

Stricken language would be deleted from and underlined language would be added to the law as it existed prior to this session of the General Assembly.

1 State of Arkansas
2 83rd General Assembly
3 Regular Session, 2001
4

As Engrossed: H3/15/01

A Bill

HOUSE BILL 2474

5 By: Representatives Hunt, Schall, Bradford, Napper
6 By: Senator Baker
7

For An Act To Be Entitled

10 AN ACT TO AMEND THE ARKANSAS CODE TO PROVIDE FOR
11 THE CREATION AND OPERATION OF PROTECTED CELLS;
12 AND FOR OTHER PURPOSES.
13

Subtitle

14 TO CREATE PROTECTED CELLS.
15
16
17

18 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF ARKANSAS:
19

20 SECTION 1. Short title.

21 This act may be cited as the "Protected Cell Company Act".
22

23 SECTION 2. Purpose.

24 This act provides:

25 (1) A basis for the creation of protected cells by a domestic insurer
26 as one means of accessing alternative sources of capital and achieving the
27 benefits of insurance securitization;

28 (2) Funds to investors in fully funded insurance securitization
29 transactions that are available to pay the insurer's insurance obligations,
30 or to repay the investors, or both; and

31 (3) A means to achieve more efficiencies in conducting insurance
32 securitizations.
33

34 SECTION 3. Definitions.

35 For the purposes of this act:

36 (1) "Domestic insurer" means an insurer domiciled in the State of

1 Arkansas:

2 (2) "Fully funded" means that, with respect to any exposure attributed
3 to a protected cell, the fair value of the protected cell assets, on the date
4 on which the insurance securitization is effected, equals or exceeds the
5 maximum possible exposure attributable to the protected cell with respect to
6 such exposures;

7 (3) "General account" means the assets and liabilities of a protected
8 cell company other than protected cell assets and protected cell liabilities;

9 (4) "Indemnity trigger" means a transaction term by which relief of
10 the issuer's obligation to repay investors is triggered by incurring a
11 specified level of losses under its insurance or reinsurance contracts;

12 (5)(A) "Fair value" of an asset or liability means the amount at which
13 that asset or liability could be bought, incurred, sold, or settled in a
14 current transaction between willing parties that is not a forced or
15 liquidation sale.

16 (B)(i) Quoted market prices in active markets are the best
17 evidence of fair value and shall be used as the basis for the measurement, if
18 available.

19 (ii) If a quoted market price is available, the fair value
20 is the product of the number of trading units times market price.

21 (iii) If quoted market prices are not available, the
22 estimate of fair value shall be based on the best information available.

23 (iv)(a) The estimate of fair value shall consider prices
24 for similar assets and liabilities and the results of valuation techniques to
25 the extent available in the circumstances.

26 (b) Examples of valuation techniques include the
27 present value of estimated expected future cash flows using a discount rate
28 commensurate with the risks involved, option-pricing models, matrix pricing,
29 option-adjusted spread models, and fundamental analysis.

30 (c) Valuation techniques for measuring financial
31 assets and liabilities and servicing assets and liabilities shall be
32 consistent with the objective of measuring fair value. Those techniques
33 shall incorporate assumptions that market participants would use in their
34 estimates of values, future revenues, and future expenses, including
35 assumptions about interest rates, default, prepayment, and volatility.

36 (d) In measuring financial liabilities and servicing

1 liabilities at fair value by discounting estimated future cash flows, an
2 objective is to use discount rates at which those liabilities could be
3 settled in an arm's-length transaction.

4 (e)(1) Estimates of expected future cash flows, if
5 used to estimate fair value, shall be the best estimate based on reasonable
6 and supportable assumptions and projections.

7 (2) All available evidence shall be considered
8 in developing estimates of expected future cash flows.

9 (3) The weight given to the evidence shall be
10 commensurate with the extent to which the evidence can be verified
11 objectively.

