Reinsurance Collateral Reduction & Accreditation Recommendations

On September 23, 2009, the NAIC Government Relations Leadership Council adopted the Reinsurance Regulatory Modernization Act of 2009 (RRMA), and agreed to submit the draft legislation to Congress for its further action. This proposed federal legislation was based on the Reinsurance Regulatory Modernization Framework Proposal (Reinsurance Framework), which the NAIC adopted during the Winter 2008 National Meeting. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which was signed into law on July 21st. This act includes the Nonadmitted and Reinsurance Reform Act (NRRA), which becomes effective 1-year after its enactment, as well as creates the Federal Insurance Office (FIO). The NRRA prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes such credit and is either (1) an NAIC-accredited state; or (2) has financial solvency requirements substantially similar to NAIC accreditation requirements.

Some states are now expressing an interest in moving forward with individual state-based reinsurance collateral reduction reforms. We have been advised that the changes being considered are generally intended to conform to key elements of the NAIC Reinsurance Framework. The Financial Regulation Standards and Accreditation (F) Committee has made an informal request to the Reinsurance (E) Task Force to consider which key elements of the Reinsurance Framework should be considered in reviewing any individual state initiatives, and whether these key elements should be incorporated into the Credit for Reinsurance Model Law and Regulation. The initial draft recommendation is attached for discussion and comment. In light of these developments, the Task Force proposes to begin the process of revising the credit for reinsurance models to make them consistent with key elements of the Reinsurance Framework, and will provide guidance to the F Committee with respect to its evaluation and possible revision of the accreditation requirements. The following steps are recommended with respect to state-based reinsurance regulatory modernization efforts:

- **Amend the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation.** The Task Force will consider amendments to Model #785 and Model #786 in order to incorporate key elements of the Framework Proposal.

- **Provide Guidance to the F Committee on Key Elements of Reinsurance Framework for Accreditation Purposes.** Once the key elements have been agreed upon by the Task force, it will submit the information to the F Committee as guidance it may use when reviewing any individual state reforms to reduce collateral. These key elements would not be required of all states; rather, they would be applicable to any state choosing to implement related reinsurance regulatory reforms.[1]

[1] It should be noted that any proposed changes to the accreditation standards would not require a state to reduce its reinsurance collateral requirements. Under the Accreditation Interlineations, it is only required that a state demonstrate that its laws and administrative practices result in solvency regulation that is similar in force and no less effective than the standard. This has been interpreted to mean that a state may comply by demonstrating that its laws result in solvency regulation that is more effective than the standard.

Attachment:

Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes

Laws and Regulations:
The Reinsurance Framework provides that reinsurers may continue to operate under the current Credit for Reinsurance Model Law. Therefore, states would not be required to adopt the new reinsurance collateral reduction framework. However, for those states choosing to reduce collateral for nonadmitted reinsurers, the following elements should be required to be evident in a state's laws and/or regulations. Further, states should be required to report certain information on a periodic basis including a listing of approved reinsurers, a listing of approved non-U.S. jurisdictions and certain details regarding domestic insurers that are taking credit for reinsurance ceded under reduced-collateral provisions. This information would be provided to the F Committee, and it could take further action based on this, if deemed necessary.

1. Requirements for Eligible Assuming Insurers

- Eligible assuming insurer (as determined by order of the commissioner) maintains capital and surplus of no less than $250 million.

- Eligible assuming insurer maintains a secure financial strength rating from at least two approved rating agencies. The maximum collateral reduction allowed for an eligible assuming insurer is consistent with the following table. The lowest financial strength rating shall be used in establishing the maximum amount of the collateral reduction.

Collateral	Best	S&P	Moody's	Fitch
0%	A++	AAA	Aaa	AAA
10%	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
20%	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
100%	B, B-, C++, C+, C, C-, D, E, F	BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD

- Eligible assuming insurer submits to the commissioner a properly executed Form AR-1 stipulating that the reinsurer submits to the jurisdiction of U.S. courts, appoints an agent for service of process in the United States, and agrees to post 100% collateral for its United States liabilities if it resists enforcement of a final U.S. judgment.

