

## **CREDIT FOR REINSURANCE MODEL LAW**

### **Preface to Credit for Reinsurance Models**

The amendments to the NAIC Credit for Reinsurance Model Law (#785) & Regulation (#786) are part of a larger effort to modernize reinsurance regulation in the United States. The NAIC initially adopted the Reinsurance Regulatory Modernization Framework Proposal during its 2008 Winter National Meeting. The NAIC recommended that this framework be implemented through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation. In addition to this proposed federal legislation, the framework also provided that changes to state insurance laws should be considered. For example, state laws to establish requirements under which states would regulate qualified reinsurers, and also to consider reinsurance risk diversification and notice requirements for ceding insurers.

On July 21, 2010, Congress passed and the President signed related federal legislation, the Nonadmitted and Reinsurance Reform Act, which became effective July 21, 2011. While this act does not implement the NAIC framework, it does preempt the extraterritorial application of state credit for reinsurance law and permits states of domicile to proceed forward with reinsurance collateral reforms on an individual basis if they are accredited. This federal legislation also does not prohibit the states from acting together, through the NAIC, to achieve the reinsurance modernization framework goals. In addition to the current work on the credit for reinsurance models, the NAIC will continue its efforts to implement other aspects of the framework. These efforts will continue both through work conducted by the Reinsurance Task Force and through referrals to the appropriate groups within the NAIC. In addition, the NAIC will consider a proposal to form a new group to provide advisory support and assistance to states in the review of reinsurance collateral reduction applications. Such a process with respect to the review of applications for reinsurance collateral reduction and qualified jurisdictions should strengthen state regulation and prevent regulatory arbitrage. Such an effort would be supported by NAIC staff with substantial expertise to support the functions of such a group.

Finally, the NAIC will continue to work on requirements for NAIC review and approval of qualified jurisdictions, and will undertake a re-examination of the collateral amounts within two years from the effective date of the revisions to the models.

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## CREDIT FOR REINSURANCE MODEL LAW

### Table of Contents

Section 1.	Purpose
Section 2.	Credit Allowed a Domestic Ceding Insurer
Section 3.	Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2
Section 4.	Qualified U.S. Financial Institutions
Section 5.	Rules and Regulations
Section 6.	Reinsurance Agreements Affected

### Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

### Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

- A. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is licensed to transact insurance or reinsurance in this state.

**Drafting Note:** A state that provides for licensing of reinsurance by line, for consistency should adopt an amended version of Subsection A requiring the assuming insurer to be “licensed to transact reinsurance in this state.”

- B. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is accredited by the commissioner as a reinsurer in this state. In order to be eligible for accreditation, a reinsurer must:
- (1) File with the commissioner evidence of its submission to this state’s jurisdiction;
  - (2) Submit to this state’s authority to examine its books and records;
  - (3) Be licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, be entered through and licensed to transact insurance or reinsurance in at least one state;

- (4) File annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; and
- (5) Demonstrate to the satisfaction of the commissioner that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer is deemed to meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than \$20,000,000 and its accreditation has not been denied by the commissioner within ninety (90) days after submission of its application.

**Drafting Note:** To qualify as an accredited reinsurer, an assuming insurer must meet all of the requirements and the standards set forth in Subsection B. If the commissioner of insurance determines that the assuming insurer has failed to continue to meet any of these qualifications, the commissioner may, upon written notice and hearing, revoke accreditation.

- C. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is domiciled in, or in the case of a U.S. branch of an alien assuming insurer is entered through, a state that employs standards regarding credit for reinsurance substantially similar to those applicable under this statute and the assuming insurer or U.S. branch of an alien assuming insurer:
  - (a) Maintains a surplus as regards policyholders in an amount not less than \$20,000,000; and
  - (b) Submits to the authority of this state to examine its books and records.
- (2) The requirement of Section 2 C(1)(a) does not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system.

**Drafting Note:** The term “substantially similar” means standards that equal or exceed the standards of the enacting state, as determined by the commissioner of the enacting state. It is expected that the NAIC will maintain a list of states whose laws establish standards that equal or exceed the standards of this model act.

- D. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution, as defined in Section 4B, for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. To enable the commissioner to determine the sufficiency of the trust fund, the assuming insurer shall report annually to the commissioner information substantially the same as that required to be reported on the NAIC Annual Statement form by licensed insurers. The assuming insurer shall submit to examination of its books and records by the commissioner and bear the expense of examination.
- (2) (a) Credit for reinsurance shall not be granted under this subsection unless the form of the trust and any amendments to the trust have been approved by:
  - (i) The commissioner of the state where the trust is domiciled; or
  - (ii) The commissioner of another state who, pursuant to the terms of the trust instrument, has accepted principal regulatory oversight of the trust.
- (b) The form of the trust and any trust amendments also shall be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the United States. The trust shall vest legal title to its assets in its trustees for the benefit of the assuming insurer’s U.S. ceding insurers, their assigns and successors in interest. The trust and the assuming insurer shall be subject to examination as determined by the commissioner.
- (c) The trust shall remain in effect for as long as the assuming insurer has outstanding obligations due under the reinsurance agreements subject to the trust. No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing the balance of the trust and listing the trust’s investments at the preceding year-end and shall certify the date of termination of the trust, if so planned, or certify that the trust will not expire prior to the following December 31.

- (3) The following requirements apply to the following categories of assuming insurer:
- (a) The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers, and, in addition, the assuming insurer shall maintain a trustee surplus of not less than \$20,000,000, except as provided in Paragraph 3(b) of this subsection.
  - (b) At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trustee surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trustee surplus may not be reduced to an amount less than thirty percent (30%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust.
  - (c)
    - (i) In the case of a group including incorporated and individual unincorporated underwriters:
      - (I) For reinsurance ceded under reinsurance agreements with an inception, amendment or renewal date on or after January 1, 1993, the trust shall consist of a trustee account in an amount not less than the respective underwriters' several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any underwriter of the group;
      - (II) For reinsurance ceded under reinsurance agreements with an inception date on or before December 31, 1992, and not amended or renewed after that date, notwithstanding the other provisions of this Act, the trust shall consist of a trustee account in an amount not less than the respective underwriters' several insurance and reinsurance liabilities attributable to business written in the United States; and
      - (III) In addition to these trusts, the group shall maintain in trust a trustee surplus of which \$100,000,000 shall be held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account; and
    - (ii) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of regulation and solvency control by the group's domiciliary regulator as are the unincorporated members.
    - (iii) Within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, the group shall provide to the commissioner an annual certification by the group's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the group.

- (d) In the case of a group of incorporated underwriters under common administration, the group shall:
  - (i) Have continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to making application for accreditation;
  - (ii) Maintain aggregate policyholders' surplus of at least \$10,000,000,000;
  - (iii) Maintain a trust fund in an amount not less than the group's several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group pursuant to reinsurance contracts issued in the name of the group;
  - (iv) In addition, maintain a joint trustee surplus of which \$100,000,000 shall be held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group as additional security for these liabilities; and
  - (v) Within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, make available to the commissioner an annual certification of each underwriter member's solvency by the member's domiciliary regulator and financial statements of each underwriter member of the group prepared by its independent public accountant.

**Drafting Note:** Unless otherwise stated, "commissioner" refers to the commissioner of insurance in the state where credit or a reduction from liability is taken.

