

**2003 DRAFTING REQUEST**

**Bill**

Received: **01/07/2003**

Received By: **pkahler**

Wanted: **As time permits**

Identical to LRB:

For: **Dale Schultz (608) 266-0703**

By/Representing: **John O'Brien**

This file may be shown to any legislator: **NO**

Drafter: **pkahler**

May Contact:

Addl. Drafters:

Subject: **Insurance - miscellaneous**

Extra Copies:

Submit via email: **YES**

Requester's email: **Sen.Schultz@legis.state.wi.us**

Carbon copy (CC:) to:

---

**Pre Topic:**

No specific pre topic given

---

**Topic:**

Reinsurer liability exception

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**Instructions:**

See Attached

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**Drafting History:**

<u>Vers.</u>	<u>Drafted</u>	<u>Reviewed</u>	<u>Typed</u>	<u>Proofed</u>	<u>Submitted</u>	<u>Jacketed</u>	<u>Required</u>
/?	pkahler 03/03/2003	jdyer 03/04/2003 jdyer 03/04/2003		_____			
/1			jfrantze 03/04/2003	_____	amentkow 03/04/2003		

Vers.      Drafted      Reviewed      Typed      Proofed      Submitted      Jacketed      Required

/2	pkahler 03/27/2003	jdye 03/27/2003	pgreensl 03/27/2003	_____	sbasford 03/27/2003	amentkow 03/31/2003	
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FE Sent For:

*None  
Needed*

<END>

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/?	pkahler 03/03/2003	jdyer 03/04/2003 jdyer 03/04/2003	3/27 ps	3/27			
/1		1/2 3/27 jld	jfrantze 03/04/2003	ps/19	amentkow 03/04/2003		

Vers.    Drafted    Reviewed    Typed    Proofed    Submitted    Jacketed    Required

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Subject: Insurance - miscellaneous

Extra Copies:

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Reinsurer liability exception

Instructions:

See Attached

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/?	pkahler	1 3/4 jld	3/4	Self 3/4			

FE Sent For:

<END>

# Bill Request Form

Legislative Reference Bureau  
100 N. Hamilton Street  
Legal Section 266-3561

You may use this form or talk directly with the LRB attorney who will draft the bill.

Date January 07-2002

Legislator, agency, or other person requesting this draft SENATOR DALE SCHULTZ

Person submitting request (name and phone number) John O'Brien 266-0703

Persons to contact for questions about this draft (names and phone numbers) SAME AS

Describe the problem, including any helpful examples. How do you want to solve the problem?

INSURANCE CUT THROUGH

Please attach a copy of any correspondence or other material that may help us. If you know of any statute sections that might be affected, list them or provide a marked-up copy.

You may attach a marked-up copy of any LRB draft or provide its number (e.g., 2001 LRB-2345/1 or 1999AB-67).

Requests are confidential unless stated otherwise. May we tell others that we are working on this for you? YES  NO

If yes: Anyone who asks? YES NO  
Any legislator? YES NO

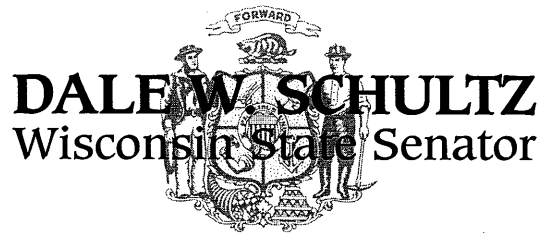
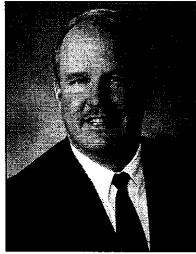
Only the following persons \_\_\_\_\_

Do you consider this request urgent? YES NO If yes, please indicate why \_\_\_\_\_

Should we give this request priority over any pending request of this legislator, agency, or person?

YES  NO





January 7, 2003

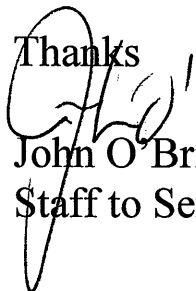
**MEMO**

To: Pam Kahler, Legislative Ref. Bureau (Drafting)

From: John O'Brien, Staff Senator Dale Schultz

Please prepare a draft, which makes changes to S 645.58 per the attached documents.

If you have questions or comments related to this request, please feel free to contact me.

