of 2010 restricts the provisions non-domiciliary states may require in reinsurance agreements. The Act provides that with the exception of certain taxes and assessments on insurance companies or insurance income, all laws, regulations, provisions, and other actions of a state that is not the domicile of the ceding company are preempted to the extent they

1. restrict or eliminate the parties’ contractual right to resolve disputes through arbitration proceedings, consistent with the provisions of the Federal Arbitration Act (FAA), 9 U.S.C. §1, *et seq.*;
2. require that a certain state’s law shall govern the reinsurance contract, disputes arising under the reinsurance contract, or requirements of the reinsurance contract;
3. attempt to enforce a reinsurance agreement on terms different from those set forth in the contract; or

4. otherwise apply the laws of the state to reinsurance agreements of ceding company not domiciled in that state. NRRA §531(b) (codified at 15 U.S.C. §8221(b)).

The requirements for reinsurance agreements entered into by Illinois-domiciled ceding companies are set forth in §§10.18 – 10.22 below.

1. [10.18] Insolvency Clause

The reinsurance agreement must provide that in the event of insolvency of the ceding company, reinsurance proceeds will be payable on the basis of its liability without diminution due to the insolvency of the ceding company. Unless the agreement specifically provides for another payee in the event of insolvency, these proceeds must be paid to the insolvent ceding company's receiver. These provisions are described at greater length in the discussion of insolvency in §§10.37 and 10.38 below (describing requirements of 215 ILCS 5/173.2, 5/173.3; 50 Ill.Admin. Code §1104.100(a)).

2. [10.19] Service of Suit Clause

If the assuming company is not licensed or accredited in Illinois, the ceding company cannot obtain statutory credit unless the reinsurance agreement requires the assuming insurer to (a) agree to submit to the jurisdiction of an alternative dispute resolution panel or court of competent jurisdiction within the United States, (b) comply with all requirements necessary to give such court or panel jurisdiction, (c) agree to abide by the final decision of such court or panel, and (d) designate the Director of the Illinois Department of Insurance or a designated attorney as its agent upon whom service of process may be effected. 215 ILCS 5/173.1(1)(E); 50 Ill.Admin. Code §1104.100(b).

3. [10.20] Agreements Must Be Reduced to Writing

To assure that a reinsurance transaction involves a bona fide transfer of risk, the Illinois Insurance Code and regulations will attach negative accounting treatment if a written agreement memorializing the transaction is not executed within a reasonable period of time.

a. [10.21] Life Reinsurance

If a ceding life insurance company wishes to take statutory credit for its reinsurance, the full agreement must be set forth in writing within a reasonable time. Illinois life reinsurance agreements, or amendments thereto, do not reduce liability or count as assets in a financial statement unless agreement, amendment, or a binding letter of intent is executed by both parties no later than the "as of date" of the financial statement. 50 Ill.Admin. Code §1103.40(a). The reinsurance agreement or amendment must be executed within a reasonable period of time, not exceeding 90 days from the execution date of the letter of intent, in order for credit to be granted for the reinsurance ceded. 50 Ill.Admin. Code §1103.40(b).

In addition, a life reinsurance agreement must provide as follows:

1) The agreement shall constitute the entire agreement between the parties with respect to the business being reinsured thereunder and that there are no understandings between the parties other than as expressed in the agreement; and

2) Any change or modification to the agreement shall be null and void unless made by amendment to the agreement and signed by both parties. 50 Ill.Admin. Code §1103.40(c).

b. [10.22] Property/Casualty Reinsurance

Under the National Association of Insurance Commissioners, Statement of Statutory Accounting Principle (SSAP) No. 62, which is employed by domestic property/casualty companies in preparing their financial statements, a property/casualty reinsurance agreement that has not been finalized, reduced to writing, and signed by the parties within nine months of inception of the reinsured policy period is presumed to be retroactive. SSAP No. 62, ¶23.

IV. [10.23] REPORTING/APPROVAL REQUIREMENTS

Upon written request, all insurance companies are required to promptly provide the Director of the Illinois Department of Insurance with certified copies of each reinsurance ceded contract, agreement, or treaty in force and a certified copy of each subsequent amendment or cancellation affecting such contracts, agreements, or treaties that are on file with the IDI. 50 Ill.Admin. Code §1101.20. The reporting and approval requirements discussed in §§10.24 – 10.28 below also apply.