12 (4) If a range is estimated for either the
13 amount or timing of possible cash flows, the likelihood of possible outcomes
14 shall be considered in determining the best estimate of future cash flows;

15 (6) "Non-indemnity trigger" means a transaction term by which relief
16 of the issuer's obligation to repay investors is triggered solely by some
17 event or condition other than the individual protected cell company incurring
18 a specified level of losses under its insurance or reinsurance contracts;

19 (7) "Protected cell" means an identified pool of assets and
20 liabilities of a protected cell company segregated and insulated by means of
21 this act from the remainder of the protected cell company's assets and
22 liabilities;

23 (8) "Protected cell account" means a specifically identified bank or
24 custodial account established by a protected cell company for the purpose of
25 segregating the protected cell assets of one protected cell from the
26 protected cell assets of other protected cells and from the assets of the
27 protected cell company's general account;

28 (9) "Protected cell assets" means all assets, contract rights, and
29 general intangibles identified with and attributable to a specific protected
30 cell of a protected cell company;

31 (10) "Protected cell company" means a domestic insurer that has one
32 (1) or more protected cells;

33 (11) "Protected cell company insurance securitization" means:

34 (A) The issuance of debt instruments by a protected cell company
35 from which the proceeds support the exposures attributed to the protected
36 cell; and

1 (B) The repayment of principal or interest, or both, to
2 investors under the transaction terms, is contingent upon the occurrence or
3 nonoccurrence of an event which exposes the protected cell company to loss
4 under insurance or reinsurance contracts it has issued; and

5 (12) "Protected cell liabilities" means all liabilities and other
6 obligations identified with and attributable to a specific protected cell of
7 a protected cell company.

8
9 SECTION 4. Establishment of protected cells.

10 (a)(1) A protected cell company may establish one (1) or more
11 protected cells by submitting a plan of operation, or amendments to a plan,
12 with respect to each protected cell in connection with an insurance
13 securitization to the commissioner for prior written approval.

14 (2) The plan shall include, but not be limited to:

15 (A) The specific business objectives of the protected
16 cell; and

17 (B) The investment guidelines of the protected cell.

18 (3) Upon receiving written approval the protected cell company
19 may, in accordance with the approved plan of operation, attribute to the
20 protected cell insurance obligations with respect to its insurance business
21 and obligations relating to the insurance securitization and assets to fund
22 the obligations.

23 (4) A protected cell shall have its own distinct name or
24 designation which shall include the words "protected cell."

25 (5) The protected cell company shall transfer all assets
26 attributable to a protected cell to one (1) or more separately established
27 and identified protected cell accounts bearing the name or designation of
28 that protected cell.

29 (6) Protected cell assets shall be held in the protected cell
30 accounts for the purpose of satisfying the obligations of that protected
31 cell.

32 (b)(1) All attributions of assets and liabilities between a protected
33 cell and the general account shall be in accordance with the plan of
34 operation approved by the commissioner.

35 (2) No other attribution of assets or liabilities may be made by
36 a protected cell company between the protected cell company's general account

1 and its protected cells.

2 (3) Any attribution of assets and liabilities between the
3 general account and a protected cell, or from investors, in the form of
4 principal on a debt instrument issued by a protected cell company in
5 connection with a protected cell company securitization, shall be in cash or
6 in readily marketable securities with established market values.

7 (c)(1) The creation of a protected cell does not create, in respect to
8 that protected cell, a legal person separate from the protected cell company.

9 (2)(A) Amounts attributed to a protected cell under this act,
10 including assets transferred to a protected cell account, are owned by the
11 protected cell company.

12 (B) The protected cell company may not be, nor hold itself
13 out to be, a trustee with respect to those protected cell assets of that
14 protected cell account.

15 (3) The protected cell company may, however, allow for a
16 security interest to attach to protected cell assets or a protected cell
17 account when in favor of a creditor of the protected cell if allowed by
18 applicable law.

19 (d)(1) This act does not prohibit the protected cell company from
20 contracting with or arranging for an investment advisor, commodity trading
21 advisor, or other third party to manage the protected cell assets of a
22 protected cell.

23 (2) All remuneration, expenses and other compensation of the
24 third party advisor or manager are payable from the protected cell assets of
25 that protected cell,, and not from the protected cell assets of other
26 protected cells or the assets of the protected cell company's general
27 account.

28 (e)(1) A protected cell company shall establish administrative and
29 accounting procedures necessary to properly identify the one (1) or more
30 protected cells of the protected cell company, and the protected cell assets
31 and liabilities attributable to the protected cells. It shall be the duty of
32 the directors of a protected cell company to:

33 (A) Keep protected cell assets and liabilities separate
34 and separately identifiable from the assets and liabilities of the protected
35 cell company's general account; and

36 (B) Keep protected cell assets and liabilities

1 attributable to one protected cell separate and separately identifiable from
2 protected cell assets and liabilities attributable to other protected cells.