Thanks  
  
John O'Brien  
Staff to Senator Dale Schultz

## **Amend Cut Through Provision to Preserve Integrity of Agreement**

**Purpose:** To amend the Insurance Law to ensure that domestic ceding companies, their reinsurers and their beneficiaries can rely on valid cut through and assumption liability agreements. To enact technical amendments to the insolvency law.

### **The Issues:**

The amendment clarifies existing language to ensure that the intent of the current statute is met with regard to utilization of cut through and assumption liability agreements. Because of adverse court decisions in other jurisdictions, the amendment is desirable to ensure that current law is not similarly misinterpreted. Clarification assures marketplace competition since cut throughs allow some insurers to compete for business that otherwise would be beyond their reach. Adopting this bill's clarifying language will create certainty that agreements will be honored in the event the insurance company becomes insolvent.

### ***Adopting the amendments will:***

- ***Recognize that the liquidator of insolvent insurance companies will recognize and honor cut through and assumption liability agreements;***
- ***Enable small domestic insurance companies to compete with large local and national carriers;***
- ***Enable small domestic insurance companies to compete with non-domestic companies whose domestic states' laws already have similar provisions;***
- ***Address consumer needs by providing a greater choice of insurance carriers, increasing capacity, thus impacting availability and affordability;***
- ***Conform state law with the laws of the majority of the states;***
- ***Clarify that the law does not intend to put reinsurers at risk of paying twice in the event that a cut through clause is used.***

### **Cut Through Background**

A cut through is a clause added to an insurance policy to provide that, in the event of the insolvency of the insurance company, the amount of any loss which would have been recovered from the reinsurer by the insurance company will be paid instead directly to the policyholder by the reinsurer. Cut throughs had their origin in the need for mortgage lenders to have assurance that the insurer writing a homeowners' policy could stand behind its obligations. The mortgage companies, and later the secondary mortgage markets, instituted rules which required an insurer of a mortgaged home to meet certain financial standards or have a specified rating by an insurer rating service. Often, small insurers or new insurers could not qualify and, thus, were shut out of the homeowners' market. Reinsurers, which were willing to stand behind the insurers via the use of a cut through, responded to the mortgage lenders' concerns. The banks were satisfied that the larger and favorably rated reinsurer was a sufficient financial strength to protect the collateral. The common market effect of the existence of cut throughs is to encourage competition among insurers by ensuring that additional insurers can compete for business. A similar parallel exists with surety companies which

protect public works projects where Federal financial requirements are imposed on surety companies. If a reinsurer issues a cut through, it has a contractual obligation to pay the beneficiary of the cut through. It also could have the obligation to pay the same proceeds to the receiver. This bill clarifies that the reinsurer's obligation is to pay the claim only once.

The use of a cut through enables insureds to utilize the financial strength of large, financially secure reinsurers. Some clients require insurers to obtain a cut through or face the possibility of losing business to a larger or non-domestic insurance company. Reinsurers usually only provide cut throughs if an underlying insured and insurer request one. Business could be lost by domestic insurers to non-domestic insurers because most states recognize cut throughs for all lines of business.

*The following states in recent years have adopted improved, related provisions: Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Idaho, Indiana, Iowa, Kansas, Louisiana, Maine, Michigan, Minnesota, Nebraska, Nevada, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Texas, Vermont, Virginia and Washington.*

**Proposed Amendment**  
**To Wisconsin Insurance Receivership Code Section 645.58**

November 26, 2002

645.58 Reinsurer's liability; arbitration clauses.

(1) LIABILITY. Except as provided in this subsection, the~~The~~ amount recoverable by the liquidator from a reinsurer shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor shall not diminish the reinsurer's obligation to the insurer's estate ~~except when the reinsurance contract provided for direct coverage of an individual named insured and the payment was made in discharge of that obligation~~ (a) where the contract or other written agreement specifically provides, in the event of a delinquency proceeding, for another payee of such reinsurance and the payment operates to extinguish the liability of the ceding insurer to the extent of payment made, or (b) where the assuming insurer has assumed policy obligations of the ceding insurer as direct obligations of the assuming insurer and payment is made to the payees under such policies and the assumption operates to extinguish the liability of the ceding insurer to the extent assumed.

