

Department of Legislative Services
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FISCAL AND POLICY NOTE
Revised

House Bill 1166
Economic Matters

(Delegate Davis)

Finance

Insurance - Ceding Insurers and Reinsurance

This bill amends the requirements that must be met by an assuming insurer before credit is allowed. The bill authorizes the Insurance Commissioner to adopt regulations to carry out the bill's provisions. Any laws of the State that are inconsistent with the bill are superseded to the extent of the inconsistency.

The bill takes effect June 1, 2013. Credit for reinsurance ceded to a reinsurer under the bill may be allowed only for reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer by the Commissioner. The bill does not impair a presently existing obligation or contract.

Fiscal Summary

State Effect: The bill's requirements can be handled with existing budgeted resources.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: Credit is allowed, if specified requirements are met, with respect to cessions of those kinds or classes of business that an assuming insurer is licensed or otherwise allowed to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit is allowed when the reinsurance is ceded to an assuming insurer that (1) is licensed to transact insurance or reinsurance in the State; (2) is accredited by the Commissioner as a reinsurer in the State according to

the bill's accreditation requirements; or (3) subject to the assuming insurer agreeing to specified requirements, maintains a trust fund meeting specified requirements in a qualified U.S. financial institution, as defined by the bill, for the payment of the valid claims of its U.S. ceding insurers and their assigns and successors in interest.

Additionally, the bill authorizes credit to be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the Commissioner as a reinsurer in the State and secures its obligations in accordance with the bill's requirements.

Even if an assuming insurer does not meet the above requirements, credit is allowed for the insurance of risks located in jurisdictions where the reinsurance is required by the applicable law or regulation of that jurisdiction.

Additionally, if the assuming insurer does not meet the above requirements, an asset or a reduction from liability for the reinsurance ceded by a domestic insurer is allowed in an amount not exceeding the liabilities carried by the ceded insurer. The reduction is in the amount of funds held by or on behalf of the ceding insurer under a reinsurance contract with the assuming insurer as security for the payment of obligations under the contract if the security meets specified requirements.

Accreditation Requirements: As noted above, credit is allowed when the assuming insurer is accredited by the Commissioner as a reinsurer in the State. In order for an assuming reinsurer to be eligible for accreditation by the Commissioner, the bill requires the reinsurer to:

- file with the Commissioner evidence of its submission to the State's jurisdiction;
- submit to the Commissioner's authority to examine its books and records;
- be licensed to transact insurance or reinsurance in at least one state or, in the case of a U.S. branch of an alien assuming insurer, be entered through and licensed to transact insurance or reinsurance in at least one state;
- file each year with the Commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; and
- demonstrate to the satisfaction of the Commissioner that the reinsurer has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers.

Under the bill, an assuming insurer has adequate financial capacity if, at the time of its application, the assuming insurer maintains a surplus as regards policyholders in an amount equal to or greater than \$20,000,000 and the Commissioner has not denied the assuming insurer's accreditation within 90 days after the application has been submitted.

Trust Fund Requirements: As noted above, credit is allowed when reinsurance is ceded to an assuming insurer that, subject to the assuming insurer agreeing to specified requirements, maintains a trust fund meeting specified requirements in a qualified U.S. financial institution for the payment of the valid claims of its U.S. ceding insurers and their assigns and successors in interest. Credit is not granted until approval of the trust has been given by either the insurance regulatory agency of the state where the trust is domiciled or the insurance regulatory agency of another who, under the terms of the trust instrument, has accepted principal regulatory oversight of the trust.

To enable the Commissioner to determine the sufficiency of a trust fund, the assuming insurer must report each year to the Commissioner information substantially the same as that required to be reported on the National Association of Insurance Commissioners (NAIC) annual statement form by authorized insurers. Additionally, the assuming insurer must submit its books and records for examination by the Commissioner and bear the expense of the examination. The trust and the assuming insurer are subject to examination as the Commissioner determines.

The bill requires the form of the trust and any trust amendments to be filed with the insurance regulatory agency of each state in which the ceding insurer beneficiaries of the trust are domiciled.