A. [10.24] Cancellation of Certain Agreements

If a canceled reinsurance contract involves more than 20 percent of the ceding company's premiums in force, the ceding company must provide written notice of the cancellation to the Director of the Illinois Department of Insurance, stating the estimated amount of gross unearned premiums and return commissions involved. 215 ILCS 5/173.5.

If an insurer loses reinsurance for all or a substantial portion of the underlying risk insured by a direct insurance policy that has been in effect for 60 days, it must, prior to issuing a notice of cancellation of the policy, file a certification of the loss of reinsurance with the Director. 215 ILCS 5/143.16a(e). The notice of cancellation may not issue until the Director has provided the insurer with written notice of acceptance of the certification. 50 Ill.Admin. Code §940.30.

The certification must consist of a written statement, signed by the insurer's principal officer, identifying the specific lines of reinsurance affected by the loss of reinsurance, giving an estimate of the number of Illinois policies to be cancelled, describing the reason for the loss of reinsurance, describing all efforts to renew or replace the reinsurance lost, and affirming that the insurer will cancel only those policies that were covered by the lost reinsurance. 50 Ill.Admin. Code

§940.30(b). The certification must be accompanied by copies of the reinsurance agreement that provided the lost coverage, the reinsurer's notice of cancellation, any amendment purporting to omit reinsurance coverage for the policies to be cancelled, and any replacement reinsurance agreement. 50 Ill.Admin. Code §940.30(c).

The Director must give written notice of acceptance of the certification within 30 days of receiving it, unless

- 1) the filing does not comply with the [regulatory requirements];**
- 2) the filing is insufficient to demonstrate that the loss of reinsurance was involuntary on the part of the insurer making the filing;**
- 3) the certification appears to be untrue; or**
- 4) the reinsurance lost does not cover a substantial part of the underlying risk.** 50 Ill.Admin. Code §940.30(d).

B. [10.25] Agreements Requiring Approval

A domestic life, accident, and health insurer, a fraternal benefit society, a burial society, or an assessment accident and assessment accident and health company may not enter into any of the following reinsurance agreements unless the agreements are approved in writing by the Director of the Illinois Department of Insurance:

1. an agreement that cedes previously issued and outstanding risks to any company;
2. an agreement that cedes any risk to a company not authorized to transact business in Illinois; and
3. an agreement in which the reinsurer assumes any outstanding risks on which the aggregate reserves and claim liabilities exceed 20 percent of the reserves and claim liabilities of the assuming company, as reported in its preceding financial statement, for either life or accident and health insurance. 215 ILCS 5/174(1)(a).

A domestic casualty, fidelity, surety, and fire and marine insurer may not enter into any of the following reinsurance agreements unless the agreements are approved in writing by the Director:

1. an agreement whereby the domestic company cedes to any company, at one time or within a period of six consecutive months, more than 20 percent of its previously retained unearned premium liability; or
2. an agreement whereby the domestic company cedes any outstanding risk to a stock company with less than \$2 million in capital and surplus, or to a mutual or reciprocal company with less than \$2 million in surplus. 215 ILCS 5/174(1)(b).

The domestic ceding company seeking approval must also file a certificate regarding fees, commissions, or other consideration paid in connection with the reinsurance agreement. 215 ILCS 5/178. The Director must approve the reinsurance agreement if its terms do not injuriously affect the rights of policyholders of any of the companies that are parties to the agreement. 215 ILCS 5/175. If the Director refuses to approve the agreement, the company is entitled to a hearing upon request. *Id.* Any agreement that is not disapproved by the Director within 30 days after its submission is deemed approved. 215 ILCS 5/174(2).

C. [10.26] Health Maintenance Organizations

A health maintenance organization (HMO) must file all reinsurance agreements and any amendments, renewals, or addenda with the Director of the Illinois Department of Insurance. 215 ILCS 125/4-12(c); 50 Ill.Admin. Code §5421.50(a)(1). The Director's approval is required for all reinsurance agreements, with the exception of individual stop-loss, aggregate excess, hospitalization benefits, or out-of-area of the service providers that reinsure less than 20 percent of the organization's total risk. 215 ILCS 125/4-12(c).

D. [10.27] Holding Company

An insurance company authorized to do business in Illinois that is a member of an insurance holding company system must file an annual Form B registration statement. 215 ILCS 5/131.13; 50 Ill.Admin. Code §852.30; 50 Ill.Admin. Code §852.ILLUSTRATION B, Form B. A foreign or alien company need not file if it attaches an affidavit to its annual statement indicating that it filed a registration statement with its domiciliary regulator, which has requirements similar to those of Illinois. 215 ILCS 5/131.13; 50 Ill.Admin. Code §852.30(e). The Director of the Illinois Department of Insurance may require the company to furnish a copy of the registration statement it filed with its domiciliary regulator. 215 ILCS 5/131.13. Any insurer required to file a Form B registration statement must disclose current information about in-force reinsurance agreements with its affiliates. 215 ILCS 5/131.13(3)(f); 50 Ill.Admin. Code §852.ILLUSTRATION B, Form B, Item 5.

