CLIENT ALERT

Covered Agreement Update: NAIC Proposes Second Round of Revisions to Credit for Reinsurance Model Law and Regulation

October 12, 2018

AUTHORS

Allison J. Tam | Leah Campbell | Deidre B. Derrig

I. Introduction

On September 25, 2018, the Reinsurance 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 (the "Model Law") and NAIC Credit for Reinsurance Model Regulation (the "Model Regulation" and together with the Model Law, the "Credit for Reinsurance Models") in response to industry and other interested parties' comments to draft revisions of the Credit for Reinsurance Models which the Task Force released on June 21, 2018 (the "June Revisions").

II. Summary of Previously Enacted Revisions to the Credit for Reinsurance Models

Prior to 2011, a reinsurer's domicile was not part of the NAIC credit for reinsurance framework. However, as early as 2008, certain states independently began a process of certifying reinsurers from jurisdictions outside the United States (the "U.S.") for reduced reinsurance collateral partially based on whether the reinsurer's domicile was a "qualified" jurisdiction. Following in the footsteps of these states, the NAIC amended the Credit for Reinsurance Models to create a framework for reducing the reinsurance collateral requirements applicable to "certified" non-U.S. reinsurers. Part of the 2011 amendments to the Credit for Reinsurance Models was the NAIC *Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions* – a process under which the NAIC determines that certain non-U.S. jurisdictions are deemed to be "Qualified Jurisdictions" (subject to state insurance commissioner consent) because their reinsurance supervisory

systems achieve an acceptable level of effectiveness in financial solvency regulation (the "NAIC Qualified Jurisdiction Process").

Seven years later, the NAIC is again amending the Credit for Reinsurance Models in order to incorporate the zero-reinsurance collateral rules arising from the *Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance* (the "Covered Agreement") applicable to reinsurers domiciled or having a principal place of business in European Union ("EU") member jurisdictions. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, a bilateral reinsurance agreement ("BRA"), such as the Covered Agreement, may preempt an inconsistent state law that treats a non-U.S. reinsurer subject to a BRA less favorably than a U.S. insurer licensed in the state. In order to avoid possible federal preemption of state credit for reinsurance rules, states must adopt credit for reinsurance laws that are consistent with the Covered Agreement before January 2022. Further detail on the Covered Agreement can be found here. The NAIC is moving quickly to amend the Credit for Reinsurance Models in this respect, so that state legislatures and insurance regulators may act to adopt legislation and/or promulgate regulation based on newly amended Credit for Reinsurance Models which comply with the Covered Agreement.

III. June 2018: First Round of Revisions

The NAIC revision process began in February 2018, when the NAIC held a public hearing. The NAIC's initial goal was to propose changes to the Credit for Reinsurance Models in order to match the requirements of the Covered Agreement. However, commentators at the public hearing urged the NAIC to consider whether the zero-reinsurance collateral arrangement benefitting EU member jurisdiction reinsurers should properly be applied in other situations. This could include, for example, situations where the U.S. enters into a BRA with jurisdictions other than the EU and where reinsurers are domiciled in a Qualified Jurisdiction that has not entered into a BRA with the U.S. Based on this input, the NAIC decided to address other scenarios where zero-reinsurance collateral would be appropriate, while also retaining the historic 100% collateral and the reduced collateral standards applicable to reinsurers domiciled in Qualified Jurisdictions.

The June Revisions extended the zero collateral provisions not only to reinsurers domiciled in an EU member jurisdiction and governed by the Covered Agreement, but also to reinsurers domiciled in jurisdictions with a BRA, other than the Covered Agreement, and to reinsurers that satisfy other NAIC standards, described below. The "reciprocal" recognition of the U.S. is inherent in the proposed amendments to the Credit for Reinsurance Models, meaning jurisdictions that are parties to the Covered Agreement or other BRAs and certain other non-U.S. jurisdictions are all treated as "reciprocal jurisdictions" under the Credit for Reinsurance Models. For ease of reference, we have assigned different defined terms to the two different kinds of reciprocal jurisdictions, as follows:

> "**BRA Reciprocal Jurisdiction**" (as used herein): a non-U.S. jurisdiction that has entered into a BRA with the U.S. containing the same reciprocity terms agreed to in the Covered Agreement and has been recognized as a reciprocal jurisdiction by a state insurance commissioner; or

"**Enhanced Reciprocal Jurisdiction**" (as used herein): a non-U.S. jurisdiction recognized as a Qualified Jurisdiction and that meets additional requirements set forth in the June Revisions.