The bill also requires that the following requirements be met:

- the form of the trust and any trust amendments must be filed with the insurance regulatory agency of each state in which the ceding insurer beneficiaries of the trust are domiciled;
- the trust instrument must provide that contested claims are valid and enforceable on the final order of any court of competent jurisdiction in the United States;
- the trust must vest legal title to its assets in its trustees for the benefit of the assuming insurer's U.S. ceding insurers and their assigns and successors in interest;
- the trust must remain in effect for as long as the assuming insurer has outstanding obligations due under the reinsurance contracts subject to the trust; and
- the trustee, not later than February 28 of each year, must (1) report to the Commissioner in writing the balance of the trust and list the trust's investments at the preceding year-end and (2) certify the date of termination of the trust, if so planned, or certify that the trust will not expire before the following December 31.

At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the insurance regulatory agency with principal regulatory oversight of the trust may authorize a reduction in the required trusteed surplus, as defined by the bill.

However, a reduction may only be authorized after a determination, based on an assessment of the risk, is made that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders, and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review and must consider all material risk factors. The minimum required trusteed surplus may not be reduced to an amount less than 30% of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust.

The bill establishes additional varied requirements for a single assuming insurer and a group including incorporated and individual unincorporated underwriters.

Certification Requirements: As noted above, the bill authorizes credit to be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the Commissioner as a reinsurer in the State and secures its obligations in accordance with the bill's requirements. The bill establishes the following requirements an assuming insurer must meet before being considered eligible for certification. An assuming insurer must:

- be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as defined by the bill;
- maintain minimum capital and surplus, or its equivalent, in an amount the Commissioner determines in accordance with regulations the Commissioner adopts;
- maintain financial strength ratings from two or more rating agencies that the Commissioner considers acceptable;
- agree to submit to the State's jurisdiction;
- appoint the Commissioner as its agent for service of process in the State;
- agree to provide security for all 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 application information filing requirements as the Commissioner determines for the initial application for certification and on an ongoing basis; and
- satisfy any other requirements for certification that the Commissioner considers relevant.

If a certified reinsurer's domiciliary jurisdiction ceases to be a qualified jurisdiction, the Commissioner may indefinitely suspend or revoke the certification.

The bill authorizes a group to be a certified reinsurer if it meets the aforementioned certification requirements as well as additional specified requirements.

Qualified Jurisdictions: The bill requires the Commissioner to maintain and publish a list of qualified jurisdictions under which an assuming insurer, licensed and domiciled in that jurisdiction, is eligible to be considered for certification by the Commissioner as a certified reinsurer.

In determining whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the Commissioner must (1) evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, initially and on an ongoing basis and (2) consider the rights, benefits, and extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the United States. The bill prohibits the Commissioner from recognizing as a qualified jurisdiction a jurisdiction that the Commissioner determines does not adequately and promptly enforce final U.S. judgments and arbitration awards.

A qualified jurisdiction must agree in writing to share information and cooperate with the Commissioner with respect to all certified reinsurers domiciled in that jurisdiction.

The Commissioner may consider other factors in determining the jurisdiction's eligibility, including whether the jurisdiction appears on NAIC's list of qualified jurisdictions. If the Commissioner approves a jurisdiction not on the list, the bill requires the Commissioner to provide information related to the approval to NAIC, as provided in regulations the Commissioner adopts. A jurisdiction that meets the requirements of NAIC's financial standards and accreditation program must be recognized as a qualified jurisdiction in the State.

Certified Reinsurer Ratings: The bill requires the Commissioner to assign a rating to each certified reinsurer, based on factors the Commissioner considers relevant, giving due consideration to the financial strength ratings that have been assigned by rating agencies in accordance with regulations the Commissioner adopts. The Commissioner must publish a list of all certified reinsurers and their ratings.

If an applicant for certification has been certified by the insurance regulatory agency of a NAIC-accredited state, the Commissioner may use information provided by that insurance regulatory agency to designate the assuming insurer as a certified reinsurer in the State and/or assign a rating to the assuming insurer. If a certified reinsurer ceases to assume new business in the State, it may request to maintain its certification in inactive status in order to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer must continue to comply with the requirements to secure its obligations. The Commissioner must assign a rating that takes into account, if relevant, the reasons why the reinsurer is not assuming new business.

Secured Obligations: A certified assuming insurer must also meet specified requirements relating to secured obligations. The bill requires a certified reinsurer to secure obligations assumed from U.S. ceding insurers at a level consistent with its rating. In order for a domestic ceding insurer to qualify for full financial statement credit, the certified reinsurer must maintain security in a form the Commissioner considers acceptable and consistent with specified requirements or in a specified multibeneficiary trust.