Moreover, the insurer must provide prior written notice at least 30 days in advance of a reinsurance transaction with an affiliate that involves a transfer of assets from or liabilities to a company equal to or exceeding the lesser of 3 percent of the company's admitted assets or 25 percent of its surplus as regards policyholders as of the end of the preceding calendar year. 215 ILCS 5/131.20a(1)(a)(i). Any series of similar transactions — carried out within a 180-day period that in the aggregate meets the foregoing thresholds — is subject to the prior approval requirement. 215 ILCS 5/131.20a(1)(a)(v). The company is also required to provide notice of proposed reinsurance agreements or modifications of reinsurance agreements, including agreements that may require as consideration a transfer of assets to a nonaffiliate if an agreement or understanding exists between the company and the nonaffiliate that any portion of those assets will be transferred to one or more of the company's affiliates. 215 ILCS 5/131.20a(1)(a)(iii).

Any such proposed reinsurance transaction must be submitted on Form D-1. 50 Ill.Admin. Code §854.30(c); 50 Ill.Admin. Code §854.ILLUSTRATION A, Form D-1. The insurer is required to furnish a description of the following:

1. the known or estimated amount of liability to be ceded;
2. the period of time during which the agreement will be in effect;
3. any agreement or understanding between the insurer and a nonaffiliate to the effect that any portion of the assets constituting the consideration for the agreement will be transferred to one or more of the insurer's affiliates;
4. the consideration involved in the transaction; and
5. the effect of the transaction on the insurer's surplus. 50 Ill.Admin. Code §854.ILLUSTRATION A, Form D-1, Item 5.

The insurer may enter into the transaction if the Director has not disapproved it within the 30-day period. See 215 ILCS 5/131.20a(1)(a); 50 Ill.Admin. Code §854.30(b).

E. [10.28] Disclosure of Material Transactions

A domestic ceding company is required to file with the Director of the Illinois Department of Insurance a report of material nonrenewals, cancellations, or revisions of its reinsurance that have not otherwise been submitted to the Director for review, approval, or information purposes. 215 ILCS 5/141.4(a).

In the case of property/casualty business, including accident and health business written by a property/casualty insurer, a nonrenewal, cancellation, or revision of a reinsurance agreement will be considered material and, therefore, reportable if it affects more than 50 percent of the insurer's total ceded written premium or more than 50 percent of the insurer's total ceded indemnity and loss adjustment reserves. 215 ILCS 5/141.4(c)(1).

In the case of life, annuity, and accident and health business, a nonrenewal, cancellation, or revision of a reinsurance agreement will be considered material if it affects more than 50 percent of the total reserve credit taken for business ceded, on an annual basis, as indicated on the insurer's most recent annual statement. 215 ILCS 5/141.4(c)(2).

For property/casualty life, annuity, and accident and health business, a nonrenewal, cancellation, or revision of a reinsurance agreement will be considered material if an authorized reinsurer representing more than 10 percent of a total cession is replaced by one or more unauthorized reinsurers, or previously established collateral requirements have been reduced or waived with respect to one or more unauthorized reinsurers representing more than 10 percent of a total cession. 215 ILCS 5/141.4(c)(3).

The report must be filed within 15 days of the end of the calendar month in which the reportable transaction occurred. 215 ILCS 5/141.4(a). The report must disclose the following information: (1) the effective date of the nonrenewal, cancellation, or revision; (2) a description of the transaction, identifying who initiated it; (3) the reason for the transaction; and (4) the identities of the replacement insurers, if applicable. 215 ILCS 5/141.4(c). Certain material cessions to a pool must also be reported. *Id.*

V. PROHIBITED REINSURANCE TRANSACTIONS

A. [10.29] Capital and Surplus Restrictions

Neither a domestic stock company with less than \$5 million capital and surplus nor a domestic mutual or reciprocal company with less than \$5 million surplus may assume as reinsurance any casualty, fidelity, surety, fire, or marine business, with the exception of facultative reinsurance or accident and health business written by a property/casualty insurer. 215 ILCS 5/174.1.

