ASSEMBLY, No. 1790

STATE OF NEW JERSEY

INTRODUCED MARCH 18, 1996

By Assemblyman BAGGER

AN ACT concerning certain dividends paid by domestic insurers and amending P.L.1970, c.22.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Section 4 of P.L.1970, c.22 (C. 17:27A-4) is amended to read as follows:

4. Standards. a. Transactions with affiliates.

(1) Transactions by registered insurers with their affiliates shall be subject to the following standards:

(a) The terms shall be fair and reasonable;

(b) Charges or fees for services performed shall be reasonable;

(c) Expenses incurred and payment received shall be allocated to the insurer in conformity with customary insurance accounting practices consistently applied;

(d) The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the precise nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties; and

(e) The insurer's surplus as regards policyholders following any transaction with affiliates or dividends or distributions to shareholder affiliates shall be reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs.

(2) The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into that transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that 30-day period:

(a) Sales, purchases, exchanges, loans or extensions of credit, guarantees or other contingent obligations, investments, or loans collateralized by the stock of a subsidiary or affiliate, provided such

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.

transactions equal or exceed: (i) with respect to insurers other than life insurers, the lesser of 3% of the insurer's admitted assets or 25% of surplus as regards policyholders, as of December 31 next preceding; (ii) with respect to life insurers, 3% of the insurer's admitted assets, as of December 31 next preceding;

(b) Loans or extensions of credit to any person who is not an affiliate, in which the insurer makes such loans or extensions of credit with the agreement or understanding that the proceeds of such transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the insurer making those loans or extensions of credit, provided those transactions are equal to or exceed: (i) with respect to insurers other than life insurers, the lesser of 3% of the insurer's admitted assets or 25% of surplus as regards policyholders, as of December 31 next preceding; (ii) with respect to life insurers, 3% of the insurer's admitted assets, as of December 31 next preceding;

(c) Reinsurance agreements or modifications thereto in which the reinsurance premium or a change in the insurer's liabilities equals or exceeds 5% of the insurer's surplus as regards policyholders, as of December 31 next preceding, including those agreements which may require as consideration the transfer of assets from an insurer to a non-affiliate if an agreement or understanding exists between the insurer and non-affiliate that any portion of those assets will be transferred to one or more affiliates of the insurer;

(d) All management agreements, service contracts and all cost-sharing arrangements; and

(e) Any material transactions, specified by regulation, which the commissioner determines may adversely affect the interests of the insurer's policyholders. Nothing herein contained shall be deemed to authorize or permit any transactions which, in the case of an insurer which is not a member of the same holding company system, would be otherwise contrary to law.

(3) A domestic insurer may not enter into transactions which are part of a plan or series of like transactions with persons within the holding company system if the purpose of those separate transactions is to avoid the statutory threshold amount and thus avoid the review that would otherwise occur. If the commissioner determines that such separate transactions were entered into over any 12-month period for that purpose, he may exercise his authority under section 8 of P.L.1993, c.241 (C.17:27A-9.1).

(4) The commissioner, in reviewing transactions pursuant to paragraph (2) of this subsection, shall consider whether the transactions comply with the standards set forth in paragraph (1) of this subsection and whether they may adversely affect the interests of policyholders.

(5) The commissioner shall be notified within 30 days of any investment of the domestic insurer in any one corporation if the total investment in that corporation by the insurance holding company system exceeds 10% of that corporation's voting securities.

(6) The commissioner may by regulation specify certain types of transactions that need not be submitted for review under this subsection if he determines that those transactions would not have a significant impact on the financial condition or methods of operation of the insurer.

b. Adequacy of surplus. For purposes of this chapter, in determining whether an insurer's surplus as regards policyholders is reasonable in relation to the insurer's outstanding liabilities and adequate to its financial needs, the following factors, among others, shall be considered:

(1) The size of the insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force and other appropriate criteria;

(2) The extent to which the insurer's business is diversified among the several lines of insurance;

(3) The number and size of risks insured in each line of business;

(4) The extent of the geographical dispersion of the insurer's insured risks;

(5) The nature and extent of the insurer's reinsurance program;

(6) The quality, diversification, and liquidity of the insurer's investment portfolio;

(7) The recent past and projected future trend in the size of the insurer's surplus as regards policyholders;

(8) The surplus as regards policyholders maintained by other comparable insurers in respect of the factors enumerated in this subsection;

(9) The adequacy of the insurer's reserves;

(10) The quality and liquidity of investments in affiliates. The commissioner may discount any such investments or treat any such investment as a disallowed asset for purposes of determining the adequacy of surplus as regards policyholders whenever in his judgment such investment so warrants; and

(11) The quality of the insurer's earnings and the extent to which the reported earnings include extraordinary items.

c. Dividends and other distributions.

