

REINSURANCE CHANGES

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Senate Bill 638 (S-1) as passed by the Senate

Sponsor: Sen. Margaret O'Brien

House Committee: Insurance

Senate Committee: Insurance

Complete to 1-24-18

Analysis available at
<http://www.legislature.mi.gov>

BRIEF SUMMARY:

Senate Bill 638 would amend Chapter 11 of the Insurance Code, dealing with reinsurance. The bill would revise the circumstances in which ceding insurers are allowed a credit for reinsurance, and add two new circumstances for the credit to be allowed. The two new circumstances involve the credit being allowed in a state with substantially similar requirements to those in Michigan, and a process for the director of the Department of Insurance and Financial Services (DIFS) to certify reinsurers in Michigan. The bill would also outline procedures for the revocation or suspension of assuming insurers, place certain management requirements on ceding insurers, adjust certain other requirements, and require the DIFS director to promulgate rules regarding reinsurance.

The bill would take effect 90 days after being enacted into law.

BACKGROUND:

Reinsurance is often described as “insurance for insurance companies.” In a reinsurance arrangement, an insurance company, or “ceding insurer,” purchases a reinsurance policy from a reinsurer, or “assuming insurer.” It works like a traditional insurance policy: the reinsurance company pays all or part of the claims of the ceding insurer when an event or threshold is triggered, subject to the terms of the policy. In exchange, the reinsurer receives a premium payment from the ceding insurer. Such an arrangement allows the ceding insurer to transfer a portion of its risk, thereby reducing the probability of a catastrophic loss, stabilizing underwriting results, and allowing the insurer to expand capacity as an underwriter.

DETAILED SUMMARY:

Reinsurance Credit

Under the Code, a “ceding insurer” must be allowed credit for reinsurance as either an asset or reduction of liability if certain criteria are met. [Note: the credit or reduction of liability is an accounting entry for an insurance company.] The bill would add to the criteria that the credit is only allowed to the extent that it is consistent with rules promulgated by the DIFS director regarding the valuation of reserve credits or assets, the amount and forms of security supporting reinsurance agreements, or the circumstances in which the credit will be reduced or eliminated.

The credit is authorized in two different circumstances: (1) if the reinsurance is ceded to an assuming insurer that is authorized to transact insurance or reinsurance in Michigan, or (2) if the reinsurance is ceded to an assuming insurer that meets any of three different sets of

requirements. The bill would revise these three sets of requirements, and add two additional sets, as follows:

(1) Currently under the Code, the credit is allowed for reinsurance ceded if the assuming insurer is accredited as a reinsurer in Michigan. The bill would remove a prohibition on receiving the credit if the assuming insurer's accreditation has been revoked by the commissioner.

A reinsurer must meet certain criteria and file information with the insurance commissioner¹ to be accredited. An insurer must also submit to the state's authority to examine its books and records; to this, the bill would add that the reinsurer bear the expense of this examination. The bill would remove a specific surplus requirement of at least \$20.0 million required for accreditation, and the option to maintain a surplus of less than \$20.0 million but receive approval from the director.

In its place, the bill would state that a reinsurer must demonstrate to the satisfaction of the director that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. This would be met if, at the time of application, the assuming insurer maintained a surplus as regards policyholders of at least \$20.0 million and its accreditation is not denied within 90 days after submission of its application.

(2) Also under the Code, the credit is allowed for reinsurance ceded if the assuming insurer maintains a trust fund in a qualified United States financial institution for the payment of the valid claims of its U.S. ceding insurers. The trust fund must meet certain criteria.

For a single assuming insurer, the trust must consist of both a trustee account and trustee surplus account of at least \$20.0 million. The bill would add provisions if the assuming insurer ever permanently discontinued writing new business secured by the trust. If the assuming insurer stopped for at least 3 full years, the commissioner with principal regulatory oversight could authorize a reduction in the required trustee surplus, but could only do so if the commissioner determined that the new required surplus level would be adequate for the protection of the ceding insurers, policyholders, and claimants. The commissioner would base this decision on an assessment of risk, which could involve an actuarial review.

