Mar. 2017

STATE LEGISLATIVE BRIEF

The NAIC Credit for Reinsurance Model Law

- *The NAIC Credit for Reinsurance Model Law (#785) and Model Regulation (#786) strengthen state regulation, prevent regulatory arbitrage, protect U.S. policyholders, and reduce the uncertainty faced by insurers when planning for collateral liability. The 2011 revisions are an accreditation requirement, effective Jan. 1, 2019.*
- *The NAIC Credit for Reinsurance Model Law allows foreign reinsurers to post less than 100% collateral for U.S. claims, provided the reinsurer is in solid financial health and is overseen by an effective regulator. Once certified under the NAIC peer review system, foreign reinsurers can apply to "passport" throughout the U.S.*
- *In part, because the 2011 revisions to the NAIC's Credit for Reinsurance Model Law have not been adopted by all states, the former administration's U.S. Treasury Department and United States Trade Representative concluded negotiations on an agreement with the European Union that requires states to eliminate collateral requirements entirely and could result in preemption of state law if the states refuse to do so. While it is presently under review by the new administration and Congress, this agreement could serve as a template for future agreements with other foreign jurisdictions if states do not adopt reinsurance collateral reforms.*

Background

State insurance regulators have historically required foreign reinsurers to hold 100% collateral within the U.S. for the risks they assume from U.S. insurers. Over the past decade, these collateral requirements have been a frequent subject of debate, with various groups calling for the elimination of collateral requirements for reinsurers licensed in well-regulated jurisdictions. In 2011, the NAIC adopted a revised Credit for Reinsurance model as part of a larger effort to modernize reinsurance regulation in the United States and in January, 2016 the model was amended to provide the commissioner authority to issue regulations with respect to certain captive reinsurance transactions. The revisions allow foreign reinsurers to post less than 100% collateral for U.S. claims, provided the reinsurer is evaluated and certified based on criteria that include, but are not limited to, financial strength, timely claims payment history and the requirement that a reinsurer be domiciled and licensed in a "qualified jurisdiction." The model ensures that collateral requirements are reduced in a consistent manner commensurate with the financial strength of the reinsurer and the quality of the regulatory regime that oversees it. Additionally, the model mandates the orderly liquidation of the U.S. assets of an insolvent non-U.S. insurer or reinsurer by the state insurance commissioner with regulatory oversight in the state in which the trust is domiciled.

As part of the implementation of the model, state regulators, through the NAIC, have established a comprehensive process to evaluate jurisdictions' oversight of reinsurers to establish "qualified jurisdictions" for purposes of reduced collateral. The peer review process improves uniformity among states and simplifies the application process for certified reinsurers. As of January 1, 2015, seven jurisdictions (Bermuda, France, Germany, Ireland, Japan, Switzerland and the U.K.) have been placed on the List of Qualified Jurisdictions. State regulators have also established a peer review system surrounding the certification of foreign reinsurers by states, which provides a foreign reinsurer with the opportunity to apply to "passport" throughout the U.S. "Passporting" is the process by which a state may recognize the review and approval of a certified reinsurer by another state, thereby improving uniformity among the states and simplifying the application process for certified reinsurers. To date, 23 foreign reinsurers have been certified for passporting purposes under this peer review system.

Why would a state choose to reduce collateral requirements for foreign reinsurers? For one, ceding insurers domiciled in states which do not adopt the reinsurance collateral reforms will potentially be subject to higher reinsurance costs than their competitors domiciled in states that have adopted the revisions, putting them at a competitive disadvantage. Some states (e.g., coastal states like Florida) have encountered challenges with respect to reinsurance capacity for catastrophe exposure. International reinsurers have taken the position that reducing collateral requirements will help with these issues. Foreign