**Drafting Note:** Consideration was given to deferring to state capital and surplus requirements as a threshold for the trustee surplus, but it was concluded that, on the basis of risk exposure and current industry security practices, the standards for credit should be higher under Subsection D. The \$100,000,000 trustee surplus requirement for a group including incorporated and individual unincorporated underwriters reflects the higher financial standards currently found among the states for a group of this type. The \$20,000,000 trustee surplus requirement is an option available to assuming insurers that do not satisfy both the licensing and financial standards of Subsection B or C.

E. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the commissioner as a reinsurer in this state and secures its obligations in accordance with the requirements of this subsection.

- (1) In order to be eligible for certification, the assuming insurer shall meet the following requirements:
  - (a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner pursuant to Paragraph (3) of this subsection;
  - (b) The assuming insurer must maintain minimum capital and surplus, or its equivalent, in an amount to be determined by the commissioner pursuant to regulation;
  - (c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner pursuant to regulation;
  - (d) The assuming insurer must agree to submit to the jurisdiction of this state, appoint the commissioner as its agent for service of process in this state, and agree to provide security for 100 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment;
  - (e) The assuming insurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis; and
  - (f) The assuming insurer must satisfy any other requirements for certification deemed relevant by the commissioner.

- (2) An association including incorporated and individual unincorporated underwriters may be a certified reinsurer. In order to be eligible for certification, in addition to satisfying requirements of Paragraph (1):
  - (a) The association shall satisfy its minimum capital and surplus requirements through the capital and surplus equivalents (net of liabilities) of the association and its members, which shall include a joint central fund that may be applied to any unsatisfied obligation of the association or any of its members, in an amount determined by the commissioner to provide adequate protection;
  - (b) The incorporated members of the association shall not be engaged in any business other than underwriting as a member of the association and shall be subject to the same level of regulation and solvency control by the association's domiciliary regulator as are the unincorporated members; and
  - (c) Within ninety (90) days after its financial statements are due to be filed with the association's domiciliary regulator, the association shall provide to the commissioner an annual certification by the association's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.
- (3) The commissioner shall create and publish a list of qualified jurisdictions, under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be considered for certification by the commissioner as a certified reinsurer.
  - (a) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. A jurisdiction may not be recognized as a qualified jurisdiction if the commissioner has determined that the jurisdiction does not adequately and promptly enforce final U.S. judgments and arbitration awards. Additional factors may be considered in the discretion of the commissioner.
  - (b) A list of qualified jurisdictions shall be published through the NAIC Committee Process. The commissioner shall consider this list in determining qualified jurisdictions. If the commissioner approves a jurisdiction as qualified that does not appear on the list of qualified jurisdictions, the commissioner shall provide thoroughly documented justification in accordance with criteria to be developed under regulations.
  - (c) U.S. jurisdictions that meet the requirement for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.
  - (d) If a certified reinsurer's domiciliary jurisdiction ceases to be a qualified jurisdiction, the commissioner has the discretion to suspend the reinsurer's certification indefinitely, in lieu of revocation.
- (4) The commissioner shall assign a rating to each certified reinsurer, giving due consideration to the financial strength ratings that have been assigned by rating agencies deemed acceptable to the commissioner pursuant to regulation. The commissioner shall publish a list of all certified reinsurers and their ratings.
- (5) A certified reinsurer shall secure obligations assumed from U.S. ceding insurers under this subsection at a level consistent with its rating, as specified in regulations promulgated by the commissioner.

- (a) In order for a domestic ceding insurer to qualify for full financial statement credit for reinsurance ceded to a certified reinsurer, the certified reinsurer shall maintain security in a form acceptable to the commissioner and consistent with the provisions of Section 3, or in a multibeneficiary trust in accordance with Subsection D of this section, except as otherwise provided in this subsection.
  - (b) If a certified reinsurer maintains a trust to fully secure its obligations subject to Subsection D of this section, and chooses to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer shall maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security as permitted by this subsection or comparable laws of other U.S. jurisdictions and for its obligations subject to Subsection D of this section. It shall be a condition to the grant of certification under Subsection E of this section that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.
  - (c) The minimum trustee surplus requirements provided in Subsection D are not applicable with respect to a multibeneficiary trust maintained by a certified reinsurer for the purpose of securing obligations incurred under this subsection, except that such trust shall maintain a minimum trustee surplus of \$10,000,000.
  - (d) With respect to obligations incurred by a certified reinsurer under this subsection, if the security is insufficient, the commissioner shall reduce the allowable credit by an amount proportionate to the deficiency, and has the discretion to impose further reductions in allowable credit upon finding that there is a material risk that the certified reinsurer's obligations will not be paid in full when due.
  - (e) For purposes of this subsection, a certified reinsurer whose certification has been terminated for any reason shall be treated as a certified reinsurer required to secure 100 percent of its obligations.
    - (i) As used in this subsection, the term "terminated" refers to revocation, suspension, voluntary surrender and inactive status.
    - (ii) If the commissioner continues to assign a higher rating as permitted by other provisions of this section, this requirement does not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended.
  - (6) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction's certification, and has the discretion to defer to the rating assigned by that jurisdiction, and such assuming insurer shall be considered to be a certified reinsurer in this state.
  - (7) A certified reinsurer that ceases to assume new business in this state may request to maintain its certification in inactive status in order to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer shall continue to comply with all applicable requirements of this subsection, and the commissioner shall assign a rating that takes into account, if relevant, the reasons why the reinsurer is not assuming new business.
- F. Credit shall be allowed when the reinsurance is ceded to an assuming insurer not meeting the requirements of Subsections A, B, C, D or E of this section, but only as to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

**Drafting Note:** For purposes of this subsection, "jurisdiction" refers to those jurisdictions other than the United States and also to any state, district or territory of the United States. Subsection E allows credit to ceding insurers that are mandated by these jurisdictions to cede to state-owned or controlled insurance or reinsurance companies or to participate in pools, guaranty associations or residual market mechanisms.



- G. If the assuming insurer is not licensed, accredited or certified to transact insurance or reinsurance in this state, the credit permitted by Subsections C and D of this section shall not be allowed unless the assuming insurer agrees in the reinsurance agreements:
- (1)
    - (a) That in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance agreement, the assuming insurer, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, will comply with all requirements necessary to give the court jurisdiction, and will abide by the final decision of the court or of any appellate court in the event of an appeal; and
    - (b) To designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the ceding insurer.
  - (2) This subsection is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if this obligation is created in the agreement.
- H. If the assuming insurer does not meet the requirements of Subsections A, B or C, the credit permitted by Subsection D or E of this section shall not be allowed unless the assuming insurer agrees in the trust agreements to the following conditions:
- (1) Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by Subsection D(3) of this section, or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund.
  - (2) The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic insurance companies.
  - (3) If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. ceding insurers of the grantor of the trust, the assets or part thereof shall be returned by the commissioner with regulatory oversight to the trustee for distribution in accordance with the trust agreement.
  - (4) The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.
- I. If an accredited or certified reinsurer ceases to meet the requirements for accreditation or certification, the commissioner may suspend or revoke the reinsurer's accreditation or certification.
- (1) The commissioner must give the reinsurer notice and opportunity for hearing. The suspension or revocation may not take effect until after the commissioner's order on hearing, unless:
    - (a) The reinsurer waives its right to hearing;
    - (b) The commissioner's order is based on regulatory action by the reinsurer's domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer's eligibility to transact insurance or reinsurance business in its domiciliary jurisdiction or in the primary certifying state of the reinsurer under Subparagraph E(6) of this section; or
    - (c) The commissioner finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the commissioner's action.