The minimum required trustee surplus could not be reduced to an amount less than 30% of the assuming insurer's liabilities attributed to reinsurance covered by the trust.

For a group of underwriters, the trust fund must meet certain criteria based on the date of the agreement. These criteria are as follows:

- For reinsurance agreements with an inception date or renewal date *on or after August 1, 1995*, the trust fund must consist of a trustee account in an amount not less than the group's several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any group member.

¹ The bill would generally remove "commissioner" throughout and replace it with "director" [of DIFS].

- For reinsurance agreements with an inception date or renewal date *on or before July 1, 1995*, the trust fund must consist of a trustee account in an amount not less than the group's several insurance and reinsurance liabilities attributable to business written in the U.S.

The bill would change these dates to *on or after January 1, 1993* and *on or before December 31, 1992*, respectively.

The bill would add additional requirements for a group of incorporated underwriters under common administration, including:

- The group must have continuously transacted an insurance business outside the U.S. for at least 3 years immediately before applying for accreditation.
- The group must maintain an aggregate policyholders' surplus of at least \$10.0 billion.
- The group must maintain a trust fund in an amount of at least the group's several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group pursuant to reinsurance contracts issued in the name of the group.
- The group must also maintain a joint trustee surplus of which \$100.0 million is held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group as an additional security for those liabilities.
- Within 90 days after its financial statements are due to be filed with the group's domiciliary regulator, the group must provide the director an annual certification of each underwriter member's solvency by the member's domiciliary regulator and financial statements of each underwriter member of the group prepared by an independent public accountant.

(3) Under the bill, the credit would be allowed if the reinsurance is ceded to an assuming insurer that is domiciled in, or for a U.S. branch of an alien assuming insurer is entered through, a state that employs substantially similar standards regarding credit to those applicable under Michigan law, and the assuming insurer or U.S. branch of alien assuming insurer meets both of the following:

- Except for reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system, maintains a surplus as regards policyholders of at least \$20.0 million.
- Submits to the state's authority to examine its books and records and bears the expense of the examination.

(4) Under the bill, the credit would be allowed if the reinsurance is ceded to an assuming insurer that has been certified by the director as a certified reinsurer in Michigan and that secures its obligations as required under the bill.

The director could not certify an assuming insurer as a certified reinsurer unless the assuming insurer meets all of the following requirements:

- It is domiciled and licensed to transact insurance or reinsurance in a "qualified jurisdiction," as determined by the director.
- It maintains minimum capital and surplus in an amount determined by the director pursuant to rules.

- It maintains financial strength ratings from 2 or more rating agencies considered acceptable by the director pursuant to rules.
- It agrees to submit to the jurisdiction of Michigan.
- It agrees to appoint the director as its agent for service of process in Michigan.
- It agrees to provide security for 100% of its liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment.
- It agrees to meet applicable information filing requirements as determined by the director, both for an initial application for certification and on an ongoing basis.
- It satisfies any other requirements for certification the director considers relevant.

The director could certify an association including incorporated and individual unincorporated underwriters as a certified reinsurer if the association meets all the following:

- It meets the requirements of a certified reinsurer, above.
- It satisfies its minimum capital and surplus requirements through the capital and surplus equivalents, net of liabilities, of the association and its members, that include a joint central fund that could be applied to an unsatisfied obligation of the association or any of its members, in an amount determined by the director to provide adequate protection.
- The incorporated members of the association are not engaged in any business other than underwriting as a member of the association. The incorporated members would be subject to the same level of regulation and solvency control by the association's domiciliary regulator as the unincorporated members.
- Within 90 days after its financial statements are due to the association's domiciliary regulator, it provides the director an annual certification by its domestic regulator of the solvency of each underwriter member or, if a certification were unavailable, financial statements prepared by independent public accountants of each member of the association.