On a cumulative basis, the Credit for Reinsurance Models will authorize varying levels of reinsurance credit depending on the non-U.S. jurisdiction and non-U.S. reinsurer:

1. a reinsurer that must provide 100% collateral because it is not from a Qualified Jurisdiction or a Reciprocal Jurisdiction (a "Fully Collateralized Reinsurer");

2. a reinsurer from a Qualified Jurisdiction eligible to provide less than one hundred percent (100%) or no collateral (a "Certified Reinsurer");

3. a reinsurer from a BRA Reciprocal Jurisdiction eligible to post no collateral ("BRA Reciprocal Jurisdiction Reinsurer"); and

4. a reinsurer from an Enhanced Reciprocal Jurisdiction eligible to post no collateral ("Enhanced Reciprocal Jurisdiction Reinsurer").

IV. September 2018: Second Round of Revisions

At the NAIC 2018 Summer National Meeting, the Task Force considered comments on the June Revisions, as further detailed here. Feedback was generally positive, noting that the proposed amendments adequately incorporated the terms of the Covered Agreement into the Credit for Reinsurance Models. Commentators also endorsed the newly introduced concept of "Reciprocal Jurisdictions." Certain areas of concern emerged, however, and the NAIC's second round of revisions to the Credit for Reinsurance Models, exposed on September 25, 2018 (the "September Revisions"), attempted to respond to several of these concerns as detailed below.

Industry Concern: Inconsistency in treatment between Enhanced Reciprocal Jurisdiction Reinsurers and BRA Reciprocal Jurisdiction Reinsurers.

Some commentators noted that under the June Revisions, Enhanced Reciprocal Jurisdiction Reinsurers could conceivably face more regulatory hurdles than reinsurers from EU member jurisdictions or BRA Reciprocal Jurisdiction Reinsurers because of the authority granted to state insurance commissioners to impose additional requirements on Enhanced Reciprocal Jurisdiction Reinsurers − beyond those found in the Covered Agreement or a future BRA. Under the September Revisions, state insurance commissioners continue to retain the ability to require additional conditions for a jurisdiction to qualify as an Enhanced Reciprocal Jurisdiction. In sum, an Enhanced Reciprocal Jurisdiction must (1) be a Qualified Jurisdiction; (2) comply with the reciprocity provisions similar to those set forth in the Covered Agreement; and (3) meet any additional conditions imposed by a state insurance commissioner.

The minimum capital and surplus and minimum capital or solvency ratios that a reinsurer from a Reciprocal Jurisdiction (a "Reciprocal Jurisdiction Reinsurer") must maintain, however, are no longer determined by the state insurance commissioner. Rather, under the September Revisions, these minimum standards are set forth in the accompanying Model Regulation and mirror those set forth in the Covered Agreement. If a state insurance commissioner adds requirements other than those required by a BRA, the failure of a BRA Reciprocal Jurisdiction Reinsurer to adhere to such requirements will not alter a ceding insurer's ability to take credit for the reinsurance provided by the BRA Reciprocal Jurisdiction Reinsurer.

The September Revisions responded to industry criticism that the proposed amendments to the Credit for Reinsurance Models provided non-U.S. reinsurers from Qualified Jurisdictions or Reciprocal Jurisdictions with a path to zero-reinsurance collateral that is not available to U.S. reinsurers. "Reciprocal Jurisdictions" are now defined in the September Revisions as those jurisdictions having a "head office or domicile in a jurisdiction that has been recognized as a Reciprocal Jurisdiction" by the state insurance commissioner. "Head office or domicile" includes incorporation, organization or statutory commercial domicile in "any jurisdiction of the United States." This results in a reinsurer that is headquartered or domiciled in a U.S. jurisdiction (i.e. an NAIC accredited state) being eligible to receive the zero-reinsurance collateral treatment afforded to Reciprocal Jurisdiction Reinsurers. For instance, under the September Revisions, an Illinois-domiciled insurer may claim statutory reinsurance credit for reinsurance placed with a Michigan-domiciled reinsurer that is not licensed in Illinois (and assuming the Michigan-domiciled reinsurer satisfies the financial, rating and commercial standards set forth in the September Revisions to the Credit for Reinsurance Models) without the Michigan reinsurer collateralizing its assumed reinsurance liabilities.

