REGULATION 81-2
CAPTIVE INSURANCE FINANCIAL REGULATION

SECTION 1: PURPOSE AND AUTHORITY

The purpose of this regulation is to set forth the financial and reporting requirements, which the commissioner deems necessary for the regulation of captive insurance companies, as authorized by the Captive Insurance Company Act, 8 V.S.A., Section 6015. Reference hereunder to "company" shall mean captive insurance company or companies, unless otherwise specified.

SECTION 2: ANNUAL REPORTING REQUIREMENTS

An association captive insurance company doing business in this state shall annually submit to the commissioner a report of its financial condition, verified by oath of two of its executive officers. The report shall be that required by 8 V.S.A., Section 3561.

A pure or industrial insured captive insurance company doing business in this state shall annually submit to the commissioner with a report of its financial condition, verified by oath of two of its executive officers. The report shall be that prescribed by the commissioner as "Captive Annual Statement: Pure or Industrial Insured".

SECTION 3: ANNUAL AUDIT

All companies shall have an annual audit by an independent certified public accountant, authorized by the commissioner and shall file such audited financial report with the commissioner on or before June 30 for the year ending December 31 immediately preceding.

The annual audit report shall be considered part of the company's annual report of financial condition except with respect to the date by which it must be filed with the commissioner.

The annual audit shall consist of the following:

(A) Opinion of Independent Certified Public Accountant

Financial statements furnished pursuant to this section shall be examined by independent certified public accountants in accordance with generally accepted auditing standards as determined by the American Institute of Certified Public Accountants.

The opinion of the independent certified public accountant shall cover all years presented.

The opinion shall be addressed to the company on stationery of the accountant showing the address of issuance, shall bear original manual signatures and shall be dated.

(B) Report of Evaluation of Internal Controls

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 the reliability of the financial records, including but not limited to such controls as the system of authorization and approval and the separation of duties.

The review shall be conducted in accordance with generally accepted auditing standards and the report filed with the commissioner.

(C) Accountant's Letter

The accountant shall furnish the company, for inclusion in the filing of the audited annual report, a letter stating:

(a) 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.

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

(c) That the accountant understands that the audited annual report and his opinions thereon will be filed in compliance with this regulation with the Department of Banking and Insurance.

(d) That the accountant consents to the requirements of Section 6 of this regulation 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 Section 6.

(e) That the accountant is property licensed by an appropriate state licensing authority 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:

(a) Balance sheet

(b) Statement of gain or loss from operations

(c) Statement of changes in financial position

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

(e) Notes to financial statements

The notes to financial statements shall be those required by generally accepted accounting principles, and shall include:

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

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

(3) 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 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 Fellow of the Casualty Actuarial Society, a member in good standing of the American Academy of Actuaries, or an individual who has demonstrated his competence in loss reserve
evaluation to the commissioner.

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

SECTION 4: DESIGNATION OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

Companies, after becoming subject to this regulation, shall within ninety days report to the commissioner in writing, the name and address of the independent certified public accountant retained to conduct the annual audit set forth in this regulation.

SECTION 5: NOTIFICATION OF ADVERSE FINANCIAL CONDITION

A company shall require the certified public accountant to immediately notify in writing an officer and all members of the Board of Directors of the company of any determination by the independent certified public accountant that the company has materially misstated its financial condition in its report to the commissioner as required in Section 6007 of 8 V.S.A. The company shall furnish such notification to the commissioner within five working days of receipt thereof.

SECTION 6: AVAILABILITY AND MAINTENANCE OF WORKING PAPERS OF THE INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

Each company shall require the independent certified public accountant 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 accountant 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 working papers obtained during the course of such investigations shall be confidential. The company shall require that the independent certified public accountant provide photocopies of any of the working papers which the Department of Banking and Insurance considers relevant. Such working papers may be retained by the Department.

"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.

SECTION 7: DEPOSIT REQUIREMENT

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 this state 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 State of Vermont or a member bank of the Federal Reserve System and 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, the commissioner shall return such deposit only after being satisfied that all obligations of the company have been discharged.

SECTION 8: ORGANIZATIONAL EXAMINATION

In addition to processing of the application, an organizational investigation or examination may be performed before an applicant is licensed. Such investigation or examination shall consist of a general survey of the company's corporate records, including charter, bylaws and minute books; verification of capital and surplus; verification of principal place of business; determination of assets and liabilities; and a review of such other factors as the commissioner deems necessary.

SECTION 9: REINSURANCE

Any captive insurance company authorized to do business in this state may take credit for reserves on risks ceded to a reinsurer subject to the following limitations:

(A) 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.

(B) 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.

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 may require that complete copies of all reinsurance treaties and contracts be filed and/or approved by him.

SECTION 10: INSURANCE MANAGERS & INTERMEDIARIES

No person shall, in or from within this state, 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.

SECTION 11: 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.

SECTION 12: CONFLICT OF INTEREST

In addition to the investment of funds in Section 11 of this regulation, each company chartered in this state is required to adopt a conflict of interest statement from 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.

SECTION 13: RESCISSION OF CAPTIVE LICENSE

The commissioner may, subject to the provisions of this section, by order rescind the license of the company:

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

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

(C) at the request of the company; or

(D) for any reason provided in 8 V.S.A., Section 6009.

Before the commissioner rescinds the license of a company under (A) or (B), the commissioner shall give the company notice in writing of the grounds on which he proposes to cancel the license, and shall afford the company an opportunity to make objection in writing within the period of thirty days after receipt of notice. The commissioner shall take into consideration any objection received by him within that period and, if he decides to cancel the license, cause the order of cancellation to be served on the company.

SECTION 14: ACQUISITION OF CONTROL OF OR MERGER WITH DOMESTIC COMPANY

No person other than the issuer shall make a tender offer of 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 company 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.

SECTION 15: 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.