- Eligible assuming insurer must file with the commissioner, both upon initial application and annually thereafter, copies of (1) audited financial statements, regulatory filings and actuarial opinions filed with its domiciliary supervisor; (2) a report in the form of the applicable NAIC Annual Filing Blank, either Schedule F or Schedule S; (3) a report of recoverables in dispute or more than 90 days past due; (4) the report of an independent auditor on the financial statements of the insurance enterprise; and (5) a certification from the domiciliary supervisor that the eligible assuming insurer is in good standing, and a list of any regulatory actions against the reinsurer.

2. Evaluation of Non-U.S. Jurisdictions

- The commissioner shall evaluate the reinsurance supervisory systems of non-U.S. jurisdictions, both initially and on an ongoing basis, consider the rights, benefits and the extent of reciprocal recognition afforded by non-U.S. jurisdictions to reinsurers licensed and domiciled in the U.S., determine the appropriate supervisory recognition approach for such jurisdictions, and create and publish a list of jurisdictions whose reinsurers may be approved by the commissioner as eligible assuming insurers. [*Note: Florida in its regulation incorporates reciprocal recognition by requiring that the non-U.S. jurisdiction allows U.S. reinsurers access to the market of the domiciliary jurisdiction on terms and conditions that are at least as favorable as those provided in Florida law and regulations for unaccredited non-U.S. assuming insurers.*]

The Framework does not provide a detailed list of factors that the commissioner should evaluate, but it references the IAIS Guidance Paper on Mutual Recognition of Reinsurance Supervision, which provides that supervisors should take into account some or all of the following:

- o The other jurisdiction's adherence to IAIS Standard No. 8, Standard on Supervision of Reinsurers and Principle No. 6, Principles on Minimum Requirements for Reinsurance Supervision and any other relevant IAIS supervisory papers applicable to reinsurance;
- o The other jurisdiction's international assessment (e.g. Financial Sector Assessment Programme) where such documents are available;
- o The other jurisdiction's self-assessment where one has been undertaken;
- o The terms of any existing Memorandum of Understanding (MoU) or Multilateral Memorandum of Understanding (MMoU);
- o The legal framework in the other jurisdiction, including whether ceding insurers receive equal and fair treatment under insolvency laws;
- o The technical competence, capabilities and efficiency of the other jurisdiction, including, but not limited to, such items as legal protections and financial resources; operational independence; accountability; maintenance of and access to sufficient human resources;
- o The appropriate treatment of confidential information; and
- o The transparency of regulatory systems and decision making processes.

[Note: Florida in its regulation provides that if the NAIC issues findings that certain jurisdictions should be considered eligible jurisdictions, the commissioner may adopt this list. This may be a more preferable method of evaluating these jurisdictions by NAIC member states due to efficiency and uniformity concerns.]

- The state shall enter into information sharing and regulatory cooperation agreement with qualified non-U.S. jurisdiction.

<u>Regulatory Practices and Procedures:</u>
The Framework sets forth certain requirements for the state of domicile of the ceding insurer taking credit for business ceded to a non-U.S. insurer without posting collateral. For those states choosing to reduce collateral for nonadmitted reinsurers, the Committee should consider the following criteria when determining whether such state maintains an acceptable level of prudential supervision:

- Appropriate staff expertise (reinsurance contract law, international accounting, reinsurance industry, etc.);
- Experience in regulating sophisticated market participants including undertaking appropriate enforcement actions as needed; and
- Appropriate staff size, depth and experience in regulating reinsurance transactions, including taking into account ceded premium volume. Criteria relating to ceded premium volume will not unfairly discriminate against otherwise qualified small jurisdictions. *[Note: Concerns were raised to the Task Force regarding the necessity of ceded premium volume.]*