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## 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 21<sup>st</sup>. This act includes the Nonadmitted and Reinsurance Reform Act (NRRRA), which becomes effective 1-year after its enactment, as well as creates the Federal Insurance Office (FIO). The NRRRA 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 recommendations were exposed at the Summer National Meeting for a comment period ending on September 16, 2010. After reviewing all comments, the Task Force has prepared the attached revised draft for consideration. 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.<sup>1</sup>

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<sup>1</sup> 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 disclose publically a listing of approved reinsurers and approved non-U.S. jurisdictions on a periodic basis.

1. Requirements for Eligible Assuming Insurers

- a. Applicable Reinsurance Contracts. The provisions of this standard shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the implementing statute or regulation. Affiliated reinsurance transactions may receive the same opportunity for reduced collateral requirements as all other reinsurance transactions.
- b. Eligible assuming insurer (as determined by order of the commissioner) maintains capital and surplus of no less than \$250 million. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least \$250 million and a central fund containing a balance of at least \$250 million.
- c. 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. The commissioner may in his or her discretion require additional collateral, if deemed appropriate.

<u>Collateral</u>	<u>A.M. Best</u>	<u>Standard &amp; Poor’s</u>	<u>Moody’s</u>	<u>Fitch</u>
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

- d. Eligible assuming insurer submits to the commissioner a properly executed Form AR-1, or equivalent document deemed acceptable to the commissioner, 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.
- e. 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 a form substantially similar to 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.

f. In order to facilitate the prompt payment of claims, an eligible assuming insurer would not have to post collateral for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a defined catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the respective eligible assuming insurer continuing to pay claims in a timely manner. Reinsurance recoverables for only the following lines of business as reported on the NAIC annual financial statement related specifically to the catastrophic occurrence will be included in the deferral:

- Line 1: Fire
- Line 2: Allied Lines
- Line 3: Farmowners multiple peril
- Line 4: Homeowners multiple peril
- Line 5: Commercial multiple peril
- Line 9: Inland Marine
- Line 12: Earthquake
- Line 21: Auto physical damage

2. Evaluation of Non-U.S. Jurisdictions

a. 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. Factors to be considered in the determination of the eligibility of the non-U.S. jurisdiction include, but are not limited, to the following:

- Reciprocal treatment of U.S. reinsurers.
- Any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers.
- The jurisdiction adequately and promptly enforces final U.S. judgments or arbitration awards.
- Relevant international standards with respect to mutual recognition of reinsurance supervision; e.g., IAIS guidance papers on mutual recognition of reinsurance supervision or other related documents.

b. If the NAIC issues advisory findings or recommendations that certain jurisdictions should be considered eligible jurisdictions, the commissioner may adopt this list.

c. The non-U.S. jurisdiction agrees to share information and cooperate with the commissioner with respect to the applicable assuming insurer.

Regulatory Practices and Procedures:

***[Staff Note: The F Committee will review this section and determine any applicable standards as deemed appropriate]***



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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 recommendations were exposed at the Summer National Meeting for a comment period ending on September 16, 2010. After reviewing all comments, the Task Force has prepared the attached revised draft for consideration. 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:

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- a. Applicable Reinsurance Contracts.<sup>2</sup> The provisions of this standard shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the implementing statute or regulation. Affiliated reinsurance transactions may receive the same opportunity for reduced collateral requirements as all other reinsurance transactions.
- b. Eligible assuming insurer (as determined by order of the commissioner) maintains capital and surplus of no less than \$250 million. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least \$250 million and a central fund containing a balance of at least \$250 million.
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- d. Eligible assuming insurer submits to the commissioner a properly executed Form AR-1, or equivalent document deemed acceptable to the commissioner, 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.

<sup>2</sup> ~~The Reinsurance Regulatory Modernization Framework contains the following provision: “In an effort to better coordinate the collateral modernization reforms included in this proposal with the life insurance reserve reform efforts currently in process, this proposal would not be applicable to life reinsurance contracts until the earlier of 24 months from the effective date of this proposal, or the implementation of U.S. principles based reserving standards for life insurance.” The Reinsurance Task Force requests comments on whether this provision should be incorporated into the Recommendations.~~

e. 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 a~~ form substantially similar to ~~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.

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