- (2) While a reinsurer's accreditation or certification is suspended, no reinsurance contract issued or renewed after the effective date of the suspension qualifies for credit except to the extent that the reinsurer's obligations under the contract are secured in accordance with Section 3. If a reinsurer's accreditation or certification is revoked, no credit for reinsurance may be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured in accordance with Subsection E(5) or Section 3.

J. Concentration Risk.

- (1) A ceding insurer shall take steps to manage its reinsurance recoverables proportionate to its own book of business. A domestic ceding insurer shall notify the commissioner within thirty (30) days after reinsurance recoverables from any single assuming insurer, or group of affiliated assuming insurers, exceeds fifty percent (50%) of the domestic ceding insurer's last reported surplus to policyholders, or after it is determined that reinsurance recoverables from any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the domestic ceding insurer.
- (2) A ceding insurer shall take steps to diversify its reinsurance program. A domestic ceding insurer shall notify the commissioner within thirty (30) days after ceding to any single assuming insurer, or group of affiliated assuming insurers, more than twenty percent (20%) of the ceding insurer's gross written premium in the prior calendar year, or after it has determined that the reinsurance ceded to any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the domestic ceding insurer.

**Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;
- C. (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;

- (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

**Drafting Note:** Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

- D. Any other form of security acceptable to the commissioner.

**Drafting Note:** There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

#### **Section 4. Qualified U.S. Financial Institutions**

- A. For purposes of Section 3C, a "qualified U.S. financial institution" means an institution that:
  - (1) Is organized or (in the case of a U.S. office of a foreign banking organization) licensed, under the laws of the United States or any state thereof;
  - (2) Is regulated, supervised and examined by U.S. federal or state authorities having regulatory authority over banks and trust companies; and
  - (3) Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.

**Drafting Note:** The NAIC's Securities Valuation Office (SVO) maintains, on a current basis, a list of all U.S. financial institutions that have, upon application to the SVO, been determined to meet the eligibility standards of its *Purposes and Procedures Manual*. These standards, developed by the NAIC's Letter of Credit (EX4) Study Group, make use of nationally recognized ratings services, and are more rigorous in the case of foreign banking organizations (whose standby letters of credit must be issued or confirmed by a qualified U.S. financial institution) than those that are applicable to domestic financial institutions whose standby letters of credit would be considered acceptable.

- B. A "qualified U.S. financial institution" means, for purposes of those provisions of this law specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:
  - (1) Is organized, or, in the case of a U.S. branch or agency office of a foreign banking organization, licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and
  - (2) Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.

**Drafting Note:** Because assets held in a fiduciary capacity are not subject to the claims of the trustee's creditors, and because the trust departments of all U.S. financial institutions (including U.S. branch or agency offices of foreign banking organizations having fiduciary powers in the U.S.) are regulated, supervised and examined by the institution's primary U.S. bank regulatory authority (federal or state), there is no need to apply additional standards measuring the financial condition or standing of the institution, as in the case of determining those institutions whose standby letter of credit obligations will be considered acceptable.

## Section 5. Rules and Regulations

- A. The commissioner may adopt rules and regulations implementing the provisions of this law.

**Drafting Note:** It is recognized that credit for reinsurance also can be affected by other sections of the enacting state's code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.

- B. The commissioner is further authorized to adopt rules and regulations applicable to reinsurance arrangements described in Paragraph (1) of this Section 5B.

**Drafting Note:** This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

- (1) A regulation adopted pursuant to this Section 5B, may apply only to reinsurance relating to:
  - (a) Life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits;
  - (b) Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period;
  - (c) Variable annuities with guaranteed death or living benefits;
  - (d) Long-term care insurance policies; or
  - (e) Such other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance.
- (2) A regulation adopted pursuant to Paragraph 1(a) or 1(b) of this Section 5B, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

**Drafting Note:** The NAIC's Actuarial Guideline XLVIII (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC Credit for Reinsurance Model Law is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to AG 48. The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules. The preceding paragraph is not intended to change the scope of, or collateral requirements for policies and treaties covered under AG 48.

- (3) A regulation adopted pursuant to this Section 5B may require the ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.
- (4) A regulation adopted pursuant to this Section 5B shall not apply to cessions to an assuming insurer that:
  - (a) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, certified in a minimum of five (5) other states; or
  - (b) Maintains at least \$250 million in capital and surplus when determined in accordance with the NAIC *Accounting Practices and Procedures Manual*, including all amendments thereto adopted by the NAIC, excluding the impact of any permitted or prescribed practices; and is

- (i) licensed in at least 26 states; or
  - (ii) licensed in at least 10 states, and licensed or accredited in a total of at least 35 states.
- (5) The authority to adopt regulations pursuant to this Section 5B does not limit the commissioner's general authority to adopt regulations pursuant to Section 5A of this law.

## **Section 6. Reinsurance Agreements Affected**

This Act shall apply to all cessions after the effective date of this Act under reinsurance agreements that have an inception, anniversary or renewal date not less than six (6) months after the effective date of this Act.

**Drafting Note:** The enacting state may wish to provide a delay in the applicability greater than six (6) months to allow time for the insurance commissioner to promulgate regulations and to allow reinsurers to prepare and submit qualifying data.

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### *Chronological Summary of Actions (All references are to the Proceedings of the NAIC).*

1984 Proc. II 9, 29, 822, 836, 837-839 (adopted).  
1986 Proc. I 9-10, 24, 799, 811, 812 (corrected).  
1987 Proc. II 15, 24, 444-448, 832, 854, 856 (amended and reprinted).  
1990 Proc. I 12-14, 851, 857-861 (amended at special plenary session September 1989 and reprinted).  
1990 Proc. I 6, 30, 840, 872, 875-878 (technical amendments adopted at winter plenary and reprinted).  
1990 Proc. II 7, 18, 748, 766, 780-783 (amended).  
1993 Proc. 4th Quarter 6, 31, 835-836, 874, 891 (amended).  
1996 Proc. 2nd Quarter 12, 12-17, 24, 862 (amended and reprinted).  
2011 Proc. 3<sup>rd</sup> Quarter 113-114, 131-137, 222-236, 289-298 (amended).  
2016 Proc. 1<sup>st</sup> Quarter Vol. I 111, 131, 138, 141, 145, 150-171 (amended).

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## CREDIT FOR REINSURANCE MODEL LAW

**This chart is intended to provide readers with additional information to more easily access state statutes, regulations, bulletins or administrative rulings related to the NAIC model. Such guidance provides readers with a starting point from which they may review how each state has addressed the model and the topic being covered. The NAIC Legal Division has reviewed each state’s activity in this area and has determined whether the citation most appropriately fits in the Model Adoption column or Related State Activity column based on the definitions listed below. The NAIC’s interpretation may or may not be shared by the individual states or by interested readers.**

**This chart does not constitute a formal legal opinion by the NAIC staff on the provisions of state law and should not be relied upon as such. Nor does this state page reflect a determination as to whether a state meets any applicable accreditation standards. Every effort has been made to provide correct and accurate summaries to assist readers in locating useful information. Readers should consult state law for further details and for the most current information.**

**CREDIT FOR REINSURANCE MODEL LAW**

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**CREDIT FOR REINSURANCE MODEL LAW**

**KEY:**

**MODEL ADOPTION:** States that have citations identified in this column adopted the most recent version of the NAIC model in a **substantially similar manner**. This requires states to adopt the model in its entirety but does allow for variations in style and format. States that have adopted portions of the current NAIC model will be included in this column with an explanatory note.

