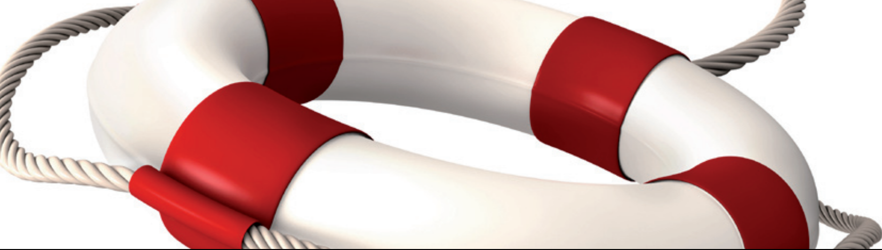

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US reinsurance collateral reform picks up pace

Reform of reinsurance collateral requirements in the US continues to progress, with four individual states already allowing unauthorised reinsurers to qualify for posting less than 100% collateral and the National Association of Insurance Commissioners (NAIC) taking action this month nearing the final step toward amending its model credit for reinsurance law and regulation. Florida, Indiana, New Jersey and New York already allow unauthorised reinsurers to qualify for posting less than 100% collateral depending on their financial strength ratings as well as other factors. The proposed amendments to the NAIC models allow for ratings-based reinsurance collateral reductions and will set a floor for collateral requirements that many states may follow. This article summarises the current state of US reinsurance collateral.

The pace of US reinsurance collateral reform received a boost when Congress adopted the Dodd-Frank Act in 2010. On 21 July 2011, subtitle B of title V of that Act became effective and, among others, imposed the pre-emption of state credit for reinsurance credit rules with respect to nondomestic ceding insurers. Section 531(a) NRRA provides that if a state of domicile of a ceding insurer is a NAIC-accredited state, or has solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and permits the ceding insurer to take credit for reinsurance on a ceded risk, then no other state in which the ceding insurer is licensed may refuse to recognise that credit for reinsurance. As all 50 states are currently NAIC-accredited, section 531(a) NRRA effectively pre-empts all nondomestic state credit for reinsurance rules for all reinsurance agreements involving a ceding insurer based in the US.

Florida was the first state to adopt reduced collateral requirements, amending its credit for reinsurance laws in 2008. Since then, at least 16 unauthorised reinsurers have received approval from Florida. In 2011, Indiana, New Jersey and New York joined Florida adopting adopt reduced collateral requirements. Florida's reduced collateral status is open only to property/casualty reinsurers, while Indiana, New Jersey and New York permit the status for both property/casualty reinsurers and life reinsurers (although New Jersey's law will not be applicable to life reinsurance until earlier of 24 months from the effective date of the Act or the implementation of principles-based standards of life insurance reserving by the NAIC). A number of legislatures in other states considered reinsurance collateral reform legislation in 2011, including Illinois, Louisiana and Texas. Similar state legislative activity in those and other states is anticipated in 2012, particularly if the NAIC adopts its model amendments at the end of this year as expected.

The NAIC is in the process of evaluating proposed amendments to its Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786), which, if adopted, will provide for reduced collateral requirements for credit for reinsurance. Many states base their credit for reinsurance statutes and regulations directly on the NAIC models or have a framework in place that is substantially similar. NAIC models are not recognised as law in any of the states, but the models are influential as accreditation standards. If the proposed amendments are adopted by the NAIC, states may choose to amend their laws and regulations to conform to the models. However, since the proposed amendments establish a floor for collateral requirements, states that choose to maintain their current stricter requirements will still meet the accreditation standard.

On 18 September 2011 the long process toward NAIC amendments reached its next to last step in the process, with the NAIC Reinsurance Task Force making its final last minute amendments and approving them after several years of deliberation. That same day, the parent committee of the NAIC Reinsurance Task Force, the E Committee, adopted the amended models by a vote of nine to two. The final step is for the NAIC Plenary to adopt them at the Fall NAIC meeting the first week of November. Then the activity is likely to turn to state legislatures in 2012 to see what additional states adopt legislation to implement the amended model law.

One of the last minute amendments proposed by New York and adopted by the Task Force and E Committee, was somewhat of a surprise and controversial. The amendment to section 8(A)(5) was as follows: "Credit for reinsurance under this section shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer. Any reinsurance contract entered into prior to the effective date of the certification of the assuming insurer that is subsequently amended after the effective date of the certification of the assuming insurer, or a new reinsurance contract, covering any risk for which collateral was provided previously, shall only be subject to this section with respect to losses incurred and reserves reported from and after the effective date of the amendment or new contract."

This could severely limit the ability of parties to take advantage of the new collateral scheme for in force business that is already reinsured and has existing collateral. In proposing the amendment, New York said it was intended to tighten up the wording to make clear that the new scheme would apply only prospectively and specifically noted the regulators' desire to limit affiliate retrocessions currently in place with substantial collateral that could 'fall off a cliff' overnight if permitted on in force risks. However, many participants in the life reinsurance industry in particular felt surprised by this last minute addition and that the Task Force was not considering the unique nature of the life reinsurance sector and its long-term risks. We will have to wait until the November NAIC meeting and the legislative efforts in individual states in 2012 to see how this long and winding road to US reinsurance collateral reform ends.