National Association of Insurance Commissioners

The Center for Insurance Policy and Research

MEMORANDUM

TO: Financial Regulation Standards and Accreditation (F) Committee

FROM: Julie Garber, Senior Manager—Solvency Regulation
Daniel Schelp, Managing Counsel

DATE: December 7, 2015

RE: Reinsurance Ceded to Certified Reinsurers—Proposed Revisions to Significant Elements

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At the 2015 Fall National Meeting, the Financial Regulation Standards and Accreditation (F) Committee agreed in principle to make the current *Reinsurance Ceded to Certified Reinsurers* provisions of Part A: Laws & Regulations—Traditional Insurers a required and uniform accreditation standard applicable to all NAIC accredited jurisdictions. At that time, the Committee directed NAIC staff to draft specific revisions to the current accreditation guidance to incorporate this change, including a discussion on the possible effective date to potentially expedite this process. These proposed revisions are attached to this memorandum as redlined revisions to the current accreditation standard for Reinsurance Ceded.

Background Information

On April 9, 2013, the NAIC adopted the significant elements of the 2011 revisions to *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786) as an "optional" accreditation standard. Specifically, under this optional standard a state is not required to adopt the certified reinsurer revisions to the models, but if it chooses to reduce its reinsurance collateral requirements the state's laws and regulations must be substantially similar to the key elements of the revisions. Under the definition of "substantially similar" in the Accreditation Interlineations, it is only required that a state demonstrate that its laws and administrative practices result in solvency regulation that is similar in force and no less effective than the standard. This has been interpreted to mean that a state may comply with an accreditation standard by demonstrating that its laws result in solvency regulation that is more effective than the standard.

At the time the NAIC adopted the optional accreditation standard, it was the opinion of the Reinsurance (E) Task Force that the 100 percent reinsurance collateral requirement under the prior law would be equally effective in comparison to the new certified reinsurer provisions, noting that "while uniform adoption of the revisions to the Models is a desired outcome, it would not be required under the current accreditation program." However, the discussion of whether the certified reinsurer revisions should be a uniform standard has continued to develop since the revisions were originally adopted. The Reinsurance (E) Task Force re-examined the issue of uniformity three years after the adoption of the standard by the NAIC. In addition, the NAIC agreed to periodically re-examine the issues of uniformity and collateral levels during the EU/U.S. Dialogue Project. At the current time, 32 states have passed this legislation, representing 66 percent of direct U.S. premium, with additional states considering adoption.

Upon further review and consultation with state regulators and interested parties, it is now the opinion of the Committee that the new certified reinsurer provisions result in increased financial solvency regulation and increased consumer protection to policyholders, and should now be adopted as a uniform standard applicable to all NAIC accredited jurisdictions under the "substantially similar" definition. Specifically, the certified reinsurer provisions result in 1) increased financial scrutiny given to certified reinsurers by state regulators and the NAIC; 2) review of the certified reinsurer's domiciliary supervisory regime by the Qualified Jurisdiction (E) Working Group with respect to the effectiveness of its supervision; and 3) the new process under which certified reinsurers may be "passported" for certification in other states, and the resulting financial analysis conducted by the Reinsurance Financial Analysis (E) Working Group upon initial application and renewal.

Proposed Revisions to Current Accreditation Guidance

In order to make *Reinsurance Ceded to Certified Reinsurers* a uniform accreditation standard, NAIC staff recommends that revisions should be made to the following paragraphs of the current Reinsurance Ceded accreditation guidance, as described in the redlined attachment: 1) paragraph (h), which requires insurers to be subject to notification requirements regarding concentration risk under Section 2J of Model #785; 2) paragraph (z), which is the introductory paragraph to the *Reinsurance*

Ceded to Certified Reinsurer provisions; 3) paragraph (z)(iv), which permits a deferral period for posting security applicable to catastrophe recoverables under Section 8A(4) of Model #786; and 4) paragraph (cc), which permits a state to defer to the certification and rating of a certified reinsurer by another NAIC accredited jurisdiction under Section 8D of Model #786. However, the Committee should be aware of the following issues with respect to these recommendations:

- **Concentration Risk.** Paragraph (h) is not specifically a part of the *Reinsurance Ceded to Certified Reinsurer* provisions, as included in the Part A Self-Evaluation Guide/Interim Annual Review form. However, adoption of the concentration risk provisions under Section 2J of Model #785 is specifically required for any state that has adopted the certified reinsurer provisions; therefore, it is also necessary to make this revision.