**RELATED STATE ACTIVITY:** Examples of Related State Activity include but are not limited to: older versions of the NAIC model, statutes or regulations addressing the same subject matter, or other administrative guidance such as bulletins and notices. States that have citations identified in this column **only** (and nothing listed in the Model Adoption column) have **not** adopted the most recent version of the NAIC model in a **substantially similar manner**.

**NO CURRENT ACTIVITY:** No state activity on the topic as of the date of the most recent update. This includes states that have repealed legislation as well as states that have never adopted legislation.

NAIC MEMBER	MODEL ADOPTION	RELATED STATE ACTIVITY
Alabama		ALA. ADMIN. CODE r. § 27-5b-1 to 27-5b-19 (2013) (2011 version of model).
Alaska		ALASKA STAT. § 21.12.020 (1966/2011) (previous version of model).
American Samoa	NO CURRENT ACTIVITY	
Arizona		ARIZ. REV. STAT. ANN. §§ 20-261.01 to 20-261.08 (1991/2015) (2011 version of model).
Arkansas		ARK. CODE ANN. §§ 23-62-305 to 23-62-309 (1991/2015) (2011 version of model).
California	CAL. INS. CODE §§ 922.2 to 922.9 (2017).	BULLETIN 87-10 (1987); BULLETIN 20112 (2011).
Colorado		COLO. REV. STAT. §§ 10-3-701 to 706 (2014) (2011 version of model).
Connecticut	CON. GEN. STAT. §§ 38a-85 to 38a-89 (1991/2017).	BULLETIN FS-24-2012 (2012); BULLETIN FS-25-2013 (2013).
Delaware		DEL. CODE ANN. tit. 18, § 910 (1953/2012) (2011 version of model); BULLETIN 88-1 (1988).
District of Columbia		D.C. CODE §§ 31-501 to 31-503 (1993/2015) (2011 version of model).
Florida		FLA. STAT. ANN. § 624.610 (1959/2012) (portions of 2011 model); FLA. ADMIN. CODE ANN. r. 69O-4-144.005 (1991/1997); FLA. ADMIN. CODE r. 69O-144.007 (2015) (2011 version of model).

**CREDIT FOR REINSURANCE MODEL LAW**

<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Georgia		GA. CODE ANN. § 33-7-14 (1991/2012) (2011 version of model); GA. CODE ANN. § 33-14-100 (2011).
Guam	NO CURRENT ACTIVITY	
Hawaii		HAW. REV. STAT. §§ 431:4A-101 to 431:4A-105 (1992/2014) (2011 version of model); HAW. REV. STAT. § 431:5-306 (1988/2004).
Idaho	IDAHO CODE ANN. § 41-514 (1991/2017).	
Illinois		215 ILL. COMP. STAT. 5/173.1 (1991/1997) (previous version of model).
Indiana		IND. CODE §§ 27-6-10-1 to 27-6-10-15 (1994/2012) (portions of 2011 version of model).
Iowa	IOWA CODE §§ 521B.101 to 521B.106 (2013/2017).	
Kansas		KAN. STAT. ANN. § 40-221a (1965/2002).
Kentucky		KY. REV. STAT. ANN. § 304.5-140 (1970/2004) (previous version of model).
Louisiana	LA. REV. STAT. ANN. §§ 22:651 to 22:652 (1958/2016).	Advisory Letter 2014-2 (2014).
Maine	ME. REV. STAT. ANN. tit. 24-A, § 731-B (1985/2017).	
Maryland		MD. CODE ANN., INS. §§ 5-901 to 5-916 (2013) (2011 version of model); MD. CODE REGS. 31.05.08.01 to 31.05.08.08 (1993).
Massachusetts		MASS. GEN. LAWS ch. 175, §§ 20 to 20A (1948/2015) (portions of 2011 version of model).
Michigan		MICH. COMP. LAWS §§ 500.1101 to 500.1124 (1994/2011) (previous version of model).
Minnesota		MINN. STAT. §§ 60A.09 to 60A.095 (1967/2009) (previous version of model).
Mississippi	MISS. CODE ANN. §§ 83-19-151 to 83-19-157 (1991/2017).	

**CREDIT FOR REINSURANCE MODEL LAW**

<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Missouri		MO. REV. STAT. § 375.246 (1990/2013) (2011 version of model).
Montana		MONT. CODE ANN. §§ 33-11-101 to 33-11-125 (1993/2015) (2011 version of model).
Nebraska		NEB. REV. STAT. §§ 44-416.05 to 44-44-416.10 (1985/2015) (2011 version of model).
Nevada	NEV. REV. STAT. §§ 681A.110 to 681A.240 (1971/2017).	
New Hampshire		N.H. REV. STAT. ANN. §§ 405.45 to 405.52a (1986/2013) (2011 version of model).
New Jersey		N.J. STAT. ANN. §§ 17:51B-1 to 17:51B-4 (1993/2011); N.J. ADMIN. CODE §§11:2-28.1 to 11:2-28.14 (1993/2012) (2011 version of model); BULLETIN 12-04 (2012).
New Mexico		N.M. STAT. ANN. § 59A-7-11 (1985/2014) (2011 version of model).
New York		N.Y. COMP. CODES R. & REGS. tit. 11, §§ 125.1 to 125.8 (1977/2013) (Regulation Nos. 17, 20, and 20-A) (portions of 2011 version of model); N.Y. INS. LAW § 1308 (1984/1985); Circular Letter 5 (1988).
North Carolina		N.C. GEN. STAT. §§ 58-7-20 to 58-7-30 (1985/2001) (previous version of model).
North Dakota		N.D. CENT. CODE §§ 26.1-31.2-01 to 26.1-31.2-05 (1991/2015) (2011 version of model).
Northern Marianas	NO CURRENT ACTIVITY	
Ohio		OHIO REV. CODE ANN. §§ 3901.61 to 3901.65 (1991/2014) (2011 version of model).
Oklahoma	OKLA. STAT. tit. 36, §§ 5121 to 5124 (1992/2016).	
Oregon		OR. REV. STAT. §§ 731.509 to 731.511 (1994/2013) (previous version of model).

