SUBCHAPTER 10-
CAPTIVE INSURANCE APPLICATION PROCEDURES

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NOTE: Rulemaking authority cited for formulation of regulations by the Captive Insurance Company, 4 CMC § 7901.

§20-40.10-100. Definitions.

In these regulations, unless the context requires otherwise,

(a) The Act means 4 CMC Division 7.

(b) Affiliated company or affiliate means any company in the same corporate system as a parent or member organization by virtue of common ownership, control, operation or management.

(c) Association means any legal association of individuals, corporations, partnerships, or other legal entities, the member organizations of which collectively:

(1) own, control, or hold with power to vote all of the outstanding voting securities of an association captive insurance company incorporated as a stock insurer, or

(2) have complete voting control over an association captive insurance company incorporated as a mutual insurer.

(d) Association captive insurance company means any company that insures risks of the member organizations of that association, and their affiliates.

(e) The Commissioner means the Insurance Commissioner of the Government of The CNMI.

(f) Company or captive insurance company means any pure captive insurance company or association captive insurance company formed or licensed under the provisions of the Act.

(g) Control means:

(1) ownership of more than 50% of the voting; stock of a corporation,

(2) ownership of stock of a corporation constituting more than 50% of the fair market value of all of said corporation's issued and outstanding shares;

(3) a contractual or other right to vote shares constituting more than 50% of the voting shares of a corporation;

(4) the right under a management agreement or other contract to make over 50% of the decisions governing the business and financial affairs of a corporation or to select all of its officers or directors, or

(5) any other right or arrangement that separately or in conjunction with other rights creates the practical ability to determine over 50% of the business and financial affairs of a corporation or to select its officers or directors.

(h) Corporate system means one or more chains of corporations connected through stock ownership or other means of control comprising a common parent corporation and one or more subsidiary corporations in which:

(1) the common parent directly controls at least one of the subsidiary corporations. and

(2) each of the subsidiary corporations is directly controlled by the common parent, by one or more subsidiary corporations, or by the common parent and one or more subsidiary corporations.

(i) License means a license to carry on the business of a captive insurance company which the Commissioner is authorized to grant in accordance with the criteria set forth in the Act.

(j) Loss reserve specialist means a person approved by the Commissioner under § 20-40.10-200 and § 20-40.10-700 of these regulations as a person qualified to assess the sufficiency of insurance loss reserves and loss expense reserves for captive insurance companies under the Act.

(k) Member organization means a corporation, partnership, or other legal entity that belongs to an association.

(l) Pure captive insurance company means any company that insures risks of its parent and affiliates and no more than three unaffiliated companies.

(m) Regulation means any regulation promulgated under the Act.

§20-40.10-200. Application Procedure for Captive Insurance License.

(a) Contents of Application. Every applicant for a captive insurance license shall pay the $200.00 statutory application fee and file the following documents with the Commissioner:

(1) A certified copy of the articles of incorporation of the company, but if the company is not yet incorporated, a copy of the proposed articles of incorporation of the company.

(2) A certified copy of the by-laws of the company, but if the company is not yet incorporated, a copy of the proposed by-laws of the company.

(3) Copies of blank forms of all policies of insurance or reinsurance that the company proposes to use.

(4) A consent of agent for service of process, in form approved by the Commissioner, duly executed by a person qualified to be a registered agent for service of process, as provided in § 20-40.9-100 and in § 20-40.10-1300 of these regulations.

(5) An application for approval of the company's designated Independent Auditor as required under § 20-40.9-900, submitted on Form C attached as Appendix 3 to these regulations.

(6) An application for approval of the company's designated Loss Reserve Specialist as required under Chapter C(3)(E) of these regulations, submitted on Form D attached as Appendix 4 to these regulations.

(7) A license application in the following attached form:

§20-40.10-300. Review of Applications and Issuance of Licenses.

(a) The Commissioner shall review each application submitted by a company that has already been incorporated to determine whether the company meets the requirements of the Act. The Commissioner shall notify each applicant in writing of his approval or disapproval of the application. Within 30 days after the Commissioner shall notify an applicant of the approval of the application, the company shall pay the $2,500.00 license fee and shall provide the Commissioner with proof of compliance with § 20-40.9-300 and § 20-40.9-400, either in the form of cash or an irrevocable letter of credit issued by a bank either chartered by the Territory of Saipan or a member of bank of the Federal Reserve System, and in either case, such bank to be approved by the Commissioner.

