

National Association of Insurance Commissioners to Hold February Hearing on Collateral Requirements for EU Reinsurers

The National Association of Insurance Commissioners (NAIC) will hold a public hearing in New York City on 20 February 2018 to consider how U.S. States should address the elimination of reinsurance collateral requirements for EU reinsurers of U.S. insurance business that were covered in the bilateral agreement between the U.S. and the EU on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement), which was signed on 22 September 2017. Under the Covered Agreement, U.S. States will need to consider action with respect to reinsurance collateral reforms within 60 months or be subject to potential federal preemption.

Set forth below are the six points on which the NAIC has requested public comments in advance of the hearing as well as a brief summary of various industry observations with respect to each point.

Request for Comments. The NAIC notice requests specific comments on the following approaches to reinsurance collateral reform:

1. *Amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) (the “Reinsurance Models”) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement.*

Observations

As background, European reinsurers have long advocated for the United States to ease reinsurance collateral requirements on EU-based reinsurers and treat them like their U.S. counterparts. As a result, in 2011 the NAIC adopted revisions to the Reinsurance Models that reduced reinsurance collateral requirements for a new class of “certified reinsurers” that are (i) in solid financial health (*e.g.*, those that maintain minimum capital and surplus of at least \$250,000,000) and (ii) subject to an effective regulatory regime (a “Qualified Jurisdiction”). Historically, state insurance regulators have required non-U.S. reinsurers to maintain within the U.S. collateral representing 100% of liabilities for the risks they assume from U.S. insurers in order for U.S. ceding insurers to take credit for reinsurance. The revised Reinsurance Models provide for a sliding scale of required collateral posting for certified reinsurers, with six categories ranging from 0% required collateral for certified reinsurers with the strongest (Secure-1) rating to 100% required collateral for those with the weakest (Vulnerable-6) rating. Under the revised Reinsurance Models, the approval of qualified jurisdictions is left to the authority of the states; however, the models provided that a list of qualified jurisdictions would be created through the NAIC committee process and states can refer to such list in approving an application of a non-U.S. entity seeking certified reinsurer status. As of January 1, 2016, seven jurisdictions (Bermuda, France, Germany, Ireland, Japan, Switzerland and the United Kingdom) have been placed on the NAIC List of Qualified Jurisdictions.

While certain of the conditions under Article 3 of the Covered Agreement for the elimination of reinsurance collateral requirements for EU-based reinsurers are substantially similar to the NAIC’s amended Reinsurance Models applicable to certified reinsurers (*e.g.*, the minimum capital and surplus requirement and prompt payment of reinsurance claims) and thus will necessitate only minimal changes to synthesize the two regimes, other certified reinsurer requirements under the Reinsurance Models (*e.g.*, a sliding scale of required collateral posting depending on the reinsurer’s financial strength rating) that are inconsistent with the Covered Agreement will require substantive revisions to the Reinsurance Models.

One trade association has proposed that collateral be reduced by 20% each year of the 60 month period resulting in a reduction to 0% at the end of the 5 year period.

2. *Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.*

Observations

At a recent NAIC national meeting, an insurance association commented that there is already significant fatigue in state legislatures from the credit for reinsurance changes over the past several years, and recommended that a process be implemented that can be consistently applied going forward for any additional qualified jurisdictions.

3. *Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements.*

Observations

A cohort of international reinsurers and trade associations have publicly advocated that existing NAIC Qualified Jurisdictions be given the same benefits of the Covered Agreement so as to maintain a level playing field for all insurers and to obviate the need for each of these jurisdictions to negotiate a similar agreement with the U.S.

However, in a statement to the U.S. House Financial Services Subcommittee on Housing and Insurance in early 2017, the National Association of Mutual Insurance Companies (NAMIC) commented that: “The EU is unlikely to be the last jurisdiction to push for zero-collateral requirements as Bermuda has already asked whether the U.S. will give them the benefit of the same deal. This could be the beginning of zero collateral for all non-U.S. reinsurers. This would ignore the work state regulators/legislatures have done in the last several years in adopting changes to the NAIC’s Credit for Reinsurance Model Act and Regulation. The state policymakers enacting these laws have considered the issues, listened to interested parties, and developed solutions that balance the interests of foreign reinsurers, the U.S. primary insurers that are their customers, and the policyholders of U.S. companies who expect their claims to be paid.”

4. *Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction.*

Observations

At the most recent NAIC national meeting it was noted that the prescribed reevaluation of the current group of seven Qualified Jurisdictions is due at the end of 2019 and that such reevaluation is still relevant (even for four of the seven jurisdictions that are members of the EU) and should be performed as the Covered Agreement provisions may not be adopted by all relevant U.S. States by that time.

5. *Considering additional “guardrails” relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral.*

Observations

In a 15 March 2017 letter to U.S. Treasury Secretary Steven Mnuchin, the NAIC noted that: “Though, over the course of the past few years, states have reduced collateral requirements, they have not been eliminated. Our approach is risk-based and reinsurer collateral requirements range from 0% to 100% based on an assessment of the financial strength of the reinsurer and quality of its supervision. While there are conditions in the [Covered] Agreement that reinsurers would have to meet to avoid being subject to

collateral requirements, several of those conditions differ materially from current state credit for reinsurance laws. In light of these differences, states may have to take alternative measures to ensure that ceding U.S. insurers, and, by extension, U.S. policyholders are protected from any risks posed by reinsurance counterparties.”

It bears noting that the Covered Agreement provides that it does not prohibit state regulators from imposing non-collateral requirements as a condition for ceding companies to enter into reinsurance agreements with EU reinsurers or to allow credit for reinsurance, but only if such requirements “do not have substantially the same regulatory impact as collateral requirements” and only if the same requirements apply with respect to reinsurance agreements with U.S. reinsurers domiciled in the state.

6. *Any other considerations to weigh as part of the states’ implementation of the Covered Agreement.*

Written comments to the NAIC are due by 6 February 2018. Hogan Lovells’ New York Insurance Practice Group will continue to closely follow U.S. developments involving reinsurance collateral reform. Should you have any questions regarding this post, please contact Robert Fettman at robert.fettman@hoganlovell.com.