- **Catastrophe Recoverables Deferral.** Paragraph (z)(iv) currently provides that it is not required for accreditation. In summary, it permits states to provide a deferral period of one year for certified reinsurers to post collateral with respect to catastrophe recoverables for a catastrophic occurrence recognized by the commissioner pursuant to Section 8A(4) of Model #786. When the Reinsurance (E) Task Force originally made its recommendations to the Committee with respect to this accreditation standard, it considered comments from interested parties recommending deletion of the language "although not required for accreditation" from this standard because of the voluntary nature of this provision. However, at that time the Task Force determined that this language should be retained as currently drafted. NAIC staff notes that Section 8A(4) specifically provides that "a certified reinsurer **shall not** be required to post security for catastrophe recoverables for a period of one year…" [Emphasis added], but staff does not have a recommendation as to whether this provision is necessary to include in the standard. The Committee may wish to seek input from the Reinsurance (E) Task Force on this matter.

- **Passporting.** Paragraph (cc) relates to the "passporting" process, which permits a state to defer to the certification and rating of a certified reinsurer by another NAIC accredited jurisdiction under Section 8D of Model #786. When the Reinsurance (E) Task Force originally made its recommendations to the Committee with respect to this accreditation standard, it considered comments from interested parties recommending deletion of the language "although not required for accreditation" from this standard because of the voluntary nature of this provision. However, at that time the Task Force determined that this language should be retained as currently drafted. NAIAC staff notes that Section 8D provides that "the commissioner **has the discretion to defer** to that jurisdiction's certification…" [Emphasis added]. As passporting has been identified by the Committee as an important component of the certified reinsurer provisions that has resulted in increased financial solvency regulation and increased consumer protection for policyholders, its inclusion as a requirement is important.

NAIC staff performed a survey of the states that have adopted both Models #785 and #786, and we determined that only one state did not adopt the Passporting provision. In addition, one state did not adopt the Concentration Risk provision, but has advised the NAIC that this provision will instead be included in its regulation. In all other respects, these states have adopted language that is substantially similar to these sections of the models.

Proposed Effective Date

NAIC staff understands that making the *Reinsurance Ceded to Certified Reinsurer* provisions a uniform accreditation standard is a priority for the NAIC. Therefore, we recommend a proposed effective date of the new standard to be Jan. 1, 2018, in accordance with the Waiver of Procedure process under the Accreditation Program Manual, which provides in relevant part:

> If FRSAC determines that a waiver of the above procedures is necessary to expeditiously consider modification or alteration of the Standards, it may upon a three-fourths (3/4) majority vote of its members present and voting, move to recommend adoption of changes or modifications to the Executive Committee… The Executive Committee will vote in accordance with its normal procedures and make the appropriate recommendation to Plenary. A 60% majority of members is required to adopt the proposal.

Of the states that have not adopted Model #785 at this time, only the Texas legislature does not meet in 2016, so that it would not be possible for Texas to adopt the significant elements of Models #785 and #786 prior to 2017. Further, the North Carolina and Wyoming legislatures meet in limited-scope or limited-duration sessions in 2016, and those sessions are generally limited to only certain topics or issues, such as budgetary items. Therefore, the earliest date that an accreditation standard could reasonably become effective with respect to all currently accredited NAIC jurisdictions is Jan. 1, 2018.

10. Reinsurance Ceded

State law should contain the NAIC *Credit for Reinsurance Model Law* (#785), the NAIC's *Credit for Reinsurance Model Regulation* (#786) and the NAIC *Life and Health Reinsurance Agreements Model Regulation* (#791) or substantially similar laws.