(b) An application submitted for a company that has not been incorporated shall be deemed to include a petition for the certificate required by § 20-40.9-500 in order to incorporate the company. The Commissioner shall, upon review of the application, notify the applicant in writing of his approval or disapproval of the application. If the Commissioner approves the application, the notice of approval shall include a certificate setting forth his findings that the establishment and maintenance of the proposed corporation will promote the general good of CNMI, as required by § 20-40.9-500. Within 60 days, after, the Commissioner shall notify the applicant of the approval of the application, the applicant shall:

(i) transmit the articles of association to the Director of Revenue and Taxation;

(ii) provide the Commissioner with certified copies of the articles of association and by-laws of the company, in the form approved by the Commissioner, and a certificate of incumbency of the officers and directors of the company;

(iii) pay the $2,500.00 license fee;

(iv) provide the Commissioner with a statement of the financial condition of the company that is sworn to under oath by the company's president and secretary and is acceptable to the Commissioner; and

(v) provide the Commissioner with proof of compliance with § 20-40.9-300 and § 20-40.9-400, either in the form of cash or irrevocable letter of credit issued by a bank either chartered by the Territory of The CNMI or a member bank of the Federal Reserve System, and in either case, such bank to be approved by the Commissioner.

§20-40.10-400. Insurance Company may Convert to Captive Insurance

(a) Any non-domestic insurance company that has operated as an insurance company on CNMI pursuant to a CNMI Certificate of Authority during the five (5) years immediately preceding the enactment of this Chapter as set forth in § 20-40.9-100 may convert its existing Certificate of Authority to a captive insurance license by submitting to the Commissioner, all documents required pursuant to § 20-40.10-200

of these regulation including a completed application form and all other documents required in the application form, together with a statement that the company intends to conduct its business in compliance with the requirements of the Act and to surrender its existing license to engage in the insurance business in CNMI upon the issuance of the license under 4 CMC Division 7 Chapter 9. Payment of the application fee of $200.00 and the license fee of $2,500.00 shall accompany the application. The Commissioner shall issue the license, unless he determines that the company does not propose to operate in a manner that complies with the Act. If the Commissioner does not issue the license, he shall notify the applicant of his decision in writing and shall refund the $2,500.00 license fee to the applicant. In such event, the applicant's existing license shall remain in full force and effect.

(b) Any insurance company already chartered and doing business in the CNMI as a captive insurance company as set forth in § 20-40.9-100 shall automatically qualify for licensure by filing an application in compliance with all the requirements of § 20-40.10-200 of these regulations including the payment of application fee of $200.00 and license fee of $2,500.00.

(c) The application procedure set forth in this subsection shall be the exclusive means by which any company referred to in § 20-40.9-100 may convert its Certificate of Authority to a captive insurance license or a company referred to in Public Law 24-03 may exercise its right of automatic qualification for licensure shall be subject to all of the requirements and limitations imposed by the Act and these regulations.

§20-40.10-500. Renewal Applications

All licenses granted under the Act shall expire on April 1 following the date of issuance. On or before March 1 of each year, every company holding a license that wishes to renew the license for an additional year shall apply to the Commissioner for a renewal of the license. The renewal application shall consist of a letter identifying the company and stating that it is applying to renew its license. Letters of credit or extensions of existing letters of credit or other documents which establish to the satisfaction of the Commissioner that the company continues to comply with the requirements of § 20-40.9-300 and § 20-40.9-400 and expiring not later than the end of the year for which renewal of the license is sought, together with a check for the $2,500.00 annual a license fee shall be included with the application. Each application for a renewal license shall be deemed to be granted unless the Commissioner notifies the applicant in writing that it has been rejected.

§20-40.10-600. Annual Report and Audit Requirements

The purpose of this regulation is to set financial and reporting requirements which the Commissioner deems necessary for the regulation of captive insurance companies, as required by § 20-40.9-700 and § 20-40.9-900.