**CREDIT FOR REINSURANCE MODEL LAW**

<b>NAIC MEMBER</b>	<b>MODEL ADOPTION</b>	<b>RELATED STATE ACTIVITY</b>
Pennsylvania		40 PA. CONS. STAT. § 482.1 (1993/2012) (2011 version of model); NOTICE 1-18-2014 (#1) (2014); NOTICE 1-25-2014 (#1 & #3) (2014).
Puerto Rico		P.R. RULE XCVIII (2012) (portions of previous model); P.R. LAWS ANN. tit. 26, § 511 (1973).
Rhode Island		R.I. GEN. LAWS §§ 27-1.1-1 to 27-1.1-10 (1991/2016) (2011 version of model).
South Carolina		S.C. CODE ANN. §§ 38-9-200 to 38-9-220 (1991/1998) (previous version of model).
South Dakota	S.D. CODIFIED LAWS §§ 58-14-1 to 58-14-33 (1993/2017).	S.D. CODIFIED LAWS §§ 58-13-4, 58-14-4 (1966).
Tennessee		TENN. CODE ANN. §§ 56-2-208 to 56-2-209 (1994/2014) (2011 version of model).
Texas		TEX. INS. CODE ANN. § 3.10 (1951/1995); § 5.75 (1955/1989) (previous version of model).
Utah	UTAH CODE ANN. §§ 31A-17-404 to 31A-17-404.3 (2016) (2011 version); UTAH ADMIN. CODE r. 590-173-8 (2017).	
Vermont		VT. STAT. ANN. tit. 8, § 3634a (1992/2014) (2011 version of model).
Virgin Islands	NO CURRENT ACTIVITY	
Virginia	VA. CODE ANN. §§ 38.2-1316.1 to 38.2-1316.8 (1991/2017).	VA ADMIN. LETTER NO. 2012-11.
Washington		WASH. REV. CODE ANN. §§ 48.12.400 to 48.12.499 (1947/2015) (2011 version of model).
West Virginia		W. VA. CODE § 33-4-15a (1992/2003) (previous version of model).
Wisconsin		WIS. ADMIN. CODE INS. §§ 52.01 to 52.07 (1993) (previous version of model).
Wyoming	WYO. STAT. ANN. §§ 26-5-112 to 26-5-117 (1992/2017).	

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

In 1982 a new task force was appointed to look at reinsurance issues. **1983 Proc. I 13.** In the course of several insolvencies, the regulators of one state learned a great deal about reinsurance activities which may be highly questionable or fraudulent. They prepared a report with proposals for dealing with insurance and reinsurance fraud. **1983 Proc. I 836-837.**

The proposals included development of a model law on reinsurance. **1983 Proc. I 837, 1983 Proc. II 845.**

A draft of the model was published in 1983. It bore little resemblance to the version adopted six months later. Attendees at the December 1983 meeting were urged to provide comments on the model. **1984 Proc. I 743-745.**

A group of regulators met in early 1994 and agreed that a number of questions pertaining to the Credit for Reinsurance Model Law had not yet been addressed or fully resolved. **1994 Proc. 1st Quarter 636.**

A suggestion was made to include provisions from an earlier NAIC proposal for a federal non-U.S. insurer act in to the Credit for Reinsurance Model Law. The federal proposal provided that no credit for reinsurance would be allowed unless the reinsurer was reviewed by the NAIC, even though the ceding company held collateral. The working group agreed to recommend that provisions of the federal bill not be included in the model act. **1994 Proc. 4th Quarter 941.**

After the model revisions had been adopted by the Executive Committee, a commissioner suggested that the drafting could be improved. The model was held at the Plenary until questions related to form could be resolved. **1996 Proc. 2nd Quarter 9.**

Technical amendments were completed before the Fall National Meeting and the model was adopted by the Plenary. **1996 Proc. 2nd Quarter 12.**

### Section 1. Purpose

This section was added to the model during the 1995 and 1996 drafting of amendments. This section was proposed to give explicit expression to the legislative intent of the law with respect to security established to secure the obligations of alien insurers. The author said the proposed language would permit the U.S. regulator to defer to an alien liquidator in the disposition of trust assets of an insolvent alien reinsurer if that was the regulator's preference. She said the regulator's position would be stronger if the statute included the language, but there could be no assurance that the proposed language would be sufficient to preserve the U.S. regulator's access to trust assets. Assurance would only come with amendment to Section 304 of the federal Bankruptcy Code to give the U.S. regulator priority in exercising supervisory authority over the trust over the alien liquidator seeking to marshal all assets of the insolvent insurer. **1996 Proc. 1st Quarter 823.**

The new Section 1 was based on New York law and was intended to clarify that the trust funds required by the law serve as security for insureds, claimants, ceding insurers, assuming insurers and the public. Additionally, the amendment specifies that the U.S. regulator will control distribution of the funds. **1996 Proc. 1st Quarter 821.**

After the model had been adopted by the drafters and forwarded to the Executive Committee for consideration, an interested party suggested that the new Section 1 might not be entirely appropriate for the purpose intended. She said the original objective had been to introduce new language to clarify the legislative intent underlying the credit for reinsurance statute as respects the collateral required to secure the obligations of alien reinsurers operating in the United States on the basis of multiple beneficiary trust funds, as provided in Section 2D of the model law. She indicated that at a recent hearing objections had been raised to the use of "inflammatory references." The working group decided to eliminate the third sentence which read: "It is intended that U.S. claimants should not be required to resort to the often insuperable obstacle of resorting to distant forums for the purpose of asserting legal rights or claims on contracts issued to U.S. residents and subject to U.S. laws." **1996 Proc. 2nd Quarter 864.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 2. Credit Allowed a Domestic Ceding Insurer

A principal regulatory tool applicable to reinsurance, particularly reinsurance ceded to unauthorized insurers, is the recognition on a ceding company's financial statement of credit for unearned premium and loss reserves ceded to an assuming insurer. Through a questionnaire sent to all states, the advisory committee concluded that there was little uniformity among the states. Statutory standards for credit for reinsurance were generally inadequate and a uniform law was needed to upgrade those standards. **1984 Proc. II 843.**

In the original model, credit was allowed in three situations: (1) where the assuming insurer is licensed in the state, or (2) satisfies certain financial standards, or (3) maintains an adequate trusteed surplus in the United States. In the event one of these criteria is not satisfied, the ceding insurer may be allowed to reduce its liability to the extent of certain security. Cessions of risks located in another jurisdiction and mandated by the law of that jurisdiction are excepted from the requirements. **1984 Proc. II 843.**

In September of 1989 a completely revised model with a much expanded Section 2 was adopted. **1990 Proc. IB 857-861.** After adoption certain technical/structural errors were discovered. These corrections were made at the December 1989 meeting. **1990 Proc. IB 872.**

A. A paper written to identify regulatory weaknesses reported that every state permits its domestic insurers to take annual statement credit for reinsurance cessions made to admitted reinsurers. However, state laws appear to be quite diverse in defining the term. **1983 Proc. II 842.**

The model language originally adopted allowed credit where the assuming insurer was licensed to transact insurance in either the state adopting the law or one which employs standards "substantially similar" regarding credit for reinsurance. The section stated that "substantially similar" meant the insurer conformed to the same standards of solvency as required of an insurer licensed in the state. Just before the model was adopted, the task force voted to adopt a drafting note stating that the same standards of solvency meant, at a minimum, the capital and surplus required of a domestic insurer. **1984 Proc. II 837-838.**

The original model allowed credit for reinsurance if the assuming insurer was licensed in the state, or if the insurer was licensed in another state whose credit requirements were substantially equivalent to those in the state granting credit and where the assuming insurer meet the standards of solvency in the granting state. In most cases, satisfaction of the minimum capital and surplus levels sufficed. A number of insurers commented that this requirement imposed an onerous regulatory burden and gave significant discretion to the commissioner, thus creating the potential for arbitrary decisions. **1984 Proc. II 843.**

When considering amendments to the model the drafters wanted to eliminate the vague "standards of solvency" but felt it was not feasible to enumerate all the standards for solvency that would be required if the assuming insurer were applying for a license in the enacting state. At the same time, they felt it would be a mistake to delete all references to solvency. **1989 Proc. I 949.**

At one point in 1995 during discussion of model act revisions, a provision was inserted in Section 2A that would have prevented a company from taking credit for the reinsurance cession if the reinsuring company was not licensed to write a particular line of business in the state. That was changed to permit the credit if the reinsurer was authorized in its state of domicile to write or assume business of the type ceded. **1996 Proc. 1st Quarter 844.**

B. When originally adopted the model provided that credit would be allowed if the assuming reinsurer was "accredited" without defining that term. **1984 Proc. II 838.** In the view of the advisory committee, this caused confusion. Credit could be allowed even though the reinsurer provided no information about its financial condition, did not submit to the jurisdiction, and provided no security in the form of letters of credit, funds withheld, or trusteed funds. The advisory group suggested a definition of accredited reinsurer which was similar to that adopted a year later. **1988 Proc. II 808, 810.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 2B (cont.)

