Reinsurance Association of America

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Support for NAIC Credit for Reinsurance Model Changes Regarding Collateral Reform

In November 2011 the National Association of Insurance Commissioners unanimously approved changes to its credit for reinsurance model law and regulation. These changes would give insurance departments the discretion to reduce the amount of collateral required of certain financially strong reinsurers from sound regulatory jurisdictions when providing reinsurance to U.S. domestic insurers.

Reinsurance − sometimes referred to as “insurance for insurers” − helps insurers manage the financial consequences of potentially catastrophic losses from the coverage they write by spreading the risk to one or more reinsurers. Capital support from reinsurance also allows insurers, particularly small domestics, to write more business. Under current law, reinsurers not licensed in the U.S., unlike their licensed counterparts, must provide collateral (in the form of letters of credit, trust accounts or funds withheld) in the amount of their liabilities for the reinsurance they write for U.S. insurers. This requirement ties up capital that could be used to write more reinsurance and creates frictional costs in the transactions of U.S. insurers.

- The NAIC has added critical new tools to the U.S. regulatory framework. Under the new models regulators will have significant oversight over foreign reinsurers. These tools will strengthen oversight by building regulators’ knowledge of ceding insurers’ reinsurance practices and the supervision of those counter parties. For example, the NAIC models would:

    - Create a framework for cooperation, coordination, review and approval of foreign jurisdiction solvency regulation requirements applied to international reinsurers. Once the jurisdiction’s framework is approved and a trusting relationship established with that regulator, the vetting of the reinsurer may take place.

    - Create a framework for oversight, to include mandatory filing and review of the international reinsurer’s financial statements, claims payment practices, business reputation, license status, regulatory sanctions, rating agency evaluations and other material deemed prudent by the state regulator.

    - Create a mechanism for an individual state regulator to grant the reinsurer the opportunity to conduct its US business with less than full collateral for its cedents based on the state regulator’s analysis and approval of the specific reinsurer. No reduction in collateral can take place for the domestic insurers supervised by the state regulator without the specific approval of the state regulator. The state regulator’s decision is controlling.

    - Encourages prompt payment of reinsurance claims to US cedents, and imposes penalties for undue delays.

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- The new credit for reinsurance rules will encourage strong international reinsurers to provide additional support to U.S. States, particularly those exposed to natural catastrophes.
    - They allow financially strong reinsurers the ability to more efficiently use currently restricted capital which may be reinvested in the U.S. to write more business. Reinsurers, like other businesses, are attracted to those markets where they can use their capital most productively and do the most business.

- The NAIC models still allow insurers to negotiate the terms of their reinsurance contracts, including collateral, with their reinsurers − The changes are permissive, not mandatory, so insurers will still have the ability to negotiate their own collateral requirements with reinsurers.

- The changes apply prospectively and are intended to apply to reinsurance contracts entered into or renewed after the date of enactment.

- The number of reinsurers and jurisdictions seeking to qualify under the new rules will be small and will not pose an excessive burden on the Insurance Department.
    - According to a 2012 Standard and Poor's Global Reinsurance Market Report based on 2011 net premiums written, the top 10 reinsurers account for nearly 70% of the global reinsurance market. These reinsurers are domiciled in 5 non-U.S. jurisdictions – Bermuda, France, Germany, Switzerland, and the UK.
    - The same Standard and Poor's data also indicates that if the list is expanded to the top 40 reinsures only 5 additional jurisdictions are added -- Australia, India, Japan, Korea, and Spain.
    - Jurisdictions that have enacted the reduced collateral rules have approved less than 30 reinsurers in the time the rules have been in place.

- The changes have received extraordinarily thorough review and debate over the past decade and particularly over the past several years. The NAIC models were supported by the global reinsurance industry and a national P&C trade association and and were not opposed by the other national P&C primary trade associations. They represent intense negotiations and compromise and received unanimous approval from the NAIC.

- States that do not pass the new NAIC model changes will disadvantage their domestic insurers in the international reinsurance market.

- The reforms have passed in 18 states thus far – NY, FL, NJ, IN, VA, GA, LA, CT, PA, DE, CA, IA, MD, AL, MO, RI, ME and NH.