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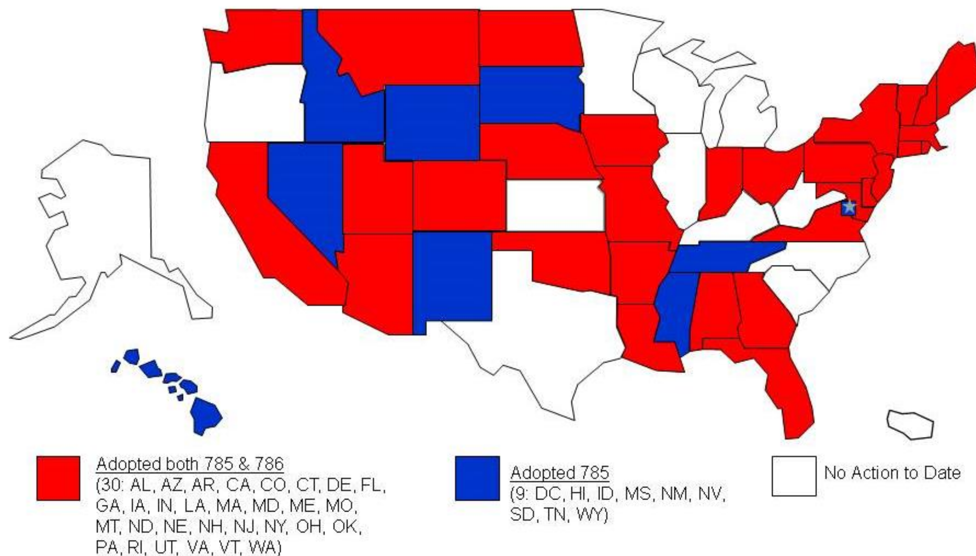
reinsurers' regulators and politicians have long objected to their companies having to post collateral in the U.S. as such capital is then unavailable for other purposes, and collateral has not typically been required of U.S. reinsurers in the majority of EU jurisdictions.

Significantly, in part because all the states have not yet adopted the 2011 revisions to the NAIC's Credit for Reinsurance Model Law, the former administration's Treasury Department and the United States Trade Representative, utilizing their authorities under the Dodd-Frank Act, concluded negotiations on an agreement with the European Union that eliminates EU reinsurer collateral requirements and could preempt state laws if the states refuse to comply with its terms. While it is presently under review by the new administration and Congress, this agreement could serve as a template for future federally negotiated agreements with other foreign jurisdictions if all states do not adopt collateral reform. Further changes to collateral requirements through federal action would be to the detriment of US consumers and companies that rely on the state insurance regulatory system's reinsurance collateral rules to protect them from the risks posed by reinsurance counterparties.

Key Points

- ✓ Currently, 38 states [AL, AZ, AR, CA, CO, CT, DE, FL, GA, HI, ID, IA, IN, LA, MA, MD, ME, MO, MS, MT, ND, NE, NH, NJ, NM, NV, NY, OH, OK, PA, RI, SD, TN, UT, VA, VT, WA & WY] and DC have adopted the 2011 revisions to the Credit for Reinsurance Model. Insurers domiciled in these 39 jurisdictions write more than 69% of the primary insurance premium in the U.S. The 2011 revisions are an accreditation requirement, effective Jan. 1, 2019.
- ✓ The 2011 revisions reduce collateral requirements in a measured and transparent manner, commensurate with the foreign reinsurer's financial strength and the effectiveness of its home country regulator. To date, the NAIC has added seven jurisdictions to the List of Qualified Jurisdictions for purposes of reduced collateral, and 23 foreign reinsurers have been certified for passporting throughout the U.S.
- ✓ In part, because the 2011 revisions to NAIC's Credit for Reinsurance Model Law have not been adopted by all states, the former administration's U.S. Treasury Department and United States Trade Representative concluded negotiations on an agreement with the European Union that requires states to eliminate EU reinsurer collateral requirements and could result in preemption of state law if the states refuse to do so. This agreement could serve as a template for future federally negotiated agreements with other foreign jurisdictions. Continued state action on the NAIC model is our best defense against the need for further federal action.



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