The purpose of the suggested definition of accredited reinsurer was to assure that the enacting state had current information about the reinsurer in annual statement format, that the enacting state had jurisdiction over the reinsurer, and that the enacting state could examine the reinsurer. An assuming reinsurer meeting all the criteria of the definition would be accredited and no affirmative action on the part of the commissioner of the enacting state would be required. **1988 Proc. II 808.**

One insurer responded to a draft which defined the accredited reinsurer as one maintaining surplus as regards policyholders of at least \$20,000,000. The comments suggested that small life insurers would be seriously affected by the proposal. **1989 Proc. I 940.**

The drafters of amendments recommended deleting the vague “standards of solvency” of the earlier model and proposed substituting a minimum standard of \$20,000,000. The figure was chosen to conform with the provision for trustee surplus in Subsection D. **1989 Proc. I 949.**

At a working group meeting in the summer of 1989, the drafters decided to add the two alternative provisions under B(4). **1989 Proc. II 727.** The amendment allowed companies with less than \$20,000,000 to apply for accreditation but did not allow these companies to use the deemer provision found in B(4)(a). **1989 Proc. II 728.**

The working group considered providing an exception for members of a pooling arrangement similar to that proposed for Subsection C. The group decided no change was required. **1989 Proc. II 727.** An industry association presented a statement detailing the reasons they thought the action was appropriate. **1989 Proc. II 733-734.**

C. The original act provided that credit should be allowed where the reinsurer was *licensed* in at least one state employing standards substantially similar to those in the model. Model law amendments first suggested in 1988 provided credit where the assuming reinsurer was *domiciled* in a state employing substantially similar standards. **1988 Proc. II 808.**

Concerns were expressed about the interpretation of the words “substantially similar.” The advisory committee suggested this could best be handled through the addition of a drafting note. **1989 Proc. I 948.**

The model is a minimum standards bill. It is contemplated that a number of states will have standards which exceed those of the state enacting the model. The drafters expected that the NAIC would maintain a list or digest of states which have enacted the model. The drafting note permits the commissioner to rely on such a digest or to make an independent determination. **1989 Proc. I 948.**

When considering possible model amendments in 1994, the chair of the working group asked for regulators’ opinions regarding a modification to Subsection C to include a requirement that the reinsurer be domiciled in a state accredited by the NAIC. An interested party said such a provision could be readily incorporated into that subsection by replacing the words “...which employs standards regarding credit for reinsurance substantially similar to those applicable under this statute...” with the words “...which has been accredited by the NAIC...”. **1994 Proc. 1st Quarter 637.**

Recommendations from technical resource advisors spoke against adding a tie to the accreditation standards. A voluntary program on the part of the NAIC (a voluntary association of insurance regulators), the program could be substantially revised or canceled. In addition, they argued, tying the standard to the NAIC accredited status of the reinsurer’s state of domicile could result in denial of credit even where the lack of NAIC accredited status was unrelated to that state’s credit for reinsurance standards. The “substantially similar” standard rests on an objective determination of the law of the reinsurer’s state of domicile. **1995 Proc. 1st Quarter 752.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 2 (cont.)

D. The model law adopted granted credit where the assuming insurer maintained a trust account in the United States which included the insurer's liabilities and a trust surplus. The committee considered capital and surplus requirements as a threshold for the trust surplus but concluded that, in view of current industry practices and conditions, higher standards were mandated. Some insurers commented that the amounts were so high that many alien reinsurers could not compete in the U.S. market. The drafters concluded that the \$20,000,000 amount was necessary to maintain the level of security provided by the other provisions of the law. **1984 Proc. II 844.**

Originally the model required the trust fund be maintained in a U.S. bank or trust company. This was changed to "qualified financial institution" in 1987. **1987 Proc. II 444.**

The drafters considered changes to this section to deal with "joint and several" characteristics of the trust, but decided to do additional research before making any changes to the model. **1989 Proc. II 727-728.**

Just before adoption of the amended model in September 1989, the working group and then the task force considered adding a second paragraph under Subsection D to include incorporated underwriters. Considerable discussion on this proposal included the opinion that the language was unclear, and that addition of this paragraph would give special advantage to alien insurers. Some felt the proposal should be voted down because it was a last minute proposal. The proposal was narrowly approved. **1990 Proc. IB 891, 895.**

The parent committee again considered the appropriateness of the addition of Subsection D(2). The advisory committee objected to giving alien insurers a right that United States companies did not enjoy abroad, and opined that the international aspects of this decision had not been considered. The committee chair replied that, in fact, the international aspects had been considered and noted that an open market was, in the long term, in the best interest of the United States market. **1990 Proc. IB 851.**

Before adoption the committee struck a phrase in Subsection D(2), "or some other national regulation" and replaced it with a phrase requiring the incorporated insurers to submit to the state's authority to examine its books and records. **1990 Proc. IB 851.**

The NAIC president clarified before adoption at the special plenary session that the incorporated insurers would submit to the authority of the states and bear the cost of any examination. **1990 Proc. IA 12.**

Some of the commissioners were concerned about the authority granted in Subsection D(2). They clarified that this applies only to reinsurance transactions, not to surplus lines. **1990 Proc. IA 13.**

In June of 1990 the working group was again asked to reconsider Section 2D(2) dealing with a group of incorporated insurers. It was the opinion of the working group that the provision in question would allow more security for the reinsurance recoverable than the alternatives. The group voted to retain the provision as adopted. **1990 Proc. II 776.**

The working group did adopt clarifying language to Subsection D(2) specifying the trust should be in an amount equal to the liabilities attributable to United States business. The language of the earlier model also did not make clear that credit is to be accorded only to reinsurance contracts issued in the group name. **1990 Proc. II 776-777.**

Another amendment removed language specifically referencing companies under the jurisdiction of the Department of Trade and Industry of the United Kingdom. The working group considered this language too restrictive. It was replaced with language from a New York regulation. **1990 Proc. II 776.**



## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 2D (cont.)