B. [10.30] Payment of Undisclosed Fees to Officer or Director

Except as fully expressed in the reinsurance agreement, no director or officer of any company that is a party to the agreement may receive any fee, commission, or other compensation, directly or indirectly, for aiding, promoting, or assisting in the negotiation of the agreement. 215 ILCS 5/179(1). Violators are guilty of a Class A misdemeanor. 215 ILCS 5/179(2).

C. [10.31] Managing General Agents

No managing general agent should receive any compensation, remuneration for, or in any manner profit from obtaining or arranging reinsurance for a domestic company with respect to business underwritten by the managing general agent. 215 ILCS 5/179a(a). Violators are guilty of a Class A misdemeanor. 215 ILCS 5/179a(b).

A “managing general agent” is defined to include any person or entity who

1. manages the insurance business of an insurer;
2. acts as an agent for such insurer;
3. with or without authority, produces and underwrites more than five percent of the insurer’s policyholder surplus within any calendar quarter or, within any calendar year, produces and underwrites more than eight percent of the insurer’s policyholder surplus;
4. has authority to bind the insurer in settlement of individual claims in amounts exceeding \$500; and
5. who negotiates reinsurance on behalf of the insurer. 215 ILCS 5/141a.

Exceptions to this definition are made for

1. the insurer’s employees,
2. the manager of the United States branch of an alien insurer,

3. an underwriting manager who manages the operations of insuring entities within the insurer's holding company system and whose compensation is not based on the volume of premiums written, or
4. the attorney-in-fact acting for the subscribers of a reciprocal insurer or inter-insurance exchange. *Id.*

VI. [10.32] CAPTIVE INSURANCE

Any domestic captive insurance company may reinsure risks ceded by any other insurer; provided the risks to be assumed are the same as those the captive insures directly. 215 ILCS 5/123C-13(A). The Illinois Insurance Code's capital and surplus restrictions on reinsurers (see §10.29 above) do not apply to reinsurance written by captives. *Id.*

Any domestic captive insurer may take credit for reserves on risks ceded to reinsurers in accordance with Article XI of the Illinois Insurance Code. 215 ILCS 5/123C-13(B). In addition, any pure or industrial insured captive (see Chapter 8 of this handbook) may take credit for reinsurance ceded to the extent the reinsurer meets the following requirements:

- a. The assuming insurer's principal business is to accept reinsurance from captives of which the assuming company controls more than 80 percent of the voting securities or control.
- b. The assuming insurer is licensed in its state of domicile.
- c. The assuming insurer submits to the authority of Illinois to examine its books and records.
- d. The assuming insurer files annually with the Director of the Illinois Department of Insurance a copy of its most recent audited financial statement.
- e. The assuming insurer maintains a surplus as regards policyholders in an amount not less than \$20 million.
- f. The assuming insurer has filed the following with the IDI:
 1. evidence of its submission to the jurisdiction of any court of competent jurisdiction within the United States and its agreement to comply with all requirements necessary to give the court jurisdiction and to abide by the final decision of the court or any appellate court; and
 2. an instrument designating the Director or a designated attorney as its agent on whom service of process may be effected. 215 ILCS 5/123C-13(B)(1).

The captive insurance company may also take credit for reinsurance that has received the prior approval of the Director. 215 ILCS 5/123C-13(B)(2).

VII. [10.33] INSOLVENCY

The receivables due from an insolvent insurer's solvent reinsurers generally constitute the largest asset available to a liquidation estate. Accordingly, the Illinois Insurance Code's provisions relating to insurance company receiverships are generally aimed at maximizing the insolvent company's recovery of reinsurance proceeds.

A. [10.34] Administrative Supervision

If the Director of the Illinois Department of Insurance determines that a domestic insurer is operating in a manner that, if continued, would make it hazardous to the public and its policyholders, the Director may issue an order that requires the insurer to file a plan to correct the deficiencies in its operations. 215 ILCS 5/186.1(4)(a). See also Chapter 5 of this handbook. The corrective order may require, prohibit, or permit certain acts subject to conditions including the Director's prior approval. These acts include the assumption or cession of reinsurance. 215 ILCS 5/186.1(4)(a)(ii).

B. [10.35] Rehabilitation

If the corrective order fails to remedy the hazardous condition, the next step may be to place the insurer into rehabilitation. As rehabilitator, the Director of the Illinois Department of Insurance may solicit contracts of reinsurance whereby a solvent company agrees to assume, in whole or in part or on a modified basis, the liability of the company in rehabilitation. 215 ILCS 5/192(2). See also §10.36 below.

