MAYER | BROWN

# GLOBAL INSURANCE INDUSTRY

## YEAR IN REVIEW

## 2019

EXCERPT

# Major New Developments Related to Credit for Reinsurance

One of the most important regulatory developments of the year was the adoption of amendments to the NAIC Credit for Reinsurance Model Law and Regulation (the "**NAIC Models**") on August 6, 2019. The amendments were designed to satisfy the requirements of (i) the bilateral agreement on insurance and reinsurance between the United States and the European Union and (ii) a substantially similar bilateral agreement between the United States and the United Kingdom (together, the "**Covered Agreements**"). The amendments have laid the foundation for state legislatures to amend their credit for reinsurance laws to become compliant with the Covered Agreements to avoid potential federal preemption.

## Background of the Covered Agreements

In contrast to primary insurance, where an insurer generally needs to be licensed in a state in order to do business in the state, a reinsurer does not need to be licensed in a state in order to provide reinsurance to insurers in the state. However, if the reinsurer is not licensed in the state, then it has generally needed to collateralize its reinsurance obligations in order for the insurer purchasing the reinsurance (the "**ceding insurer**") to take credit for the reinsurance on its balance sheet. Because reinsurers provide the financial support that enables primary insurers to meet their obligations to policyholders, requiring unlicensed reinsurers to maintain collateral in the United States is intended to ensure that claims-paying resources are available and accessible to US ceding insurers and regulators should they be needed, particularly in the wake of a natural disaster.

Originally, reinsurers that were not licensed in the state of domicile of the ceding insurer were required to post collateral for 100% of their reinsurance obligations. In 2011, however, the NAIC Models were amended to modify that requirement for some reinsurers. In states that have amended their laws and regulations to adopt the 2011 amendments, reinsurers that have completed a prescribed process to become "certified" reinsurers can post significantly less than 100% collateral to secure their US reinsurance obligations. Under the 2011 amendments, individual reinsurers are certified based on criteria that include, but are not limited to, financial strength, timely claims payment history and the requirement that a reinsurer be domiciled and licensed in a "qualified jurisdiction." The NAIC has established a process to evaluate jurisdictions' oversight of reinsurers, under which it has designated seven non-US jurisdictions as "qualified jurisdictions" for this purpose (Bermuda, France, Germany, Ireland, Japan, Switzerland and the United Kingdom). The NAIC has also established a peer review system to oversee the certification of non-US reinsurers by states, which enables non-US reinsurers that become certified in one state to "passport" that certification throughout the United States.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd-Frank**") established the legal framework for the United States to enter into bilateral or multilateral "covered agreements" with foreign jurisdictions that address regulatory measures with respect to the business of insurance or reinsurance. If state laws are inconsistent with a covered agreement and provide less favorable treatment to non-US insurers or reinsurers than US companies, then the covered agreement will preempt state law. A covered agreement can serve as a basis for preemption of state law only if the agreement relates to measures substantially equivalent to the protections afforded consumers under state law.

## The Covered Agreements

The US-EU covered agreement, signed on September 22, 2017 by the US Department of the Treasury ("**Treasury**"), the Office of the US Trade Representative ("**USTR**") and the EU, requires US states to eliminate reinsurance collateral requirements for EU reinsurers that satisfy certain stipulated qualifications within five years or else the Dodd-Frank preemption provisions will come into effect. In exchange, the EU will not impose local presence requirements on US insurers and reinsurers operating in the EU and, in effect, must defer to US group capital regulation for US entities of EU-based insurers and reinsurers.

On December 19, 2018, in anticipation of Brexit, the Treasury, the USTR and the UK signed a UK-specific Covered Agreement. The motivation for the US-UK Covered Agreement was to ensure that the arrangements embodied in the US-EU Covered Agreement would apply to the US-UK relationship after the UK ceased to be a member of the EU. The US-UK Covered Agreement effectively replicates the terms of the US-EU Covered Agreement.