In September 1993 a working group agreed upon language to amend Section 2D(1) of the model law to permit companies to continue to take statutory credit for reinsurance ceded to Lloyd's after the introduction of corporate capital. The chair acknowledged that there were other areas of the model law that would have to be reexamined to determine whether revisions might be necessary, but priority was given to the language on corporate Lloyd's. **1993 Proc. 4<sup>th</sup> Quarter 881.**

One meeting attendee said it was important to be certain that language drafted was not worded so broadly as to permit any group which included individuals and had established a trust fund in the amount of \$100 million to qualify as an accredited reinsurer and thereby circumvent other applicable requirements, such as those for risk-based capital. **1993 Proc. 4<sup>th</sup> Quarter 881-882.**

One of the drafting suggestions narrowed the scope by specifically referring to Lloyd's. A comment was made that explicit reference to "underwriters at Lloyd's" could present a problem for states that had statutory prohibitions against special purpose legislation. **1993 Proc. 4<sup>th</sup> Quarter 881-882.**

The working group members agreed that the suggested amendatory language would satisfactorily address the concerns expressed. The chair noted several unresolved questions remained and that further revisions to the model law would be considered. **1993 Proc. 4<sup>th</sup> Quarter 883.**

The language of Subsection D(2) was extensively revised in 1996 and some replaced with new language found in Paragraphs (2) and (3). **1996 Proc. 2<sup>nd</sup> Quarter 13-14.**

A group considering amendments to the Credit for Reinsurance Model Law received a letter outlining reasons why granting credit for reinsurance is sound financial regulation, pro-competitive and proper. The letter also addressed the scope of the trust fund to assist the regulators as they considered amending the trust requirements. **1994 Proc. 2<sup>nd</sup> Quarter 871-872.**

Technical resource advisors urged the working group to consider adding provisions that would apply to a single alien reinsurer seeking to qualify under Section 2D(1) of the model law. An extended discussion followed, during which the chair observed that under the arrangement proposed, the credit risk of reinsurance recoverables would effectively be borne by the trust. An interested party responded with the viewpoint that the proposal would enhance the overall quality of security, whileworking to the advantage of U.S. reinsurers, since it could be expected that a substantial volume of retrocessional business would flow into the U.S. marketplace as a result of the incentives for trustee alien reinsurers to buy retro protections from licensed reinsurers. He suggested it would be good regulatory policy to encourage any arrangement that provided such advantages. The chair countered that good regulatory policy should require that the obligations of alien reinsurers be collateralized on a gross basis, noting that it was not realistic to expect regulators to evaluate every alien reinsurer's retrocessional arrangements. Another regulator observed it would be difficult to make such evaluations because of the potential depletion of recoverable balances as a result of allowable offsets. The interested party acknowledged this was a legitimate concern, but said it could be possible to devise a way to address that problem. **1994 Proc. 2<sup>nd</sup> Quarter 868-869.**

An interested party commented that her association's members thought reinsurance capacity might be restricted if alien reinsurers were subjected to unduly burdensome collateralization requirements. The member companies were less concerned over recoverability than they were over the potential for capacity restriction and increases in the cost of reinsurance and said that they apparently believed that they were capable of determining, either on their own or with the advice of their reinsurance intermediaries, the creditworthiness of alien insurers. **1994 Proc. 4<sup>th</sup> Quarter 959.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 2D (cont.)

The chair asked if eliminating offset provision from retrocessional covers was a viable method of alleviating the concerns of regulators regarding the potentially negative impact of offset provisions on their ability to recover amounts for which alien reinsurers had taken credit in their U.S. trust funds. One company representative said in his opinion very few reinsurers could be expected to willingly forego the protection afforded by offset provisions, and that the elimination of offset clauses would inevitably lead to a general increase in the cost of reinsurance to reflect the attendant increase in the claims burden that reinsurers would have to bear in the absence of traditional offset provisions. He observed that the ultimate effect of any loss of offset rights would be to weaken reinsurers' financial conditions generally, and said that to do so would be in the interest of neither the buyers of reinsurance protection nor of the regulator. **1994 Proc. 4th Quarter 959.**

An interested party opined that the current model law requirement that alien reinsurers fund an amount equal to U.S. liabilities plus \$20 million did not leave a very substantial margin for unrecoverability of obligations of the alien reinsurer's retrocessionaires. He observed that the risk-based capital requirements made it impossible for any state to approve a new reinsurer having only \$20 million in policyholder surplus. **1994 Proc. 4th Quarter 959.**

An early 1995 draft of the model act contained a new Subsection E to address reinsurance ceded to an unauthorized alien assuming insurer. A technical resource advisor reported that there was not agreement among the advisors regarding the subsection. The majority of advisors recommended that, if the working group wanted to include a provision of this kind, it would best be done via a drafting note to the model regulation. **1995 Proc. 1st Quarter 731.**

An extensive discussion followed among the working group members regarding the question of whether the language of the state regulation on which Subsection E was based was more or less conservative as respects security required of alien reinsurers than the provisions currently contained in Section 2 and 3 of the model law. There were divergent opinions among regulators as to whether this provision had the effect of strengthening or weakening the alien reinsurer security provisions currently incorporated in the model law. One interested party suggested the availability of the proposed Subsection E would effectively reduce the overall level of security for unauthorized reinsurance recoverables. **1995 Proc. 1st Quarter 732.**

A regulator said in his opinion the proposed Subsection E represented a clear weakening of the traditional requirements regarding collateralization of unauthorized reinsurance recoverables, since the effect of the provision would be to substitute collateral equal to only 15% of the largest segment of recoverable balances, the resources for Incurred But Not Reported (IBNR) losses, for the 100% requirement contained in the present model. He said he would be opposed to inclusion of such a provision in any form. **1995 Proc. 1st Quarter 732.**

The working group agreed not to make substantive changes to Subsection D, but the subsection was rearranged for clarity. **1995 Proc. 1st Quarter 733-734.**

One regulator suggested a change to the second sentence in Paragraph (1) to add at the beginning of the phrase "To enable the commissioner to determine the sufficiency of the trust fund..." and the working group agreed to the change. **1996 Proc. 1st Quarter 844.**

It was suggested that the language of Paragraph (3)(i) would effectively permit adequacy of the trust fund established by a "group including incorporated and individual unincorporated underwriters" to be determined on a collective basis, which meant that one or more individual underwriters or syndicates could have a deficiency in their subaccount balances. If the overall fund balance was deemed to be adequate, credit for cessions to the group would be allowed despite the individual deficiency. One state had taken the position that each syndicate would have to demonstrate compliance with trust fund requirements. The technical resource group believed that the language in its current form would permit any regulator to exercise sufficient oversight and control, and cautioned against efforts to introduce expanded requirements that would increase the administrative burden on regulators without providing a commensurate increase in the ability to maintain oversight and control. **1996 Proc. 1st Quarter 844-845.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 2D (cont.)