(a) **NAIC Membership.** Every company that is licensed under the Act shall be required to become a member of the National Association of Insurance Commissioners.

(b) **Annual Statement.** Every company that is licensed under the Act shall, on or before March 1 of each year, file with the Commissioner a financial statement, verified under oath by two executive officers of the company, setting forth its financial condition, transactions, and affairs as of the 31st day of December immediately preceding, in general form and context as approved by the National Association of Insurance Commissioners, plus any additional information required by the Commissioner.

(c) **Annual Audit.** Every company that is licensed under the Act shall have an annual audit by its appointed Independent Auditor as approved by the Commissioner and shall file such audited financial report with the Commissioner on or before the last day of the sixth month following the end of the company's annual account period. The audited report shall be accompanied by a verification of two executive officers of the company.

(d) **Unqualified Opinion.** The audited report shall include an unqualified opinion with respect to the financial condition of the company. An auditor, who has rendered other than an unqualified opinion on the financial condition of a captive insurance company or who is aware that captive insurance fails to meet the necessary capital and surplus requirements of the Act and the president of the captive insurance company shall both notify the Commissioner in writing within fifteen days of the issuance of such opinion or the discovery of failure to meet the capital or surplus requirements of the Act.

§20-40.10-700. Report Form

The annual audit report shall consist of the following:

(a) Opinion of Independent Certified Public Accountant.

(1) Financial statements furnished pursuant to this section shall be examined by Independent Auditor in accordance with Statutory Accounting Practices in general form and context approved by the National Association of Insurance Commissioners.

(2) The opinion of the Independent Auditor shall cover all years presented.

(3) The opinion shall be addressed to the company on stationery of the Independent Auditor showing the address of issuance, shall bear original manual signatures and shall be dated.

(4) The opinion shall contain an evaluation of management experience, ability to control.

(b) Report of Evaluation of Internal Controls

(1) This report shall include an evaluation of the internal controls of the company relating to the methods and procedures used in the securing of assets and reliability of the financial records, including but not limited to such controls as the system of authorization and approval and the separation of duties.

(2) The review shall be conducted in accordance with statutory accounting practices. The report must be filed with the Commissioner.

(c) **Letter of Independent Auditor.** The Independent Auditor shall furnish the company, for inclusion in the filing of the audited annual report, a letter stating:

(1) That he is independent with respect to the company and conforms to the standards of his profession as contained in the Code of Professional Ethics and pronouncements of the American Institute of Certified Public Accountants and pronouncements of the Financial Accounting Standards Board.

(2) The general background and experience of the staff engaged in audit including the experience in auditing captives or other insurance companies.

(3) That the accountant understands that the audited annual report and his opinions thereon will be filed in compliance with this regulation with the Commissioner.

(4) That the accountant consents to the requirements of § 20-40.10-1000 of the regulations and that the accountant consents and agrees to make available for review by the Commissioner, his designee or his appointed agent, the work papers as defined in § 20-40.10-1000 of the regulations.

(5) That the accountant is properly licensed by the Territory of The CNMI or another appropriate state licensing authority as approved by the Commissioner and that he is a member in good standing in the American Institute of Certified Public Accountants.

(d) **Financial Statements**. Statements required shall be as follows:

(1) Balance Sheet

(2) Statement of gain or loss from operations

(3) Statement of changes in financial position

(4) Statement of changes in capital paid up, gross paid in and contributed surplus and unassigned funds (surplus)

(5) Notes to financial statements. The notes to financial statements shall be those required by statutory accounting practices, and shall include:

(A) A reconciliation of differences, if any, between the annual statement and audited financial report and any other statement or form filed with the Commissioner.

(B) A summary of ownership and relationship of the company and all affiliated corporations or companies insured by the captive.

(C) A narrative explanation of all material transactions and balances with the company.

(e) **Certification of Loss Reserves and Loss Expense Reserves.** The annual audit shall include an opinion by the company's designated Loss Reserve Specialist as to the adequacy of the company's loss reserves and loss expense reserves.

The individual who certifies as to the adequacy of reserves shall be approved by the Commissioner and shall be a member of the Casualty Actuarial Society with three years of property and casualty loss and loss expense reserve evaluation experience, or a member in good standing of the American Academy of Actuaries with five years of property and casualty loss and loss expense reserve evaluation experience.