The Covered Agreements eliminate local presence and collateral requirements for qualified US reinsurers operating in the UK and EU insurance markets. The Covered Agreements also eliminate the requirement for collateral for qualified UK and EU reinsurers operating in the US insurance market as a condition for their US ceding insurers to take credit for reinsurance. In addition, if US states implement appropriate group capital standards, the Covered Agreements provide that US insurance groups operating in the UK and EU will be supervised, at the worldwide group level, only by their relevant US insurance supervisors. Conversely, UK and EU insurers operating in the US will be supervised at the worldwide group level only by their relevant UK and EU insurance supervisors.

Broadly speaking, the Covered Agreements: (i) eliminate, as a requirement for reinsurance placement or as a condition for receiving financial statement credit for reinsurance, requirements for reinsurers based in the other jurisdiction to have a local presence or to post collateral; (ii) provide that an insurance or reinsurance group will be subjected to worldwide group supervision only in its "home" jurisdiction—not in its "host" jurisdictions where it operates; and (iii) establish regulatory best practices to be encouraged for cooperative exchanges of information among regulators across jurisdictions.

In order to obtain the benefits of the Covered Agreements, a non-US reinsurer must meet a number of requirements, including, among other things, maintaining a minimum capital and surplus of at least $250 million, meeting certain minimum solvency or capital ratios, adhering to prompt claim payment standards and furnishing certain financial information to the ceding insurer's domiciliary regulator upon request.

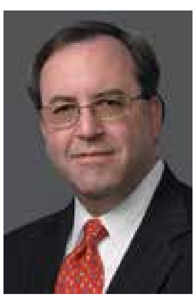
## 2019 Amendments to the NAIC Models

The NAIC quickly recognized that it would need to amend the NAIC Models to dovetail with the Covered Agreements. Originally, those amendments were expected to be adopted in December of 2018, but adoption was delayed because Treasury had expressed concerns about certain provisions that granted state insurance regulators discretion that could result in reinsurance collateral requirements that were inconsistent with the Covered Agreements. Accordingly, in early 2019, the NAIC Reinsurance (E) Task Force made revisions to the proposed amendments to address Treasury's concerns, and the revised text of the amendments was adopted in June 2019.

One of the most important features of the 2019 amendments to the NAIC Models is the concept of a "reciprocal jurisdiction." Reciprocal jurisdictions include: (i) jurisdictions with which the United States has entered into a covered agreement, (ii) US jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program and (iii) qualified non-US jurisdictions that have agreed to mutual recognition and reciprocity conditions that mirror those in the Covered Agreement (this category currently includes Bermuda, Japan and Switzerland). Under the 2019 amendments, the benefits of the Covered Agreements are extended to all reinsurers domiciled in a reciprocal jurisdiction—not just to EU and UK reinsurers—provided that the reinsurers meet the capital and other standards required by the Covered Agreements and the NAIC Models.

The NAIC is now tasked with ensuring that the individual US states amend their laws and regulations to conform to the amended NAIC Models in order to avoid federal preemption. Under the Covered Agreement, the Director of the Federal Insurance Office ("**FIO**") will begin evaluating US state insurance laws and regulations for possible federal preemption by March 1, 2021, making those states with the highest volume of gross ceded reinsurance a priority. The FIO Director will complete any necessary preemption determinations by September 1, 2022. With that in mind, at the 2019 NAIC Fall National Meeting, the amended NAIC Models were designated as NAIC state accreditation standards effective September 1, 2022. As a result, states that fail to amend their laws and regulations by January 1, 2023 to comport with the amended NAIC Models will risk losing their NAIC accreditation. That prospect, together with the possibility of federal preemption, will doubtless motivate states to take the necessary steps to adopt the amended NAIC Models, but crowded state legislative agendas may make actually achieving that goal a challenge.

# Authors



**Lawrence Hamilton**
Partner
lhamilton@mayerbrown.com
Chicago
+1 312 701 7055

**Sanjiv Tata**
Partner
stata@mayerbrown.com
New York
+1 212 506 2205

View the full Global Insurance Industry 2019 Year in Review.

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.