Credit for Reinsurance Model Law (#785)	**REFERENCE**
a. Credit allowed for reinsurance ceded to a licensed insurer?	______________
b. Credit allowed for reinsurance ceded to an accredited insurer who meets requirements similar to those in Section 2B and 2I of the model law?	______________
c. Credit allowed for reinsurance ceded to an insurer domiciled and licensed in a state which employs substantially similar standards regarding credit for reinsurance and who maintains capital and surplus of at least $20,000,000 and submits to this states authority to examine its books and records?	______________
d. Credit allowed for reinsurance ceded to an insurer who maintains a trust fund, established in a form approved by the commissioner, in a qualified U.S. financial institution for the payment of the valid claims of its U.S. policyholders and ceding insurers, their assigns and successors in interest and who reports financial information annually to the commissioner to determine the sufficiency of the trust fund?	______________
e. In instances where reinsurance is ceded to insurers maintaining a trust fund, trustees of the trust required to report to the department annually, on or before February 28, the balance of the trust and a listing of the trust's assets as of the end of the year and a certification of the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the next following December 31?	______________
f. Credit for reinsurance allowed under c. or d. above only permitted where assuming insurer agrees in the reinsurance agreements: 1) that in the event of a failure of the assuming insurer to perform its obligations, the assuming insurer shall submit to the jurisdiction of any court of competent jurisdiction in any state of the U.S.; and 2) to designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process instituted by or on behalf of the ceding company?	______________

REFERENCE

g. Credit allowed for reinsurance ceded to an insurer not meeting the requirements of a., b., c., or d. above, or with respect to a certified reinsurer described below, in an amount not exceeding the liabilities carried by the ceding insurer and only in the amount of funds held by or on behalf of the ceding insurer in the form of cash, securities listed by the Securities Valuation Office of the NAIC, including those deemed exempt from filing as defined by the *Purposes and Procedures Manual of the Securities Valuation Office*, and qualifying as admitted assets, clean, irrevocable, unconditional letters of credit, and other forms of security acceptable to the commissioner? ________________________

h. ~~If the state's law allows credit for reinsurance ceded to a certified reinsurer consistent with Section 2E of Model #785 and Section 8 of Model #786, c~~Ceding insurers must be subject to notification requirements with respect to reinsurance concentration risk substantially similar to those in Section 2J of Model #785. ________________________

Life and Health Reinsurance Agreements Model Regulation (#791)

i. Scope similar to Section 3? ________________________

j. No insurer, for reinsurance ceded establishes any asset or reduces any liability due to the terms of the reinsurance agreement, in substance or effect if any of the conditions in Section 4A exist? ________________________

k. Agreements entered into after the effective date of this regulation which involve the reinsurance of business issued prior to the effective date of agreements, along with subsequent amendments shall be filed by the ceding company with the commissioner within 30 days from the execution date along with attachments noted in Section 4C(1)? ________________________

l. Any increase in surplus net of federal income tax resulting from arrangements described in Section 4C(1) to be reported as described in Section 4C(2)? ________________________

m. Written agreements with provisions similar to Section 5? ________________________

n. Insurers required to reduce to zero any reserve credits or assets established with respect to existing reinsurance agreements entered into prior to the effective date of this regulation which would not be recognized under the provisions of this regulation? ________________________

Credit for Reinsurance Model Regulation (#786)

o. Credit for reinsurance allowed for reinsurance ceded by domestic insurers to assuming insurers that were licensed in the state as of the last date of the ceding insurers' statutory financial statement? ________________________

p. Credit for reinsurance provisions for accredited reinsurer similar to Section 5? ________________________

REFERENCE

q. Credit for reinsurance provisions for reinsurers licensed and domiciled in other states similar to Section 6? ____________________

r. Credit for reinsurance provisions for reinsurers maintaining trust funds similar to Section 7? ____________________

s. Credit for reinsurance required by law similar to Section 9? ____________________

t. Reduction from liability for reinsurance ceded to an unauthorized assuming insurer similar to Section 10? ____________________

u. Provisions for trust agreements similar to Section 11? ____________________

v. Provisions for letters of credit similar to Section 12? ____________________

w. Provisions for unencumbered funds similar to Section 13? ____________________

x. Provisions for reinsurance contracts similar to Section 14? ____________________

y. The adoption of Form AR-1—Certificate of Assuming Insurer. ____________________

Reinsurance Ceded to Certified Reinsurers

z. ~~Although not required for accreditation, a~~A state's laws and regulations ~~may~~ shall allow credit for reinsurance ceded to a certified reinsurer, including affiliated reinsurance transactions. ~~For such cases, i~~Its laws and regulations shall contain provisions that are substantially similar to those applicable to certified reinsurers contained in Section 2E of Model #785 and Section 8 of Model #786. ____________________

i. The credit allowed is based upon the security held by or on behalf of the ceding insurer in accordance with the rating assigned to the certified reinsurer by the commissioner? The amount of security required in order for full credit to be allowed shall not be less than that required under Section 8A(1) of Model # 786. ____________________

ii. The security provided by the certified reinsurer is in a form consistent with the provisions of Section 2E(5) of Model #785 and Section 8A of Model #786? ____________________

iii. The commissioner requires the certified reinsurer to post 100% security upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurer? ____________________