Certification shall be in such form as the Commissioner deems appropriate.

(f) **Summary of Underwriting and Reinsurance Ceded.** The annual audit shall include a summary of all of the insurance underwritten and a schedule of reinsurance ceded during the year to all reinsurers including a statement of the percentage of each premium attributable to the insurance of an affiliated company.

§20-40.10-800. Change of Independent Auditor.

Each company that is licensed under the Act shall notify the Commissioner in writing of any change in the Independent Auditor appointed by the company. The change appointment of the Independent Auditor shall be deemed to be approved by the Commissioner unless notice is given to the company, within sixty days after receipt of the notice by the Commissioner's office, that the auditor is not approved, in which case the company shall appoint a substitute and notify the Commissioner of the substitute auditor which substitute shall be subject to the approval of the Commissioner under this subsection.

§20-40.10-900. Notice of Adverse Financial Condition.

Each company that is licensed under the Act shall require its Independent Auditor to immediately notify in writing the president or his designee and all members of the board of directors of the captive insurance company of any determination by the Independent Auditor that the company has materially misstated its financial condition in any of its reports to the Commissioner. The president of the company or his designee shall furnish such notification

to the Commissioner within five working days of receipt of such information from the Independent Auditor.

§20-40.10-1000. Access to and Maintenance of Working Papers of Independent Auditor and Loss Reserve Specialist.

Each company that is licensed under the Act shall require its Independent Auditor and Loss Reserve Specialist to make available for review by the Commissioner or his appointed agent the work papers prepared in the conduct of the audit of the company. The company shall require that the Independent Auditor and Loss Reserve Specialist retain the audit work papers for a period of not less than five years after the period reported upon.

The aforementioned review by the Commissioner shall be considered investigations, and all work papers obtained during the course of such investigations shall be confidential. The company shall require that the Independent Auditor and Loss Reserve Specialist provide photocopies of any of the work papers which the Commissioner considers relevant. Such work papers may be retained by the Commissioner.

Work Papers as referred to in this section include, but are not necessarily limited to, schedules, analyses, reconciliations, abstracts, memoranda, narratives, flow charts, copies of company records or other documents prepared or obtained by the accountant and his employees in the conduct of their examination of the company.

§20-40.10-1100. Security.

Whenever the Commissioner deems that the financial condition of the company warrants additional security, he may require a company to deposit with the Treasurer of The CNMI or an escrow agent approved by the Commissioner cash or securities approved by the Commissioner or, alternatively, to furnish the Commissioner a clean irrevocable letter of credit issued by a bank chartered by the Territory of The CNMI or a member bank of the Federal Reserve System, and, in either case, such bank to be approved by the Commissioner. The company may receive interest or dividends from said deposit or exchange the deposits for others of equal value with the approval of the Commissioner. If such company discontinues business and surrenders its license, the Commissioner shall return such deposit only after being satisfied that all obligations of the company have been discharged.

§20-40.10-1200. Other Requirements and Restrictions.

This Chapter contains interpretations of various additional requirements and restrictions applicable to captive insurance companies.

(a) Annual Meeting of the Board of Directors in the CNMI.

(1) To fulfill the requirements of § 20-40.9-100(b)(2), requiring the Board of Directors of each captive insurance company to hold at least one meeting each year in the CNMI, a quorum of the Board of Directors, consisting of a majority of the whole number of directors, shall be physically present in The CNMI for the meeting. The year referred to in this provision shall be the company's annual accounting period.

(2) For companies that qualify as captive insurance companies under §§ 20-40.9-100(b)(5) and 20-40.9-100(e), a copy of the minutes of the annual meeting of the Board of Directors shall be filed with the Commissioner within thirty days after such meeting.

(b) Principal Place of Business

(1) To fulfill the requirements of § 20-40.9-100(b)(3), requiring that a captive insurance company maintain its principal place of business in the CNMI, a company must have an office in the CNMI in which it maintains its business and corporate records, financial books, copies of all insurance policies that it issues and copies of its audited financial reports. A captive insurance company may establish its principal office in The CNMI in office space that it shares with other businesses, including other captive insurance companies or affiliates of the captive insurance company, or it may locate its principal place of business in an office in the CNMI of a company that engages in the business of managing the business affairs of captive insurance companies.

