CLIENT ALERT

Proposed Revisions to the NAIC Credit for Reinsurance Model Law and Regulation to Incorporate the Terms of the Covered Agreement

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On June 21, 2018, the Reinsurance (E) Task Force (the "Task Force") of the National Association of Insurance Commissioners (the "NAIC") exposed for comment proposed revisions to the NAIC Credit for Reinsurance Model Law and the NAIC Credit for Reinsurance Model Regulation (the "Credit for Reinsurance Models"). These proposed revisions would implement the reinsurance collateral provisions of the covered agreement on prudential measures regarding insurance and reinsurance entered into by the United States (the "U.S.") and the European Union (the "EU") on September 22, 2017 (the "Covered Agreement"). Prior to proposing these revisions, the Task Force held a public hearing on February 20, 2018, which was attended by representatives from U.S. domestic insurers, international reinsurers and various trade associations. The proposed revisions to the Credit for Reinsurance Models reflect some of the comments made during that public hearing.

Background

The NAIC has spent many years and held numerous meetings addressing the equities of requiring non-U.S. reinsurers to post collateral for the benefit of U.S. ceding insurers while concurrently exempting U.S.-licensed reinsurers from those same collateral requirements. Traditionally, the one-hundred percent reinsurance collateral rule applied to non-U.S. reinsurers regardless of the reinsurer's financial strength or ratings, or the quality of the reinsurer's domestic regulator. In 2011, however, the NAIC adopted amendments to the Credit for Reinsurance Models that created the framework for reducing the reinsurance collateral requirements applicable to non-U.S. reinsurers. The reduced collateral amendments to the Credit for Reinsurance Models are based on an assessment of the effectiveness and appropriateness of the reinsurance supervisory system employed by the non-U.S. reinsurer's domestic jurisdiction, as well as the capital and surplus requirements, financial strength ratings and other standards imposed on the non-U.S. reinsurer.

While the NAIC was modifying its credit for reinsurance rules, the U.S. Congress debated and ultimately adopted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") which included the Nonadmitted and Reinsurance Reform Act (the "NRRA"). The NRRA legislated the process whereby the Secretary of the U.S. Department of Treasury ("Treasury") and the U.S. Trade Representative (the "USTR") could negotiate bilateral agreements with one or more foreign governments, authorities or regulatory entities regarding prudential measures with respect to the business of insurance or reinsurance. Pursuant to Dodd-Frank, a covered agreement must achieve a level of protection for U.S. insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under state laws or regulations.

In the fall of 2015, the Federal Insurance Office ("FIO") (established within Treasury by Dodd-Frank) and the USTR advised Congress that a covered agreement with the EU would be beneficial in terms of promoting insurance-sector oversight, policyholder protection, and national and global financial stability, and would afford U.S. insurers and reinsurers operating in the EU a more fair and balanced regulatory scheme. In November of 2015, FIO and the USTR began jointly negotiating the legal text of the Covered Agreement with the EU, which was then submitted to Congress and signed on September 22, 2017.

Revisions to Address Conformity with the Covered Agreement

A covered agreement may pre-empt inconsistent state laws that result in less favorable treatment of a non-U.S. insurer that is subject to a covered agreement than a U.S. insurer that is licensed in the state. Unless revised to incorporate the terms of the Covered Agreement, state credit for reinsurance laws based on the current Credit for Reinsurance Models may be subject to federal pre-emption beginning in January of 2022. By revising the Credit for Reinsurance Models to incorporate the terms of the Covered Agreement, the NAIC is paving the way for each state to similarly revise its credit for reinsurance laws to avoid federal pre-emption of these laws by the Covered Agreement.

Pre-emption Time Frame

The Director of FIO, after consultation with the USTR and an affected state, is charged with determining if a state's credit for reinsurance laws and regulations will be pre-empted by the Covered Agreement. The Director must determine whether a state's laws and regulations are inconsistent with the Covered Agreement and whether they treat a non-U.S. reinsurer less favorably than a reinsurer licensed in the state. By July of 2020, the U.S. must begin deliberations on federal pre-emption of state insurance laws and must complete such deliberations and render a determination by January of 2022. Faced with the specter of federal pre-emption of a state's credit for reinsurance regulatory scheme, the NAIC is ambitiously working to present a formal draft of revisions to the Credit for Reinsurance Models at the 2018 NAIC Summer National Meeting, with the aim of adopting such revisions at the 2018 NAIC Fall National Meeting.

Summary of Proposed Amendments to Credit for Reinsurance Models

The proposed changes to the Credit for Reinsurance Models would result in three distinct categories of non-U.S. reinsurers eligible for either reduced or "zero reinsurance collateral." As proposed, the Credit for Reinsurance Models would retain the current approach to reduced reinsurance collateral afforded to "certified reinsurers" who satisfy several financial and rating standards and are domiciled in jurisdictions that the NAIC has recognized as Qualified Jurisdictions.