(2) ARBITRATION. After December 31, 1989, a domestic insurer may not enter into a reinsurance contract that contains an arbitration provision permitting its reinsurer to require arbitration of an action on or related to the contract when the domestic insurer is subject to a delinquency proceeding under this subchapter.

(3) APPLICATION AND EFFECTIVE DATE. The amendatory provisions of this Act, effective \_\_\_\_\_, 2003, applicable to this section are not intended to affect contracts entered into prior to the effective date of this Act and shall not imply interpretation of prior law. Provisions of Section 645.58(1) in effect prior to the enactment of this Act apply to contracts entered into prior to the effective date of this Act.



State of Wisconsin  
2003 - 2004 LEGISLATURE

LRB-1346/1

PJK:.....

Jld

~~PRELIMINARY DRAFT NOT READY FOR INTRODUCTION~~

SDM  
(3-3)

D-note

gen cat

1 AN ACT ~~;~~ relating to: reduction in amount recoverable by a liquidator from a  
2 reinsurer.

***Analysis by the Legislative Reference Bureau***

Current law provides that, regardless of any provision in a reinsurance contract, the amount recoverable by a liquidator from the reinsurer of an insurer (ceding insurer) subject to delinquency proceedings is not reduced as a result of the delinquency proceedings, and that no payment made directly to an insured or other creditor reduces the reinsurer's obligation to the ceding insurer's estate except when the reinsurance contract provides for direct coverage of a named insured and payment is made in discharge of that obligation.

This bill clarifies when the amount recoverable by a liquidator from a reinsurer of a ceding insurer is reduced. Those situations are: 1) when the reinsurance contract specifically provides for another payee in the event of delinquency proceedings and the payment extinguishes the liability of the ceding insurer to the extent of the payment made by the reinsurer; and 2) when the reinsurer has assumed policy obligations of the ceding insurer as direct obligations of the reinsurer, makes \* payment with respect to those obligations, and the assumption extinguishes the liability of the ceding insurer to the extent assumed.

***The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:***

1 SECTION 1. 645.58 (1) of the statutes is renumbered 645.58 (1) (intro.) and  
2 amended to read:

3 645.58 (1) LIABILITY. (intro.) The Except as provided in this subsection, the  
4 amount recoverable by the liquidator from a reinsurer shall not be reduced as a  
5 result of delinquency proceedings, regardless of any provision in the reinsurance  
6 contract or other agreement. Payment made directly to an insured or other creditor  
7 shall not diminish the reinsurer's obligation to the insurer's estate except when the  
8 ~~reinsurance contract provided for direct coverage of an individual named insured~~  
9 ~~and the payment was made in discharge of that obligation.~~ any of the following  
10 applies:

History: 1989 a. 23.

11 SECTION 2. 645.58 (1) (a) of the statutes is created to read:

12 645.58 (1) (a) The reinsurance contract or other agreement specifically  
13 provides for another payee of the reinsurance in the event of delinquency  
14 proceedings, and the payment operates to extinguish the liability of the ceding  
15 insurer to the extent of the payment made by the reinsurer.

16 SECTION 3. 645.58 (1) (b) of the statutes is created to read:

17 645.58 (1) (b) The reinsurer has assumed policy obligations of the ceding  
18 insurer as direct obligations of the reinsurer, payment is made to the payees under  
19 the policies, and the assumption operates to extinguish the liability of the ceding  
20 insurer to the extent assumed.

21 SECTION 4. Initial applicability.

22 (1) This act first applies with respect to reinsurance contracts or other  
23 agreements entered into on the effective date of this subsection.

24 (END)

D-note

**DRAFTER'S NOTE**  
**FROM THE**  
**LEGISLATIVE REFERENCE BUREAU**

LRB-1346/7dn

PJK:.....

JLd

I followed the language submitted to me, but it seems to me that actual payment is ~~required~~ under proposed s. 645.58 (1) (a),<sup>v</sup> because the payment extinguishes the liability of the ceding insurer to the extent of the payment, and that actual payment is not ~~required~~ under proposed s. 645.58 (1) (b),<sup>v</sup> because the assumption extinguishes the liability of the ceding insurer to the extent assumed. If you agree, I will redraft this bill to make that clear.

necessary

Pamela J. Kahler  
Senior Legislative Attorney  
Phone: (608) 266-2682  
E-mail: pam.kahler@legis.state.wi.us

**DRAFTER'S NOTE  
FROM THE  
LEGISLATIVE REFERENCE BUREAU**

LRB-1346/1dn  
PJK:jld:jf

March 4, 2003

I followed the language submitted to me, but it seems to me that actual payment is necessary under proposed s. 645.58 (1) (a), because the payment extinguishes the liability of the ceding insurer to the extent of the payment, and that actual payment is not necessary under proposed s. 645.58 (1) (b), because the assumption extinguishes the liability of the ceding insurer to the extent assumed. If you agree, I will redraft this bill to make that clear.