E. Subsection E remains substantially unchanged since it was first adopted, except for the references to other subsections. **1984 Proc. II 838.**

The drafters recognized a special problem for reinsurers in many non-U.S. jurisdictions and carved out a limited exception to the credit requirements. A ceding insurer may take credit where the assuming insurer does not meet the standards of the prior subsections with regard to risks located in jurisdictions where the reinsurance is required by that jurisdiction. **1984 Proc. II 844.**

F. The assuming insurer qualifying for credit must also agree to submit to the jurisdiction of U.S. courts in the event of its failure to pay amounts due under contracts, and to designate the commissioner as its attorney for the purpose of serving process. A few insurers were concerned that this subsection might alter the terms of an arbitration clause in the reinsurance agreement. The drafters added the final sentence to remove the potential for any unintended conflict with arbitration clauses. **1984 Proc. II 844.**

A correction made in 1985 clarified that the last sentence of the subsection applied both to Paragraphs (1) and (2). **1986 Proc. I 812.**

The working group considered a proposal that the model bill specify certain provisions which must be included in a reinsurance contract. The advisory committee felt it was not feasible to set out all of the minimum standards but the model does include certain standards in Section 2F. **1989 Proc. I 949.**

#### **Section 3. Asset or Reduction From Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer Not Meeting the Requirement of Section 2**

The model adopted allowed a reduction from liability for cessions to assuming insurers not satisfying the requirements of Section 2, but only to the extent of security provided by, or on behalf of, the insurer taking credit. The model identified the forms of security accepted in most states. The model as originally adopted only accepted letters of credit issued or confirmed by a bank that is a member of the federal reserve system. **1984 Proc. II 844.**

An amendment adopted in September 1989 added the words “by a domestic insurer” to the title and first sentence. **1990 Proc. IB 859.**

C. A representative of a British banking firm appeared before the task force to protest the use of the standards for letters of credit which excluded U.S. branches and agencies of all foreign banks from eligibility as issuers of letters of credit. **1985 Proc. II 719-720.**

In 1987 this section was changed to allow letters of credit issued by a “qualified U.S. financial institution” as that term was defined in a new Section 4. **1987 Proc. II 446.**

The United States Treasury Department wrote a letter expressing support for the draft. It moves in the direction of applying equality of competitive opportunity with U.S. banks, to U.S. branches and agencies of foreign banking institutions. The Treasury Department heard complaints from individual foreign banks concerning their inability to participate in the market in the United States. Under the International Banking Act, foreign banks are accorded equality of competitive opportunity with domestic institutions in similar circumstances, even if some specific regulations or requirements applied to foreign banks differ from those affecting domestic banks. The measures contemplated by the NAIC were in keeping with federal policy. **1987 Proc. II 449-450.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 3C (cont.)

Section 3C contained a reference to the definition for letters of credit; however, the version adopted in 1990 contained a reference to the definition in Section 4 which was misplaced. A correction was made in June 1990. **1990 Proc. II 776.**

#### Section [ ] Credit Allowed a Foreign Ceding Insurer [Optional]

As early as August 1993, the chair of the working group considering credit for reinsurance issues received a suggestion to add a new section to the model act that would allow credit to a foreign ceding insurer to the extent credit had been allowed by the ceding insurer's state of domicile. **1994 Proc. 1st Quarter 639.**

In early 1994, the Credit for Reinsurance Working Group began discussing further amendments to the model act. A group of technical advisors wrote a letter urging the viewpoint that credit for reinsurance should be determined by the state of domicile of the ceding insurer and that, if that state is accredited by the NAIC, other states should recognize the credit allowed by the state of domicile. The group viewed this as a very important principle. The writers said it seemed to them unnecessary and undesirable to have a separate and inconsistent determination of statutory surplus made by each state in which the ceding insurer is licensed. **1994 Proc. 1st Quarter 640.**

One regulator restated the position taken by his state on the question of application of its law to licensed foreign ceding companies as well as domestic companies. He said his state supported the idea of uniformity of regulation from one state to another insofar as possible, but did not want to relinquish the right to take regulatory action against a foreign company whose reinsurance arrangements were deemed to be unsatisfactory. Another regulator pointed out that the commissioner was permitted the discretion to waive the \$20 million surplus stipulated in the model. **1994 Proc. 1st Quarter 637.**

A regulator suggested that language be added to the proposed section setting forth criteria by which a state might decline to allow credit. **1994 Proc. 1st Quarter 637.**

A later meeting was held to consider further the concept of extraterritorial application of the credit for reinsurance law. Language was drafted that would provide a procedure to be followed by those states that chose to apply their credit for reinsurance law to licensed foreign companies as well as domestic companies. Technical resource advisors expressed concern with the basic premise. They expressed the strong belief that credit for reinsurance is a fundamental element in the determination of the financial condition of the ceding insurer, and should be determined by the insurer's state of domicile. They urged regulators not to change the feature of the current model that addresses credits allowed domestic insurers and does not address foreign insurers. **1994 Proc. 2nd Quarter 877-879.**

A draft of the Credit for Reinsurance Model Law was considered at a September 1994 meeting of regulators. A drafting note was suggested for the new section on regulation of reinsurance of foreign carriers by non-domiciliary jurisdictions, and one regulator wrote a letter of objection to the drafting note. The regulator stated that the drafting note contained language that implied a consensus of opinion which, in his view, did not exist among regulators as respects extraterritorial application of the act. At his suggestion these words were deleted at the end of the first sentence: "...on the premise that regulation of the financial condition of foreign insurers, including credit for reinsurance, is best left to their states of domicile." The letter writer said the premise was presumptuous in its far-reaching implications, i.e., that it is "best" for the individual states to relinquish, or to abdicate, their regulatory responsibilities regarding the financial condition of foreign insurers doing business within their borders. **1994 Proc. 3rd Quarter 783-784.**

## CREDIT FOR REINSURANCE MODEL LAW

### Proceeding Citations

Cited to the Proceedings of the NAIC

#### Section 4. Qualified U.S. Financial Institutions

This section was added to the model in 1987. Changes to the types of financial institutions that could maintain trust funds or issue letters of credit resulted in the need for this definition. **1987 Proc. II 447.**

A. The Reinsurance and Anti-Fraud Task Force created new language defining credit standards for domestic and foreign banks which issue letters of credit supporting reinsurance transactions. The language also became part of the procedures of the NAIC Securities Valuation Office. The “member of the federal reserve” requirement embodied in the original model was eliminated to allow foreign banks which cannot be members of the federal reserve to write letters of credit. The new SVO facility will provide a list of qualified banks for use by regulators in approving letters of credit transactions involving reinsurance credit. **1987 Proc. II 855-856.**

#### Section 5. Rules and Regulations

The authority to adopt regulations was part of the original model, although the NAIC did not develop a regulation for some time. **1984 Proc. II 839.**

When drafting amendments in 1989, the working group considered a proposal to require a state to adopt rules and regulations versus the optional authority in the model. The group agreed no change was required. **1989 Proc. II 727.**

#### Section 6. Reinsurance Agreements Affected

This section was added to the draft of amendments being considered at the December 1988 meeting. It was suggested by the advisory committee that the model should identify those reinsurance contracts to which the statutory credit provisions would be applicable. **1989 Proc. I 949.**

At the working group meeting the following summer, it was decided to add a drafting note to the working draft. **1989 Proc. II 727.**

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#### *Chronological Summary of Actions*

*June 1984: Model adopted.*

*December 1985: Technical correction to Section 2F.*

*June 1987: Revised requirement for who may issue letters of credit; added Section 4 defining qualified financial institutions.*

*September 1989: Revised Section 2 substantially. Revised requirements for letters of credit; added Section 5.*

*December 1989: Technical corrections to Section 2 adopted.*

*June 1990: Clarified Section 2D and made a technical amendment to Section 2C.*

*March 1994: Adopted an amendment to provide for credit for incorporated underwriters.*

*September 1996: Model extensively revised; new Section 1 added.*

**CREDIT FOR REINSURANCE MODEL LAW**

**Proceeding Citations**

Cited to the Proceedings of the NAIC

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