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NAIC Relaxes Collateral Requirements for Non-admitted Reinsurance

On November 6, 2011, at its Fall National Meeting in National Harbor, Maryland, the National Association of Insurance Commissioners ("NAIC") adopted landmark amendments to its model law and regulation on "credit for reinsurance." The amendments effectively replace the old credit-for-reinsurance regime, in which non-admitted off-shore reinsurers, regardless of financial strength, must secure their reinsurance commitments by posting collateral in order for the ceding company to be able to record the reinsurance as an asset or reduction of a liability. If enacted by the various states, the new regime would provide state insurance regulators with discretion to grant financial statement credit for all or part of such reinsurance without such onerous security.

Before these changes, the NAIC model law permitted the ceding company to claim credit only if the assuming reinsurer was licensed in the state, was "accredited" by the state insurance regulator (a status available only to companies licensed in the U.S. and meeting certain other criteria) or maintained a trust fund with a "qualified U.S. financial institution" in certain specified amounts for the purpose of paying claims.¹ Where the assuming insurer did not fall within any of these criteria -- *e.g.*, reinsurers lacking a U.S. license and not maintaining sizeable trusts -- credit could be obtained only to the extent that the assuming reinsurer posted security (either to be held by the cedent or in trust with a qualified U.S. financial institution) in the form of cash, securities satisfying the state's criteria for "admitted assets," letters of credit or other permitted collateral.² (Trusts established for such purposes, which are fairly commonplace, are often referred to as "Reg. 114 Trusts" after the New York Insurance Department regulation that codifies credit-for-reinsurance requirements in that state.) The amendments effect some technical changes to these existing provisions.

Notably, the amendments also *expand* the situations in which credit is permitted by introducing the concept of a "certified" reinsurer. The amendments provide that credit shall be allowed to a ceding company where (i) the reinsurer is certified by the state insurance regulator and (ii) security is provided in accordance with a sliding scale described below, which may in some cases be less than 100% of the liabilities ceded.³ In order to be eligible to be a certified reinsurer, a carrier must

- be domiciled and licensed to transact insurance or reinsurance in a "qualified" jurisdiction (discussed below);
- maintain capital and surplus of at least \$250,000,000;

¹ NAIC Credit for Reinsurance Model Law ("Model Law") § 2(A)-(D).

² *Id.*, § 3; NAIC Credit for Reinsurance Model Regulation ("Model Reg.") § 11.

³ Model Law § 2(E); Model Reg. § 8(A)(1).

- maintain financial strength ratings from two or more of Standard & Poor's, Moody Investors Service, Fitch Ratings, A.M. Best Company or any other "Nationally Recognized Statistical Rating Organization" (as defined);
- agree to submit to the jurisdiction of the state, appoint the regulator as its agent for service of process in the state and agree to provide security for 100% 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;
- agree to meet applicable information filing requirements; and
- satisfy any other requirements for certification deemed relevant by the insurance regulator.⁴

The amendments provide that the insurance regulator must create and publish a list of "qualified" jurisdictions for purposes of the criterion described in the first bullet above. In order to determine whether a jurisdiction is eligible to be recognized as a qualified jurisdiction, the regulator must "evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction" and consider the extent to which the jurisdiction grants reciprocity with respect to U.S. insurance laws. Furthermore, a jurisdiction cannot be qualified unless it agrees to share information with the state regulator and enforces U.S. judgments and arbitration awards.⁵

In addition, the regulator is required to consider guidance from the NAIC in determining qualified jurisdictions. If the regulator approves a jurisdiction as qualified that does not appear on the NAIC's own list of qualified jurisdictions, the regulator must provide a "thoroughly documented justification" for such determination.⁶

The regulator is required to assign a rating to each certified reinsurer, giving "due consideration" to the reinsurer's financial strength ratings from rating agencies, and to publish a list of all certified reinsurers and their ratings. The maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as outlined in the table below.⁷ The regulator must use the *lowest* financial strength rating received from an approved rating agency in establishing the *maximum* rating of a certified reinsurer.

⁴ Model Law § 2(E)(1); Model Reg. § 8(B)(3)(b) and (c).

⁵ Model Law § 2(E)(3)(a).

⁶ Model Law § 2(E)(3)(b).

⁷ Model Reg. § 8(B)(4)(a).

Ratings	Best	S&P	Moody's	Fitch
Secure – 1	A++	AAA	Aaa	AAA
Secure – 2	A+	AA+, AA, A-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure – 3	A	A+, A	A1, A2	A+, A
Secure – 4	A-	A-	A3	A-
Secure – 5	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB
Vulnerable – 6	B, B-, C++, C+, C, C-, D, E, F	BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD

The regulator must allow the ceding company to claim credit for reinsurance ceded to a certified reinsurer based upon the security held by or on behalf of the ceding insurer in accordance with these ratings. The amount of security required in order for full credit to be allowed corresponds with the following requirements:⁸

Rating	Security required
Secure – 1	0%
Secure – 2	10%
Secure – 3	20%
Secure – 4	50%
Secure – 5	75%
Vulnerable – 6	100%

The NAIC credit-for-reinsurance amendments follow steps taken by a number of states, including New York⁹ and Florida,¹⁰ to relax their own collateral requirements for reinsurance. It remains to be seen whether the remaining states will coalesce around the amended NAIC model or forge their own paths on this issue.

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⁸ Model Reg. § 8(A)(1).

⁹ 11 NYCRR § 125.4.

¹⁰ Fla. Stat. § 624.610(3)(e); Fla. Admin. Code 690-144.007

For More Information

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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