C. [10.36] Liquidation

If the insurer cannot be rehabilitated, it will be placed in liquidation. Subject to court supervision, the Director of the Illinois Department of Insurance, as receiver, will marshal the assets of the insolvent insurer, provide for the orderly payment of claims, and supervise the winding up of the insurer's affairs.

1. [10.37] Powers and Duties of the Liquidator

The Director of the Illinois Department of Insurance, as liquidator, may negotiate a voluntary commutation and release of all obligations arising from the insolvent insurer's reinsurance contracts. 215 ILCS 5/209(7.5)(c). As in rehabilitation, the Director, as liquidator, may solicit contracts of reinsurance whereby a solvent company agrees to assume, in whole or in part or on a modified basis, the liability of the company to its former policyholders or creditors. 215 ILCS 5/193(4). The Director may cede or reinsure all or so much of in-force business as may be necessary to another company in preference to satisfying other obligations or creditors. *Id.* The Director may also assign the insolvent insurer's rights to receive reinsurance proceeds for losses to the Illinois Life and Health Insurance Guaranty Association, the Illinois Health Maintenance Organization Guaranty Association, or any similar organization in another state. *Id.* The supervising court approves any such transaction if it finds that it represents the best possible contract in the interest of the parties. *Id.*

The amount recoverable by the Director, as liquidator, from a reinsurer is not reduced as a result of entry of an order of liquidation, notwithstanding any provision in the reinsurance agreement. 215 ILCS 5/193(8). Unless the reinsurance agreement lawfully provides for payment to the ceding company's direct insured, the reinsurer's payment to the direct insured will not diminish the reinsurer's obligations to the insolvent, ceding company. *Id.* All reinsurance agreements to which the insolvent insurance company is a party, whether or not they contain an insolvency clause (see §10.18 above) is construed to contain the following provisions:

(a) Upon entry of an order of liquidation and notwithstanding the Director's failure to pay all or a portion of a claim, the reinsurance obligation shall be due and owing to the Director on the basis of claims allowed in the liquidation proceeding. The reinsurer shall submit the amounts due and owing directly to the company as ceding insurer or to the Director.

(b) The Director shall give written notice or arrange for the giving of written notice to reinsurers or their agents of the pendency of a claim against the company indicating the policy or bond reinsured within a reasonable time after the claim is filed. The reinsurer may interpose, at its own expense, in the proceeding where the claim is to be adjudicated, any defenses that it may deem available to the company or Director. *Id.*

These provisions represent an attempt to automatically incorporate several standard provisions into the reinsurance agreement in the event of liquidation. See §10.38 below.

a. [10.38] Insolvency Clause Revisited

Legislation mandating an insolvency clause was adopted to counteract the decision of the United States Supreme Court in *Fidelity & Deposit Co. of Maryland v. Pink*, 302 U.S. 224, 82 L.Ed 213, 58 S.Ct. 162 (1937). In *Pink*, the New York Superintendent of Insurance, acting as liquidator of an insolvent ceding company, allowed a claim and demanded reimbursement from its reinsurer for the reinsurer's portion of the full amount of the ceding company's liability to the claimants rather than the amount the ceding company was actually able to pay the claimants. The reinsurer took the position that its contract only required it to indemnify the ceding company "against loss" — which meant it was required only to reimburse the liquidator for that portion of the losses the estate had actually paid to claimants. 58 S.Ct. at 164.

The Supreme Court agreed, holding that the liquidator's reinsurance recovery was limited to the reinsurer's share of only that portion of allowed claims that was actually paid. *Id.* The *Pink* decision, founded as it was on the language of the standard reinsurance agreements in use at the time, firmly established the indemnity principle in the context of insurance company receiverships.

To remedy this situation, the New York Legislature enacted a statute in 1939 that required a reinsurance contract to contain an "insolvency clause" if the ceding company wished to obtain statutory credit for the losses ceded to the reinsurer. Most states, including Illinois, have since adopted similar legislation. The Illinois Insurance Code thus prohibits a ceding company from

receiving statutory credit for its cession unless the reinsurance agreement provides that the reinsurance is payable by the assuming company on the basis of the liability of the ceding company under the contract or contracts reinsured without diminution because of the ceding company. 215 ILCS 5/173.2. It is this provision that makes reinsurance such a valuable resource for the estates of insolvent insurers.

b. [10.39] Cut-Through Provisions

The Illinois Insurance Code provides that in the event of the ceding company's insolvency, reinsurance proceeds must be paid directly to the insolvent insurer's liquidator, receiver, or statutory successor, except when the agreement specifically provides another payee of such reinsurance in the event of the insolvency of the ceding company or when the reinsurer or the assuming insurer, with the consent of the direct insureds, has assumed such policy obligations of the ceding company as its direct obligations to the payees under such policies, in substitution for the obligations of the ceding company to such payees. 215 ILCS 5/173.3(1).