(2) For companies that qualify as captive insurance companies under § 20-40.9-100(b)(5) and § 20-40.9-100(e), such company shall be required to maintain an office in the CNMI in which it maintains copies of its business and corporate records, financial books, copies of all insurance policies that it issues, and copies of its audited financial reports. For companies qualifying under § 20-40.9-100(b)(5) and § 20-40.9-100(e), such office in the CNMI may be an office space that it shares with other businesses, including other captive insurance companies or affiliates of the captive insurance company, or it may locate its office as required under this section in an office in the CNMI of a company that engages in the business of managing the business affairs of captive insurance companies.

§20-40.10-1300. Resident Registered Agent for Service of Process.

The registered agent of a licensed captive insurance company shall be either an individual who resides in the CNMI or a corporation formed in the CNMI or a partnership formed in the CNMI that maintains an office in the CNMI that is regularly open for business during normal business hours. Each captive insurance company licensed under the Act shall notify the Commissioner in writing within 30 days of any change in the address of its registered agent for service of process.

§20-40.10-1400. Extension of Period Between Examination.

Under 4 CMC § 20-40.9-900, requiring that the Commissioner make an examination of the affairs of each captive insurance company at least once every three years, but the Commissioner has the right, upon application, to enlarge the three year period to five years upon application, provided that certain conditions are met, each captive insurance company shall apply for such an enlargement of the examination period either at the time of application for licensure, within 30 days after the issuance of the license, or by request made in writing accompanying the company's annual audit report. If the Commissioner grants the application, the enlargement of the examination period to five years shall remain in effect until the Commissioner, in his discretion, revokes his consent to the enlargement of said period in writing.

§20-40.10-1500. Restrictions on Insurance of Direct Risks by Captive Insurance Companies.

(a) Title 20 of the NMI Administrative Code § 20-40.9-100(a)(1), limiting the insurance of risks by pure captive insurance companies, applies only to direct insurance of risks and not to reinsurance, which is governed by § 20-40.9-100(a)(3) and § 20-40.10-1600 of these regulations. A pure captive insurance company shall not insure any direct risk of any entity other than its parent and three affiliates of the captive insurance company, except that it may insure risks of three unaffiliated companies, provided that at least 60% of its premium income during each calendar year shall be derived from its parent and affiliates. For purposes of applying the amount of 60% requirement, the premiums derived by a captive insurance company shall be the gross amount of premiums for direct insurance, and it shall not be increased reduced by the amount of any reinsurance provided or ceded by the captive insurance company.

(b) Title 20 of the NMI Administrative Code § 20-40.9-100(a)(2) of, limiting the insurance of risks by an association captive insurance company to risks of its member organizations and of affiliates of its member organizations, does not apply to reinsurance, which is governed by § 20-40.9-100(a)(3) and § 20-40.10-1600 of these regulations.

§20-40.10-1600. Reinsurance.

(a) Any captive insurance company authorized to do business under the Act may take credit for reserves on risks ceded to a reinsurer subject to the following limitations:

(1) No credit shall be allowed for reinsurance where the reinsurance contract does not result in the complete transfer of the risk or liability to the reinsurer.

(2) No credit shall be allowed, as an asset or a deduction from liability, to any ceding insurer for reinsurance unless the reinsurance is payable by the assuming insurer on the basis of the liability of the ceding insurer under the contract reinsured without diminution because of the insolvency of the ceding insurer. In the event the captive insurance company is declared insolvent by its board of directors or by the Commissioner or is placed in receivership for rehabilitation or liquidation any reinsurance due or becoming due and payable by the assuming insurer shall be paid to the Commissioner. The NAIC Insurers Rehabilitation and Liquidation Model Act shall be used to administer any company place din receivership or liquidation.

(3) No credit shall be allowed for reinsurance ceded unless the reinsurer and amount of reinsurance has been approved by the Commissioner annually.

(b) Reinsurance under this section shall be effected through a written agreement of reinsurance setting forth the terms, provisions and conditions governing such reinsurance.

The Commissioner in his discretion shall require that complete copies of all reinsurance treaties and contracts be filed and/or approved by him.

