LLB&L Client Alert

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NAIC Sanctions Reform of State-Based Reinsurance Collateralization Requirements

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Sunday, December 7th marked the fruition of a years-long initiative led by prominent overseas reinsurers to convince the National Association of Insurance Commissioners ("NAIC") to permit the reduction of U.S. reinsurance collateralization requirements. On that day, the Plenary of the NAIC, convening in Dallas at the NAIC Winter 2008 National Meeting (the "NAIC National Meeting"), adopted the last in a series of reinsurance modernization proposals debated by the NAIC's Reinsurance (E) Task Force ("RTF"). The proposal, known as the Reinsurance Regulatory Modernization Framework Proposal (the "Framework"), was introduced in late 2007. (For discussions relating to the development of the Framework, see our *Client Alert* dated December 7, 2007 and the August 2008 issue of our *Re News and Focus*.)

Overview of Framework Adopted by NAIC Plenary

The Framework is aptly named. It sets forth, in concept, (i) reduced reinsurance collateral requirements for highly-rated U.S. and non-U.S. reinsurers, and (ii) principles for single-state reinsurer licensing (in the case of U.S. reinsurers) and certification (in the case of non-U.S. reinsurers).

Key elements of this conceptual framework are:

- New reduced collateral requirements which, as discussed in our previous reports, assign percentage collateralization requirements to U.S. and non-U.S. reinsurers on a sliding scale based upon their rating organization financial strength ratings.
- Reinsurers may elect to be governed by the new requirements or continue to meet the reinsurance collateral requirements of the existing NAIC Credit for Reinsurance Model Law (the "Model Law"). Under the Model Law, a cedent is permitted to take financial statement credit for reinsurances ceded to reinsurers licensed or accredited in its state of domicile without the need for such reinsurers to post collateral.
- Reinsurers that opt for governance under the new requirements would be regulated by a home state supervisor, for U.S. reinsurers, or a port of entry state supervisor, for non-U.S. reinsurers.
- Only those non-U.S. reinsurers whose domiciliary regulatory regimes have been evaluated and recognized as eligible by a newly proposed NAIC Reinsurance Supervision Review Department ("RSRD") would be permitted to opt-in.
- The Framework applies prospectively and benefits only those reinsurers writing new or renewal business. Reinsurers in run-off would not benefit from the Framework's reduced collateral requirements.

Implementation of the Framework

Adoption by Plenary was merely the predicate to implementation of the Framework. That work now begins. The Chair of the RTF, New Jersey Insurance Commissioner Steven M. Goldman, envisages that implementation would be a two-step process. As quoted in the NAIC's News Release dated December 7, 2008 entitled "Reinsurance Reform Moves Ahead," Commissioner Goldman stated that "Now, we must focus on developing the specifics of this new regulatory regime and taking the appropriate legislative steps to make the proposal a reality." At this point, the specifics of that new regime are unclear. What is clear is that Plenary has instructed the RTF to follow certain "Principles for the Creation of the RSRD," which appear to be principles suggested by the National Conference of Insurance Legislators ("NCOIL"). The NAIC's preliminary statement of these principles, as set forth in the NAIC's December 7th News Release, may be summarized as follows:

- The RSRD should be a transparent and publicly accountable part of the NAIC governed by a board comprised of state insurance regulators chosen from the chief regulatory officers of all states.

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- The RSRD's ceded premium volume criteria should not unfairly discriminate against small states, as measured by ceded premium volume, that apply for approval as a home state or port of entry state supervisor.

After the NAIC develops the specifics of the new reinsurance regulatory regime, legislative action or, in some cases, mere regulatory action in all states or the adoption of Federal enabling legislation would be necessary to implement the new regime. At present, it is unclear whether Federal enabling legislation will be introduced next year and, if so, to what extent the legislation would preempt or merely supplement state insurance law to enable port of entry states to regulate reinsurers on a national basis. Regulators at the NAIC National Meeting expressed hope that the implementation process would be expedited by Federal enabling legislation enacted in 2009. NCOIL, however, cautioned regulators during the NAIC National Meeting against Federal involvement in the implementation process.

Impact of Framework Adoption upon State Collateral Reduction Proposals

Based upon discussions with certain state regulators and upon published reports, states will proceed as follows in light of the Framework's adoption:

- Some of those states that have not yet formally introduced collateral reduction proposals will hold such action in abeyance pending conclusion of the Framework implementation process. As discussed above, that process would entail state legislative action or, in some cases, mere regulatory action, or the adoption of Federal enabling legislation.
- Although Florida has already promulgated its own reinsurance collateral reduction rule, it plans to adopt the Framework when implemented.
- Despite published reports to the contrary, New York will proceed with the adoption of its own reduced collateral proposal to avoid excessive delay in implementing the Framework.

Reinsurers Excluded from Framework

As discussed above, reinsurers in run-off would not benefit from the Framework as adopted by NAIC Plenary. However, a proposal was introduced at the RTF's December 5th meeting in Dallas to afford some alternative form of relief to trusteed reinsurers (i.e., those that currently maintain a multi-beneficiary trust for the benefit of their U.S. cedents) that are in run-off. Under that proposal, which will be reviewed shortly by the RTF, the domiciliary regulator of the U.S. reinsurance trust of a non-U.S. reinsurer in run-off would have the sole discretion to permit such reinsurer to maintain less than the minimum trust surplus of $20 million now required by the Model Law but not less than 5 percent of the total reinsurance liabilities secured by the trust.

In light of the further action needed by the NAIC to agree upon the specifics for implementation of the Framework, including a new Model Law, new NAIC Credit for Reinsurance Model Regulations, legislative or regulatory action by the states, or possible Federal legislation, it is difficult to predict how long implementation would take throughout the United States. Some have estimated that it could take two to three years. At the same time, however, some states, such as Florida and probably New York, may begin implementation in 2009.

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