Absent such cut-through provisions or assumption agreements, an assuming insurer is prohibited from settling any portion of a claim with the direct policyholder of a company in rehabilitation or liquidation. 215 ILCS 5/173.3(2).

c. [10.40] Reinsurer's Interposition Rights

The reinsurance agreement may provide that, in the event of the ceding company's insolvency, the liquidator or receiver will give written notice of the pendency of a claim against the insolvent ceding company on the policy or bond within a reasonable time after the claim is filed. 215 ILCS 5/173.4. The reinsurer may investigate such claim and, at its own expense, interpose any defense it considers available to the ceding company in the proceeding in which the claim is to be adjudicated. *Id.* The expense thus incurred by the reinsurer will be chargeable against the insolvent ceding company as a part of the expense of liquidation in proportion to the benefit that accrues to the insolvent ceding company as a result of the defense interposed by the reinsurer. *Id.* When multiple reinsurers are involved in the same claim and the majority in interest elect to interpose a defense, the expense of the interposed defense is apportioned in accordance with the terms of the reinsurance agreement as if the expense had been incurred by the insolvent ceding company. *Id.*

2. [10.41] Disposition of Security Provided by Insolvent Alien Reinsurer

Upon the insolvency of an alien reinsurer that provides security to fund its United States obligations, the assets representing such security are maintained in the United States and claims are filed and valued by the state insurance official with regulatory oversight. The assets are distributed in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic United States insurance companies. 215 ILCS 5/173(b).

3. [10.42] Priority of Reinsurance Claims

When a ceding company is placed in liquidation, the insolvent company's direct policyholders and the guaranty funds or associations that have paid claims on their behalf submit

proofs of claim to the liquidator who, upon payment of those claims, seeks reimbursement from the insolvent company's reinsurers. Because the liquidation acts were enacted to protect consumers who have purchased direct insurance, the consumers' claims are typically given priority of payment over the claims of general creditors. 215 ILCS 5/205(1)(c). However, when the insolvent company has written reinsurance, the companies that ceded risk to it are considered merely general creditors. *In re Liquidations of Reserve Insurance Co.*, 122 Ill.2d 555, 524 N.E.2d 538, 544, 120 Ill.Dec. 508 (1988) (interpreting 215 ILCS 5/205(1)(d)). This is because the parties to a reinsurance agreement — being sophisticated insurance companies — do not require the protection the liquidation acts provide to consumers.

4. [10.43] Setoffs

The Illinois Insurance Code allows a reinsurer to set off debts owed it by an insolvent insurer when there is "mutuality" (*i.e.*, the debts and credits are due simultaneously to and from the same parties acting in the same capacity). 215 ILCS 5/206. Interpretation of this statute has been the subject of widespread litigation.

5. [10.44] Reinsurer's Liability for Estimated Claims

The estimation and allowance of the loss development on a known loss or occurrence can trigger the reinsurer's obligation to pay the insolvent ceding company under the following circumstances:

- a. when the policyholder of the insolvent insurer has filed a contingent claim (see Chapter 5 of this handbook) but has been unable to liquidate that claim if (1) it may reasonably be inferred from the proof presented that a claim exists under the policy, (2) the policyholder has submitted suitable proof that no further valid claims arising out of the cause of action other than those already presented can be made, and (3) the total liability of the insolvent insurer to all claimants arising out of the same act is no greater than its total liability would be but for its liquidation, rehabilitation, or conservation (215 ILCS 5/209(4)(b), 5/209(7.5)(a)); or
- b. when a third party that has a cause of action against a policyholder of the insolvent insurer has filed a claim if (1) it may reasonably be inferred from the proof presented that the claimant would be able to obtain a judgment against the policyholder, (2) the claimant has furnished suitable proof that no further valid claims arising out of the cause of action other than those already presented can be made, and (3) the total liability of the insolvent insurer to all claimants arising out of the same act is no greater than its total liability would be but for its liquidation, rehabilitation, or conservation (215 ILCS 5/209(6), 5/209(7.5)(a)).