Pamela J. Kahler  
Senior Legislative Attorney  
Phone: (608) 266-2682  
E-mail: [pam.kahler@legis.state.wi.us](mailto:pam.kahler@legis.state.wi.us)



per Eileen, go ahead w/ redraft of  
to include language Fred Kappeler  
and I discussed (adding  
language re. payment made  
in (1)(a) to be parallel  
w/ (1)(b))



revision

2003 BILL

SOON  
(3-27)

Regen

1 AN ACT to renumber and amend 645.58 (1); and to create 645.58 (1) (a) and  
2 645.58 (1) (b) of the statutes; relating to: reduction in amount recoverable by  
3 a liquidator from a reinsurer.

*Analysis by the Legislative Reference Bureau*

Current law provides that, regardless of any provision in a reinsurance contract, the amount recoverable by a liquidator from the reinsurer of an insurer (ceding insurer) subject to delinquency proceedings is not reduced as a result of the delinquency proceedings, and that no payment made directly to an insured or other creditor reduces the reinsurer's obligation to the ceding insurer's estate except when the reinsurance contract provides for direct coverage of a named insured and payment is made in discharge of that obligation.

This bill clarifies when the amount recoverable by a liquidator from a reinsurer of a ceding insurer is reduced. Those situations are: 1) when the reinsurance contract specifically provides for another payee in the event of delinquency proceedings and the payment extinguishes the liability of the ceding insurer to the extent of the payment made by the reinsurer; and 2) when the reinsurer has assumed policy obligations of the ceding insurer as direct obligations of the reinsurer, makes payment with respect to those obligations, and the assumption extinguishes the liability of the ceding insurer to the extent assumed.

*The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:*

the reinsurer pays the other payee

the reinsurer

**BILL**

1           **SECTION 1.** 645.58 (1) of the statutes is renumbered 645.58 (1) (intro.) and  
2 amended to read:

3           645.58 (1) **LIABILITY.** (intro.) The Except as provided in this subsection, the  
4 amount recoverable by the liquidator from a reinsurer shall not be reduced as a  
5 result of delinquency proceedings, regardless of any provision in the reinsurance  
6 contract or other agreement. Payment made directly to an insured or other creditor  
7 shall not diminish the reinsurer’s obligation to the insurer’s estate except when the  
8 ~~reinsurance contract provided for direct coverage of an individual named insured~~  
9 ~~and the payment was made in discharge of that obligation.~~ any of the following  
10 applies:

11           **SECTION 2.** 645.58 (1) (a) of the statutes is created to read:

12           645.58 (1) (a) The reinsurance contract or other agreement specifically  
13 provides for another payee of the reinsurance in the event of delinquency  
14 proceedings, and the payment operates to extinguish the liability of the ceding  
15 insurer to the extent of the payment made by the reinsurer.

✓  
Payment is made to the other payee,

16           **SECTION 3.** 645.58 (1) (b) of the statutes is created to read:

17           645.58 (1) (b) The reinsurer has assumed policy obligations of the ceding  
18 insurer as direct obligations of the reinsurer, payment is made to the payees under  
19 the policies, and the assumption operates to extinguish the liability of the ceding  
20 insurer to the extent assumed.

21           **SECTION 4. Initial applicability.**

22           (1) This act first applies with respect to reinsurance contracts or other  
23 agreements entered into on the effective date of this subsection.

24    **(END)**

**Mentkowski, Annie**

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**From:** OBrien, John  
**Sent:** Monday, March 31, 2003 12:02 PM  
**To:** LRB.Legal  
**Subject:** Draft review: LRB 03-1346/2 Topic: Reinsurer liability exception

It has been requested by <OBrien, John> that the following draft be jacketed for the SENATE:

Draft review: LRB 03-1346/2 Topic: Reinsurer liability exception