(1) A domestic insurer subject to registration under section 3 of P.L.1970, c.22 (C.17:27A-3) shall report to the commissioner any dividend or distribution to its shareholders within five business days following declaration and at least 30 days, after receipt of that report by the commissioner, prior to payment. For good cause shown, the commissioner may reduce the notification period prior to payment to a period of not less than 10 days. The commissioner shall limit or

disallow the payment of any dividend or distribution if he determines that the insurer's surplus as regards policyholders is not reasonable in relation to its outstanding liabilities and adequate to its financial needs pursuant to subsection b. of this section or if the insurer is otherwise found to be in a hazardous financial condition.

(2) (a) No domestic insurer subject to registration under section 3 shall pay any extraordinary dividend or make any other extraordinary distribution to its shareholders until (i) 30 days after the commissioner has received notice of the declaration thereof and has not within such period disapproved such payment, or (ii) the commissioner shall have approved such payment within such 30-day period.

(b) For purposes of this paragraph, an extraordinary dividend or distribution includes any dividend or distribution of cash or other property, whose fair market value together with that of other dividends or distributions made within the preceding 12 months exceeds the greater of (i) 10% of such insurer's surplus as regards policyholders as of December 31 next preceding, or (ii) the net gain from operations of such insurer, if such insurer is a life insurer, or the net income, if such insurer is not a life insurer, not including realized capital gains, for the 12-month period ending December 31 next preceding, but shall not include pro rata distributions of any class of the insurer's own securities.

(c) Notwithstanding any other provision of law, a domestic insurer may declare an extraordinary dividend or distribution which is conditional upon the commissioner's approval thereof, and such a declaration shall confer no rights upon policyholders until (i) 30 days after the commissioner has received notice of the declaration thereof and has not within such period disapproved such payment, or (ii) the commissioner shall have approved such payment within such 30-day period.

(3) Except for extraordinary dividends or distributions paid pursuant to paragraph (2) of this subsection, all dividends or distributions to shareholders shall be declared or paid by insurers subject to registration under section 3 of P.L.1970, c.22 (C.17:27A-3) from only earned surplus. Dividends or distributions, including extraordinary dividends or distributions, lawfully paid pursuant to this subsection that exceed earned surplus shall to the extent of that excess be deemed a return of capital distributed from gross "paid in and contributed surplus." For purposes of this paragraph, "earned surplus" means unassigned funds (surplus), as reported on the insurer's annual statement as of December 31 next preceding, less unrealized capital gains and revaluation of assets.

d. Management of domestic insurers subject to registration.

(1) Notwithstanding the control of a domestic insurer by any person, the officers and directors of the insurer shall not thereby be relieved of any obligation or liability to which they would otherwise be

subject by law, and the insurer shall be managed so as to assure its separate operating identity consistent with P.L.1970, c.22 (C.17:27A-1 et seq.).

(2) Nothing herein shall preclude a domestic insurer from having or sharing a common management or cooperative or joint use of personnel, property or services with one or more other persons under arrangements meeting the standards of paragraph (1) of subsection a. of this section.

(3) Not less than one-third of the directors of a domestic insurer, and not less than one-third of the members of each committee of the board of directors of any domestic insurer, shall be persons who are not officers or employees of that insurer or of any entity controlling, controlled by, or under common control with, that insurer and who are not beneficial owners of a controlling interest in the voting securities of that insurer or any such entity. At least one such person shall be included in any quorum for the transaction of business at any meeting of the board of directors or any committee thereof.

(4) The board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with, the insurer and who are not beneficial owners of a controlling interest in the voting securities of the insurer or any such entity. The committee shall be responsible for recommending the selection of independent certified public accountants, reviewing the insurer's financial condition, the scope and results of the independent audit and any internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation, including bonuses or other special payments, of the principal officers.

(5) The provisions of paragraphs (3) and (4) of this subsection d. shall not apply to a domestic insurer if the person controlling the insurer is an entity having a board of directors and committees thereof that substantially meet the requirements of those paragraphs.

(cf: P.L.1995, c.338, s.2)

2. This act shall take effect immediately and, at the election of the domestic insurer, may apply to dividends or distributions made in previous years to the extent that the treatment of those dividends or distributions continues to have an effect on current financial statements of the insurer.

STATEMENT

This bill amends the law which regulates insurance holding company systems to clarify the accounting treatment of dividends lawfully paid that exceed earned surplus. The bill provides that the amount by which those dividends exceed earned surplus is to be considered return of capital for accounting purposes.

Clarifies accounting treatment of certain dividends lawfully paid by insurance holding company systems.