The reinsurer is not liable for that portion of any estimated and allowed contingent claim that is attributable to incurred, but not reported, losses unless (a) the claims develop into known losses and expenses or (b) the reinsurance agreement provides for payment of such losses and reserves. 215 ILCS 5/209(7.5)(b).

D. [10.45] Guaranty Funds and Associations

A general description of the rights and duties of the various guaranty funds and associations is provided in Chapter 5 of this handbook. The discussion in §§10.46 – 10.48 below concentrates on the funds' and associations' rights and duties with respect to reinsurance for the insolvent ceding company.

1. [10.46] Illinois Life and Health Guaranty Association

The Illinois Insurance Code authorizes the Illinois Life and Health Guaranty Association to solicit contracts of reinsurance whereby a solvent company agrees to assume, in whole or in part or on a modified basis, the liability of the insolvent life and health insurer to its former policyholders or creditors. 215 ILCS 5/531.08(13)(h) (authorizing Association to exercise all rights of Director of Illinois Department of Insurance, as liquidator, under 215 ILCS 5/193(4)). See §10.37 above.

After an order of rehabilitation or liquidation, the Association may elect to succeed to the rights of the insolvent insurer under any contract of reinsurance to which the insolvent insurer was a party, to the extent the reinsurance agreement provides for losses occurring after the date of the order of rehabilitation or liquidation. 215 ILCS 5/531.08(14). If the Association makes such an election, then it must pay all unpaid premiums due under the reinsurance contract for coverage relating to periods before and after the date of the order of rehabilitation or liquidation. *Id.*

2. [10.47] Illinois Insurance Guaranty Fund

The Illinois Insurance Guaranty Fund “steps into the shoes” of an insolvent casualty, fidelity, surety, or fire and marine company to the extent of its obligations for covered claims and, to such extent, has all of the rights, duties, and obligations of the insolvent insurer, subject to the relevant limitations within the Illinois Insurance Code, as if the insurer had not become insolvent. 215 ILCS 5/537.4. However, the Director of the Illinois Department of Insurance, as liquidator, retains the sole right to recover any reinsurance proceeds. *Id.*

3. [10.48] Illinois Health Maintenance Organization Guaranty Association

The Illinois Insurance Code authorizes the Illinois Health Maintenance Organization Guaranty Association to solicit contracts of reinsurance whereby a solvent company agrees to assume, in whole or in part or on a modified basis, the liability of the insolvent life and health insurer to its former policyholders or creditors. 215 ILCS 125/6-8(9)(h) (authorizing Association to exercise all rights of Director of Illinois Department of Insurance, as liquidator, under 215 ILCS 5/193(4)). See §10.37 above.

After an order of rehabilitation or liquidation, the Association may elect to succeed to the rights of the insolvent organization under any reinsurance, stop-loss, or similar agreement to which the insolvent organization was a party, to the extent the reinsurance agreement provides for losses occurring after the date of the order of rehabilitation or liquidation. 215 ILCS 125/6-8(10). As a condition of making this election, the Association must pay premiums for coverage relating to periods before and after the date of the order of rehabilitation or liquidation. *Id.*

VIII. [10.49] REINSURANCE INTERMEDIARIES

The Illinois Insurance Code provides for licensing of certain key players in reinsurance transactions and also is intended to enhance state regulators' ability to locate a reinsurer's assets in the event of insolvency. The Director of the Illinois Department of Insurance may issue an intermediary license to a firm, association, or corporation with those employees designated in the license application or any supplement thereto serving as the intermediaries. 215 ILCS 100/10(d). Nonresident licensees must designate the Director as their agent for service of process. *Id.*

The regulatory requirements vary depending on whether the intermediary is an intermediary broker or an intermediary manager. Reinsurance intermediaries who are found to have violated these requirements may be subject to a penalty of up to \$100,000 per violation. 215 ILCS 100/55(a).

A. [10.50] Intermediary Brokers

An intermediary broker is a person, other than an officer or employee of the ceding company, who solicits, negotiates, or places cessions or retrocessions on behalf of a ceding company and who lacks authority to bind reinsurance on behalf of the insurer. 215 ILCS 100/5.

No person who maintains an office in Illinois may act as an intermediary broker unless licensed as an insurance producer. 215 ILCS 100/10(a). A person who does not maintain an office in Illinois may not act as an intermediary broker (1) unless he or she procures a nonresident reinsurance intermediary license or (2) is a licensed producer in another state with laws similar to those of Illinois. *Id.* Insurers are prohibited from engaging the services of any person, firm, or corporation to act as an intermediary broker that has not obtained a license. 215 ILCS 100/25(a). An insurer must obtain annually a copy of the financial statement of each intermediary broker with which it transacts business. 215 ILCS 100/25(c).