The bill requires the certified reinsurer to bind itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each trust account, to fund, on termination of the trust account, out of the remaining surplus of the trust, any deficiency of any other trust account.

If the security is insufficient, the bill requires the Commissioner to reduce the allowable credit by an amount proportionate to the deficiency, and the Commissioner may impose further reductions in allowable credit on finding that there is a material risk that the certified reinsurer's obligations will not be paid in full when due.

If a certified reinsurer's certification has been revoked, suspended, voluntarily surrendered, or placed on inactive status for any reason, the reinsurer must be treated as a certified reinsurer required to secure 100% of its obligations. If the Commissioner continues to assign a higher rating as allowed by the bill, the requirement to secure 100% of its obligations does not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended.

Enforcement Authority: The bill authorizes the Commissioner to suspend or revoke, after providing notice and an opportunity for hearing to the reinsurer, a reinsurer's accreditation or certification if the reinsurer ceases to meet the requirements for accreditation or certification. Any revocation or suspension does not take effect until after the Commissioner's order on hearing unless (1) the reinsurer waives its right to a hearing; (2) the Commissioner's order is based on a regulatory action by the reinsurer's domiciliary jurisdiction or primary certifying state, as defined by the bill, suspending or revoking the reinsurer's eligibility to transact insurance or reinsurance; (3) the reinsurer voluntarily surrenders its license or certification to transact insurance or reinsurance business in its domiciliary jurisdiction or primary certifying state; or (4) the Commissioner finds that an emergency requires immediate action by the Commissioner and a court of competent jurisdiction has not stayed the Commissioner's action.

A reinsurance contract issued or renewed after the suspension date of a reinsurer's accreditation or certification generally does not qualify for credit. Similarly, credit for reinsurance may not be granted after the revocation date of an accreditation or certification.

Reinsurance Contract Conditions: Credit is allowed when reinsurance is ceded to an assuming insurer that, subject to the assuming insurer agreeing to specified requirements, maintains an appropriate trust fund. The assuming insurer must agree in the reinsurance contract:

- that in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance contract, the assuming insurer, at the request of the ceding insurer, must (1) submit to the jurisdiction of any court of competent jurisdiction in any state; (2) comply with all requirements necessary to give the court jurisdiction; and (3) abide by the final decision of the court or of any appellate court in case of an appeal; and
- to designate the Commissioner as its resident agent on whom any lawful process may be served in any action, suit, or proceeding instituted by or on behalf of the ceding insurer.

For an assuming insurer that meets the above description and a certified assuming insurer, the bill requires the assuming insurer to agree to specified conditions in the trust agreements.

Management of Exposure: The bill requires a ceding insurer to take steps to manage its reinsurance recoverables proportionate to its own book of business and to diversify its reinsurance program. If specified conditions are met, a domestic ceding insurer must provide a notice to the Commissioner that demonstrates the domestic ceding insurer is safely managing its exposure.

Current Law: Generally, an insurer may reinsure all or part of a particular risk. An insurer may accept reinsurance only of those risks, and retain risk on reinsurance only within those limits, as the insurer is otherwise authorized to insure.

Credit may not be allowed, as an asset or deduction from liability, to a ceding insurer for reinsurance unless (1) the reinsurer is authorized to transact insurance business in the State or is a solvent insurer approved or accepted by the Commissioner for the purpose of reinsurance and (2) the reinsurance contract provides, in substance, that in the event of the insolvency of the ceding insurer, the reinsurance must be payable under the terms of a contract reinsured by the reinsurer on a specified basis. Generally, payments made by a reinsurer must be made directly to the ceding insurer or its domiciliary receiver.

Each unauthorized insurer that applies for approval or renewal of approval as an accepted reinsurer must file annually with the Commissioner (1) an annual statement on convention form; (2) a certificate evidencing a deposit; and (3) a certificate of compliance.

Background: The bill contains provisions consistent with the 2011 amendments to NAIC's Model Law on Credit for Reinsurance.

Additional Information

Prior Introductions: None.

Cross File: SB 777 (Senator Pugh) – Finance.

Information Source(s): Maryland Insurance Administration, Department of Legislative Services

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