Cumulatively, the June Revisions and September Revisions would recognize the following types of jurisdictions and corresponding reinsurer types, who are eligible to post either reduced or no collateral, as follows:

Jurisdiction Type	Corresponding Reinsurer Type (as used herein)	Amount of Collateral to be Posted
A jurisdiction that is a not a Qualified Jurisdiction or a Reciprocal Jurisdiction	"Fully Collateralized Reinsurer"	100% collateral
Qualified Jurisdiction: a non-U.S. jurisdiction that the NAIC deems to be a "Qualified Jurisdiction" utilizing the NAIC Qualified Jurisdiction Process	"Certified Reinsurer"	0−100% collateral

Reciprocal Jurisdictions:	"Reciprocal Jurisdiction Reinsurer," being either a:	
a. "**BRA Reciprocal Jurisdiction**": a non-U.S. jurisdiction that has been recognized as a reciprocal jurisdiction by the state insurance commissioner and has entered into a BRA with the U.S. that includes all the same reciprocity terms provided for in the Covered Agreement; or	"BRA Reciprocal Jurisdiction Reinsurer" or	0% collateral
b. "**Enhanced Reciprocal Jurisdiction**": any jurisdiction that has been recognized as a reciprocal jurisdiction by the state commissioner (including U.S. states), that the NAIC deems to be a Qualified Jurisdiction pursuant to the NAIC Qualified Jurisdiction Process and that meets additional requirements set forth in the September Revisions	"Enhanced Reciprocal Jurisdiction Reinsurer"	0% collateral

Industry Concern: Greater clarity and standardization required with respect to the requirements to attain Reciprocal Jurisdiction Reinsurer Status.

The NAIC will maintain a list of Reciprocal Jurisdictions utilizing a yet-to-be developed process similar to its current process to identify Qualified Jurisdictions (the "NAIC Reciprocal Jurisdiction List"). A state insurance commissioner may approve a jurisdiction not included on the NAIC Reciprocal Jurisdiction List provided it does so in compliance with applicable law, regulation or in accordance with a process published through the NAIC Committee Process. The state insurance commissioner may also remove a jurisdiction from the NAIC Reciprocal Jurisdiction List upon determining that the jurisdiction no longer meets one or more of the requirements of a Reciprocal Jurisdiction or is not in compliance with a BRA.

Under the June Revisions, the state insurance commissioner had the discretion to require a formerly deemed Reciprocal Jurisdiction Reinsurer to post collateral for its assumed liabilities upon the suspension or revocation of its Reciprocal Jurisdiction Reinsurer status. The September Revisions remove this discretion by providing that if the state insurance commissioner suspends or revokes a Reciprocal Jurisdiction Reinsurer's eligibility for zero-reinsurance collateral treatment, for all reinsurer agreements entered into after the suspension, and for all reinsurance agreements entered into before and after its revocation, the former Reciprocal Jurisdiction Reinsurer must post collateral as if it were an unauthorized assuming reinsurer and in a form acceptable to the state insurance commissioner.

Industry Concern: Credit for Reinsurance Models' approach to receivership not consistent with the Covered Agreement.

Under the Covered Agreement, a state commissioner has the discretion to require a reinsurer governed by the Covered Agreement to post collateral upon the insolvency or conservation of a U.S. domiciled ceding insurer. By contrast, under the June Revisions to the Credit for Reinsurance Models, a state commissioner is mandated to require an assuming reinsurer to fully collateralize its assumed liabilities. The September Revisions remove a state commissioner's discretion in this regard including any discretion afforded the commissioner under the Covered Agreement. Rather, a newly added provision in the September Revisions provides that "[u]pon entry of an order of rehabilitation, liquidation or conservation against the ceding insurer, the supervising court shall require an assuming insurer under this subsection to post one hundred percent (100%) collateral for the benefit of the ceding insurer or its estate."

V. Conclusion

The public comment period for the September Revisions to the Credit for Reinsurance Models concludes on October 16, 2018. It is anticipated that the final form of the revised Credit for Reinsurance Models will be adopted at the NAIC 2018 Fall National Meeting to be held in San Francisco on November 15−18, 2018.

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

Allison J. Tam
212 728 8282
atam@willkie.com

Leah Campbell
212 728 8217
lcampbell@willkie.com

Deidre B. Derrig
202 303 1274
dderrig@willkie.com

Copyright © 2018 Willkie Farr & Gallagher LLP.

This alert is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This alert may be considered advertising under applicable state laws.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.