The contract between an intermediary broker and its principal is subject to a number of mandatory provisions, including provisions for (1) termination of the intermediary broker's authority at any time and (2) disclosure to the principal of any relationship between the intermediary broker and the assuming insurer. 215 ILCS 100/15. The intermediary broker is subject to extensive record-keeping and record maintenance requirements and, further, must provide the principal with access to those records. 215 ILCS 100/20.

B. [10.51] Intermediary Managers

An intermediary manager is defined as a person, firm, association, or corporation that acts on behalf of the assuming insurer with authority to bind or manage the reinsurance business of the principal. 215 ILCS 100/5. This definition does not include an employee of the reinsurer, the manager of the United States branch of an alien insurer, or an underwriting manager in a holding company system. *Id.*

An intermediary manager must be licensed as a producer in Illinois if it maintains an office within the state or wishes to represent a domestic reinsurer. 215 ILCS 100/10(b). The

intermediary manager may be licensed by another state with laws substantially similar to those of Illinois if it wishes to represent a nondomestic insurer. 215 ILCS 100/10(b)(3). The Director of the Illinois Department of Insurance may require the intermediary manager to post a bond in an amount sufficient to protect the reinsurer and maintain an errors-and-omissions policy. 215 ILCS 100/10(c).

The contract between the intermediary manager and the reinsurer must be approved by the reinsurer's board of directors and submitted to the Director for approval at least 30 days in advance of any subject reinsurance transaction. 215 ILCS 100/30. Additionally, the intermediary manager's contract with the reinsurer is subject to a number of mandatory provisions relating to termination, accounts, maintenance of funds, record-keeping, etc. *Id.* The intermediary manager is subject to extensive record-keeping and record maintenance requirements and, further, must provide the reinsurer with access to those records. 215 ILCS 100/35.

The Illinois Insurance Code imposes strict limitations on the circumstances under which an intermediary manager may cede retrocessions or settle claims without prior approval of the reinsurer. 215 ILCS 100/40. Reinsurers are prohibited from engaging the services of any person, firm, or corporation to act as an intermediary manager that has not obtained a license. 215 ILCS 100/45(a). Reinsurers must retain binding authority for retrocessional contracts and participation in syndicates and, further, must report the termination of any contract with an intermediary manager to the Director within 30 days. 215 ILCS 100/45(d), 100/45(e). Intermediary managers are subject to examination by the Director. 215 ILCS 100/50.

IX. [10.52] SPECIAL PURPOSE REINSURANCE VEHICLES

Article XIE of the Illinois Insurance Code, the Special Purpose Reinsurance Vehicle Law, 215 ILCS 5/179E-1, *et seq.*, provides for the formation and regulation of special purpose reinsurance vehicles (SPRVs) that upon the submission of a satisfactory application to the Director of the Illinois Department of Insurance, may receive certificates of authority for the limited purpose of entering into and effectuating insurance securitizations and SPRV contracts. An SPRV contract is an agreement between an SPRV and a ceding company by which the SPRV agrees to pay the ceding company an agreed amount upon the occurrence of a triggering event. 215 ILCS 5/179E-15. The triggering event is usually some form of catastrophic loss.

An SPRV may not be under common control with any ceding company that is a party to the SPRV contract. 215 ILCS 5/179E-40. Securitization transactions must be fully funded, and assets must be held in trust for the ceding company. 215 ILCS 5/179E-30(a). Trust assets must be valued at their fair value. 215 ILCS 5/179E-30(b)(17).

The ceding company may receive financial statement credit for risks ceded pursuant to an SPRV contract to the extent that (a) the fair value of the assets held in trust for the benefit of the ceding company equals or exceeds the obligations due to the ceding company by the SPRV, (b) the assets are held in trust in accordance with the relevant provisions of Article XIE, (c) the assets are administered in the manner and pursuant to the arrangements as set forth in Article XIE, and (d) the assets are held and invested in one or more of the forms allowed by 215 ILCS 5/179E-85 and 5/179E-90.

However, “[t]he securities issued by the SPRV under an SPRV insurance securitization shall not be deemed to be insurance or reinsurance contract.” 215 ILCS 5/179E-95. Investors in securitization contracts are not to be deemed to be in the business of insurance solely due to such investments. *Id.*