§20-40.10-1700. Insurance Managers and Intermediaries.

(a) In addition to the 'Principal Place of Business' of the captive insurance company shall be a person who resides in the CNMI. Any entity or association organized under the laws of the CNMI and keeping a principal office in the CNMI may apply and be authorized as an insurance manager provided that the individuals authorized to act under the license of the entity or association reside in the CNMI and are authorized by the Commissioner.

(b) In considering whether to authorize a person as an insurance manager, the Commissioner shall determine whether the person has adequate knowledge of the insurance business to enable such person to act as an insurance manager. All persons filing an application for an insurance manager shall submit a Biographical Data Affidavit by using Form B of these regulations.

(c) No person shall, in or from within this Territory, act as an insurance manager, broker, agent, salesman, or reinsurance intermediary for captive business without the authorization of the Commissioner. Application for such authorization must be on a form prescribed by the Commissioner. The application fee for an insurance manager, broker, agent, salesman or reinsurance intermediary for captive business shall be $10.00.

§20-40.10-1800. Directors.

Every company shall report to the Commissioner within thirty days after any change in its executive officers or directors, including in its report a statement of the business and professional affiliations of any new executive officer or director. No director, officer or employee of a company shall, except on behalf of the company, accept, or be the beneficiary of, any fee, brokerage, gift or other emolument because of any investment, loan, deposit, purchase, sale, payment or exchange made by or for the company but such person may receive reasonable compensation for necessary services rendered to the company in his or her usual private professional or business capacity.

Any profit or gain received by or on behalf of any person in violation of this section shall inure to and be recoverable by the company.

§20-40.10-1900. Conflict of Interest.

In addition to the investment of funds limitation in § 20-40.10-1800 of these regulations, each company licensed under the Act is required to adopt a conflict of interest statement for officers, directors and key employees. Such statement shall disclose that the individual has no outside commitments, personal or otherwise, that would divert him from his duty to further the interests of the company he represents but this shall not preclude such person from being a director or officer in more than one insurance company.

Each officer, director, and key employee shall file such disclosure with the Board of Directors yearly.

§20-40.10.2000. Suspension or Revocation.

The Commissioner may, for any of the following reasons, conduct for suspension or revocation of the license of a captive insurance company in accordance with the Administrative Adjudication Law:

(1) if the company has not commenced business according to its plan of operation within two years of being licensed; or

(2) if the company ceases to carry on insurance business in or from within the CNMI; or

(3) for any reason provided in § 20-40.9-1000; or

(4) at the request of the company.

§20-40.10-2100. Waiver of Hearing.

(a) In the event the suspension or revocation of license is requested by the president or any board of director of the captive insurance company, such request shall be deemed to be a waiver of hearing. The Commissioner may upon receipt of such request from the company immediately issue the order of suspension or revocation

of license with or without further hearing and shall cause such order to be served on the company.

(b) If a captive insurance company shall fail to file a notice of defense within fifteen (15) days after service of the accusation or statement of issues, such failure shall be deemed to be a waiver of all rights to a hearing. The Commissioner upon finding that a captive insurance company has failed to file a notice of defense, may immediately issue an order of suspension or revocation of the captive insurance license and shall cause such order to be served on the company.

§20-40.10-2200. Acquisition of Control of or Merger with Domestic Company.

No person other than the issuer shall make a tender offer for or a request or invitation for tenders of, or enter into any agreement to exchange securities for, seek to acquire, or acquire in the open market or otherwise, any voting security of a domestic if, after the consummation thereof, such person would, directly or indirectly (or by conversion or by exercise of any right to acquire) be in control of such company; and no person shall enter into an agreement to merge with or otherwise to acquire control of a domestic company without the prior written approval of the Commissioner. In considering any application for acquisition of control or merger with a domestic company, the Commissioner shall consider all of the facts and circumstances surrounding the application as well as the criteria for establishment of a company set out in this chapter.

§20-40.10-2300. Change of Business.

Any change in the nature of the captive, business from that stated in the company's plan of operation filed with the Commissioner upon application requires prior approval from the Commissioner. Any change in any other information filed with the application must be filed with the Commissioner but does not require prior approval.