3 (2)(A) If this subsection (e) is violated, the remedy of tracing
4 shall be applicable to protected cell assets when commingled with protected
5 cell assets of other protected cells or the assets of the protected cell
6 company's general account.

7 (B) The remedy of tracing shall not be an exclusive
8 remedy.

9 (f) When establishing a protected cell, the protected cell company
10 shall attribute to the protected cell assets with a value at least equal to
11 the reserves and other insurance liabilities attributed to that protected
12 cell.

13
14 SECTION 5. Use and operation of protected cells.

15 (a)(1) The protected cell assets of a protected cell may not be
16 charged with liabilities arising out of any other business the protected cell
17 company may conduct.

18 (2) All contracts or other documentation reflecting protected
19 cell liabilities shall clearly indicate that only the protected cell assets
20 are available for the satisfaction of those protected cell liabilities.

21 (b)(1) The income, gains, and losses, realized or unrealized, from
22 protected cell assets and liabilities shall be credited to or charged against
23 the protected cell without regard to other income, gains, or losses of the
24 protected cell company, including income, gains, or losses of other protected
25 cells.

26 (2)(A) Amounts attributed to any protected cell and
27 accumulations on the attributed amounts may be invested and reinvested
28 without regard to any requirements or limitations of Arkansas Code Title 23,
29 Chapter 63, Subchapter 8.

30 (B) The investments in a protected cell or cells shall not
31 be taken into account in applying the investment limitations applicable to
32 the investments of the protected cell company.

33 (c) Assets attributed to a protected cell shall be valued at their
34 fair value on the date of valuation.

35 (d)(1) A protected cell company shall, in respect to its protected
36 cells, engage in fully funded indemnity triggered insurance securitization to

1 support in full the protected cell exposures attributable to that protected
2 cell.

3 (2) A protected cell company insurance securitization that is
4 non-indemnity triggered shall qualify as an insurance securitization after
5 the commissioner adopts regulations addressing the methods of funding of the
6 portion of the risk that is not indemnity based, accounting, disclosure, risk
7 based capital treatment, and assessing risks associated with such
8 securitizations.

9 (3) A protected cell company insurance securitization that is
10 not fully funded, whether indemnity triggered or non-indemnity triggered, is
11 prohibited.

12 (4)(A) Protected cell assets may be used to pay interest or
13 other consideration on any outstanding debt or other obligation attributable
14 to that protected cell.

15 (B) Nothing in this subsection (d) shall prevent a
16 protected cell company from entering into a swap agreement or other
17 transaction for the account of the protected cell that has the effect of
18 guaranteeing interest or other consideration.

19 (e)(1) In all protected cell company insurance securitizations, the
20 contracts or other documentation effecting the transaction shall contain
21 provisions identifying the protected cell to which the transaction will be
22 attributed.

23 (2) The contracts or other documentation shall clearly disclose
24 that the assets of that protected cell, and only those assets, are available
25 to pay the obligations of that protected cell.

26 (3) Failure to include the language required by this subsection
27 (e) in the contracts or other documentation shall not be used as the sole
28 basis by creditors, reinsurers or other claimants to circumvent the
29 provisions of this act.

30 (f)(1) A protected cell company shall only be authorized to attribute
31 to a protected cell account the insurance obligations relating to the
32 protected cell company's general account.

33 (2) A protected cell shall not be authorized to issue insurance
34 or reinsurance contracts directly to policyholders or reinsureds or have any
35 obligation to the policyholders or reinsureds of the protected cell company's
36 general account.

1 (g) At the cessation of business of a protected cell, the protected
2 cell company shall voluntarily close out the protected cell account.

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4 SECTION 6. Reach of creditors and other claimants.

5 (a)(1)(A) Protected cell assets shall only be available to the
6 creditors of the protected cell company that are creditors to that protected
7 cell.

8 (B) Those creditors shall be entitled to have recourse to
9 the protected cell assets attributable to that protected cell, and shall be
10 absolutely protected from the creditors of the protected cell company that
11 are not creditors in respect to that protected cell.

12 (C) Creditors of a protected cell shall not be entitled to
13 have recourse against the protected cell assets of other protected cells or
14 the assets of the protected cell company's general account.