REFERENCE

iv. ~~Although not required for accreditation, a~~A state's laws or regulations ~~may~~shall ~~allow~~ include provisions for granting a certified reinsurer a deferral period ~~to a certified reinsurer~~ for posting security applicable to catastrophe recoverables, substantially similar to Section 8A(4) of Model #786. ~~In such cases, t~~The deferral period shall not exceed one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a catastrophic occurrence as recognized by the commissioner, and shall not apply to lines of business other than those provided in Section 8A(4) of Model #786.

v. Credit for reinsurance ceded to a certified reinsurer shall apply only to reinsurance contracts meeting requirements substantially similar to Section 8A(5) of Model #786?

aa. In order to be a certified reinsurer, an assuming insurer must be certified by the commissioner in accordance with the process similar to Section 8B of Model #786?

i. The commissioner is required to post notice upon receipt of any application for certification substantially similar to the requirements of Section 8B(1) of Model #786?

ii. The commissioner is required to publish a list of all certified reinsurers and their ratings substantially similar to the requirements in Section 2E(4) of Model #785 and Section 8B(2) of Model #786?

iii. A certified reinsurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner?

iv. A certified reinsurer must maintain capital and surplus, or its equivalent, of no less than $250,000,000, calculated in accordance with Section 8B(4)(h) of Model #786? This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least $250,000,000 and a central fund containing a balance of at least $250,000,000.

v. A certified reinsurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner, and the maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as set forth in Section 8B(4)(a) of Model #786? These ratings must be based on interactive communication between the rating agency and the assuming insurer and not based solely on publicly available information.

REFERENCE

vi. A certified reinsurer is rated by the commissioner on a legal entity basis, with consideration given to the group rating where appropriate (an association including incorporated and individual unincorporated underwriters that have been approved to do business as a single certified reinsurer may be evaluated on the basis of its group rating)? Factors may be considered in the evaluation process similar to those provided under Section 8B(4) and (5) of Model #786.

vii. A certified reinsurer must submit a properly executed Form CR-1 as evidence of its submission to the jurisdiction of the state, appointment of the commissioner as an agent for service of process in the state, and agreement to provide security for one hundred percent (100%) of its liabilities attributable to reinsurance ceded by ceding insurers if it resists enforcement of a final U.S. judgment? The commissioner must not certify any assuming insurer that is domiciled in a jurisdiction that the commissioner has determined does not adequately and promptly enforce final U.S. judgments or arbitration awards.

viii. A certified reinsurer must agree to meet applicable information filing requirements substantially similar to those provided under Section 8B(7) of Model #786, both with respect to an initial application for certification and on an ongoing basis?

ix. Changes in rating or revocation of certification of a certified reinsurer are applied by the commissioner in a manner substantially similar to the provisions of Section 2I of Model #785 and Section 8B(8) of Model #786?

bb. The commissioner is required to 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?

i. In determining whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner evaluates the reinsurance supervisory system of the non-U.S. jurisdiction, both initially and on an ongoing basis, under criteria substantially similar to those provided under Section 8C(2) of the model regulation?

ii. The commissioner shall consider the list of qualified jurisdictions published by the NAIC in determining qualified jurisdictions? If the commissioner approves a jurisdiction as qualified that does not appear on the NAIC list of qualified jurisdictions, the commissioner must provide thoroughly documented justification with respect to criteria substantially similar to that provided under Section 8C(2) of Model #786.

REFERENCE

iii. U.S. jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program are recognized as qualified jurisdictions? ____________________________

cc. ~~Although not required for accreditation, a~~A state's laws and regulations ~~may~~ shall allow a commissioner to defer to the certification and rating of a certified reinsurer issued by another NAIC accredited jurisdiction. ~~For such cases, r~~Recognition of certification is made in accordance with provisions substantially similar to Section 8D of Model #786? ____________________________

dd. Reinsurance contracts entered into or renewed with a certified reinsurer must include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer for reinsurance ceded to the certified reinsurer? ____________________________

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