In addition, the proposed amendments to the Credit for Reinsurance Models would create two new categories of non-U.S. reinsurers subject to the zero reinsurance collateral requirement. Like the current Qualified Jurisdiction/certified reinsurer tests for reduced collateral, the new proposals related to the zero reinsurance collateral condition comprise a two-part process: (1) the non-U.S. reinsurer's domestic jurisdiction (or location of its head office) must satisfy specified conditions in order to be deemed a "Reciprocal Jurisdiction" by the ceding insurer's domestic state and (2) the reinsurer must satisfy financial, rating and commercial standards (e.g., minimum capital and surplus, minimum solvency or capital ratios, submission to U.S. jurisdiction, absence of participation in a solvent scheme of arrangement, submission of certain documentation to the U.S. regulatory bodies, prompt payment of claims, etc.). The proposed zero reinsurance collateral categories are as follows:

1. The Covered Agreement/Reciprocal Jurisdiction Standard. Under this proposal, which carries out the standards of the Covered Agreement, zero reinsurance collateral would be required from a qualifying reinsurer domiciled or with its head office in a jurisdiction that has entered into a covered agreement with the U.S. and is recognized as a Reciprocal Jurisdiction by the ceding insurer's domestic insurance commissioner; and

2. The Enhanced Qualified Jurisdiction Standard. Under this proposal, which exists outside the covered agreement context, zero reinsurance collateral would be required from a qualifying non-U.S. reinsurer that is domiciled or has its head office in a Qualified Jurisdiction, as determined by the NAIC, provided such Qualified Jurisdiction meets additional standards resulting in a designation by the ceding insurer's domestic state as a "Reciprocal Jurisdiction," including:

    a. reciprocal credit for reinsurance standards applied to U.S. reinsurers,

    b. the absence of "local presence" requirements applied to U.S. reinsurers, and

    c. statutory or regulatory recognition by the Qualified Jurisdiction that insurers and insurance groups that are domiciled or maintain their headquarters in a U.S. state (accredited by the NAIC) shall be subject to worldwide group supervision (including group capital, governance and solvency) by such U.S. state and will not be subject by the Qualified Jurisdiction to group supervision at the level of the worldwide parent undertaking of the insurance group.

Monitoring Compliance by Reciprocal Jurisdictions

The proposed revisions aim to police compliance with the standards applicable to assuming reinsurers in Reciprocal Jurisdictions. To be eligible for the elimination of the requirement to post collateral, an assuming reinsurer must execute a form appended to the Credit for Reinsurance Models and thereby agree to:

- provide prompt notice to the commissioner of the ceding insurer's domiciliary state if its capital and surplus and, as applicable, solvency capital requirement ("SCR") or risk-based capital ("RBC") ratio fall below the Credit for Reinsurance Models' required minimum;

- consent to jurisdiction of the courts of the ceding insurer's domiciliary state and appoint the domiciliary state's commissioner for service of process; and

- pay all final judgments obtained by the ceding insurer against the assuming reinsurer.

Credit will be allowed for cessions to a Reciprocal Jurisdiction assuming reinsurer only if the reinsurance agreement includes provisions that require the assuming reinsurer to:

- fully collateralize all its assumed liabilities under a reinsurance agreement if the assuming reinsurer resists enforcement of a final judgment for a claim ceded under the reinsurance agreement; and

- represent that it is not participating in any solvent scheme of arrangement involving any ceding insurer in the ceding insurer's domiciliary state and, should the assuming reinsurer enter into such an arrangement, provide security in an amount equal to one-hundred percent of the liabilities attributable to the ceding insurer consistent with the terms of the scheme.

If an assuming reinsurer from a Reciprocal Jurisdiction fails to meet the requirements set forth in the Credit for Reinsurance Models, the ceding insurer's domiciliary commissioner may (a) revoke or suspend the eligibility of the assuming reinsurer to benefit from the collateral elimination, (b) require the assuming reinsurer to post security as would be required by an unaccredited or unlicensed reinsurer, or (c) adopt any similar requirement that would have substantially the same regulatory impact as security. The revocation arguably impacts the assuming reinsurer's agreements that pre-date the loss of eligibility, thereby potentially allowing a ceding insurer's domiciliary commissioner to require that such assuming reinsurer post security for these reinsurance agreements in order for the ceding insurer to obtain statutory reinsurance credit.

The NAIC will maintain a list of Reciprocal Jurisdictions that state insurance commissioners may defer to in order to recognize a Reciprocal Jurisdiction. Each state commissioner will also maintain a list of assuming reinsurers from Qualified Jurisdictions that have gained the status of an assuming reinsurer from a Reciprocal Jurisdiction and a state commissioner may defer to another state's determination of an eligible assuming reinsurer.

Conclusion

The proposed revisions to the Credit for Reinsurance Models are meant to be prospective and apply only to reinsurance agreements entered into, amended or renewed after the ceding insurer's domiciliary state enacts the revisions into law ("adoption") and only with respect to losses incurred and reserves reported from and after the later of (i) adoption or (ii) the effective date of such new reinsurance agreement, amendment or renewal.

The public comment period for the revisions the Reinsurance Model Law concludes on July 23, 2018. The Task Force will consider comments received on the proposed amendments to the Credit for Reinsurance Models during the 2018 NAIC Summer National Meeting to be held in Boston from August 4-7.

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

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