15 (2) Protected cell assets shall only be available to creditors
16 of a protected cell company after all protected cell liabilities have been
17 extinguished or as provided for in the plan of operation relating to that
18 protected cell.

19 (b) When an obligation of a protected cell company to a person arises
20 from a transaction, or is otherwise imposed, in respect to a protected cell:

21 (1) That obligation of the protected cell company shall extend
22 only to the protected cell assets attributable to that protected cell, and
23 the person shall, with respect to that obligation, be entitled to have
24 recourse only to the protected cell assets attributable to that protected
25 cell; and

26 (2) That obligation of the protected cell company shall not
27 extend to the protected cell assets of any other protected cell or the assets
28 of the protected cell company's general account, and that person shall not,
29 with respect to that obligation, be entitled to have recourse to the
30 protected cell assets of any other protected cell or the assets of the
31 protected cell company's general account.

32 (c) When an obligation of a protected cell company relates solely to
33 the general account, the obligation of the protected cell company shall
34 extend only to, and that creditor shall, with respect to that obligation, be
35 entitled to have recourse only to the assets of the protected cell company's
36 general account.

1 (d)(1) The activities, assets, and obligations relating to a protected
2 cell are not subject to the laws of this state governing life and health and
3 property and casualty guaranty or insolvency funds.

4 (2) A protected cell or a protected cell company shall not be
5 assessed by or otherwise be required to contribute to any guaranty fund or
6 guaranty association in this state with respect to the activities, assets, or
7 obligations of a protected cell.

8 (3) This subsection (d) shall not affect the activities or
9 obligations of an insurer's general account.

10 (e) The establishment of one (1) or more protected cells alone shall
11 not be deemed to be a fraudulent conveyance, an intent by the protected cell
12 company to defraud creditors, or the carrying out of business by the
13 protected cell company for any other fraudulent purpose.

14
15 SECTION 7. Conservation, rehabilitation or liquidation of protected
16 cell companies.

17 (a) Notwithstanding any provision of the Arkansas Insurance Code, or
18 any regulation promulgated under the Arkansas Insurance Code, or any other
19 applicable law or regulation, upon any order of conservation, rehabilitation,
20 or liquidation of a protected cell company, the receiver shall be bound to
21 deal with the protected cell company's assets and liabilities, including
22 protected cell assets and protected cell liabilities, in conformance with
23 this act.

24 (b) With respect to amounts recoverable under a protected cell company
25 insurance securitization, the amount recoverable by the receiver shall not be
26 reduced or diminished as a result of the entry of an order of conservation,
27 rehabilitation or liquidation with respect to the protected cell company,
28 notwithstanding any provision in the contracts or other documentation
29 governing the protected cell company insurance securitization.

30
31 SECTION 8. No transaction of an insurance business.

32 (a) A protected cell company insurance securitization shall not be
33 deemed to be an insurance or reinsurance contract.

34 (b) An investor in a protected cell company insurance securitization
35 shall not, by sole means of this investment, be deemed to be transacting
36 insurance business in this state.

1 (c) The underwriters or selling agents, and their partners, directors,
 2 officers, members, managers, employees, agents, representatives, and
 3 advisors, involved in a protected cell company insurance securitization,
 4 shall not be deemed to be conducting an insurance or reinsurance agency,
 5 brokerage, intermediary, advisory or consulting business by virtue of their
 6 activities in connection with the protected cell company insurance
 7 securitization.

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9 SECTION 9. Authority to adopt regulations.

10 The commissioner may promulgate regulations necessary to carry out the
 11 purpose and intent of this act.

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13 SECTION 10. EMERGENCY CLAUSE. It is found and determined by the
 14 General Assembly of the State of Arkansas that the creation and operation of
 15 protected cells are essential to the regulation of sponsored captive insurers
 16 and producer reinsurance captive insurers since these insurers are not
 17 subject to the guaranty fund. Therefore, an emergency is declared to exist
 18 and this act being immediately necessary for the preservation of the public
 19 peace, health and safety shall become effective on the date of its approval
 20 by the Governor. If the bill is neither approved nor vetoed by the Governor,
 21 it shall become effective on the expiration of the period of time during
 22 which the Governor may veto the bill. If the bill is vetoed by the Governor
 23 and the veto is overridden, it shall become effective on the date the last
 24 house overrides the veto.

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/s/ Hunt, et al.

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