The director would publish a list of "qualified jurisdictions" under which an assuming insurer licensed and domiciled in a qualified jurisdiction would be eligible to be considered for certification by the director as a certified reinsurer.

To determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer would be eligible to be recognized as a qualified jurisdiction, the director would evaluate the appropriateness and effectiveness of the reinsurance supervisory system, initially and on an ongoing basis, and consider the rights, benefits, and extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. A qualified jurisdiction would have to agree to share information and cooperate with the director with respect to certified reinsurers within that jurisdiction. The director could not recognize a jurisdiction as a qualified jurisdiction if he or she were to determine that the jurisdiction does not adequately and promptly enforce final U.S. judgement and arbitration awards. The director could also consider additional factors to determine qualified jurisdiction eligibility.

Additionally, for purposes of determining whether a jurisdiction is a qualified jurisdiction, the director would have to consider a list of qualified jurisdictions published by the National Association of Insurance Commissioners (NAIC) committee process. If the

director approved a jurisdiction as qualified that was not on the NAIC list, the director would have to provide documented justification to the NAIC in accordance with criteria required pursuant to rules. The director would have to recognize a U.S. jurisdiction that meets the accreditation requirements under the NAIC financial standards and accreditation program as a qualified jurisdiction. If a certified reinsurer's domiciliary jurisdiction ceased to be qualified, the director could suspend the reinsurer's certification indefinitely, instead of revoking it.

The director would assign a rating to all certified insurers, considering the financial strength ratings that have been assigned by ratings agencies. The director would have to publish a list of all certified reinsurers and their ratings.

A certified reinsurer would have to secure obligations assumed from U.S. ceding insurers at a level consistent with its rating, according to rules promulgated by the director. The following would apply to a certified reinsurer securing its obligations:

- A domestic ceding insurer does not qualify for full financial statement credit for reinsurance ceded to a certified reinsurer unless the certified reinsurer maintains security in a form acceptable to the director and consistent with statute or in accordance with the trust fund requirements.
- If a certified reinsurer maintained a trust to secure its obligations and chose to secure its obligations incurred as a multibeneficiary trust, the certified reinsurer must maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security under the Code or comparable laws of other states and for its obligations in any other trust fund. The director could not certify a reinsurer unless the reinsurer bound itself, through language of the trust and agreement with the commissioner with regulatory oversight of each trust account, to fund, on termination of a trust account, out of the remaining surplus any deficiency of any other account.
- The \$20.0 million trustee surplus requirement does not apply to a multibeneficiary trust maintained by a certified reinsurer for purposes of securing obligations, but the trust must maintain a minimum trustee surplus of \$10.0 million.
- With respect to obligations incurred by a certified reinsurer, if the security is insufficient, the director must reduce the allowable credit by an amount proportionate to the deficiency and 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.

For purposes of these provisions, a certified reinsurer whose certification had been terminated would be required to secure 100% of its obligations. If the director continued to assign a higher rating, this requirement would not apply to a certified reinsurer in inactive status or to a reinsurer whose certification had been suspended. "Terminated" would mean revoked, suspend, voluntarily surrendered, or place in inactive status.

If an applicant for certification had been certified as a reinsurer in an NAIC-accredited jurisdiction, the director could defer to that certification and defer the rating assigned by that jurisdiction, and the applicant would be considered a certified reinsurer in Michigan.

A certified reinsurer that stopped new business in Michigan could request to maintain its certification in inactive status to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer would continue to comply with all applicable requirements, and the director would assign a rating that takes into account the reasons why the reinsurer is not assuming new business.

(5) Under the Code, the credit is allowed if the assuming insurer does not meet any of the above requirements, but only for the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction. The bill would not change this provision.

Conditions to Allow Credit

Currently under the Code, if the assuming insurer is not licensed or accredited, the credit related to the trust fund is not allowed unless the assuming insurer agrees to certain conditions in the reinsurance agreements. Under the bill, this provision would also apply to an assuming insurer that is not certified in Michigan. Also under the Code, the credit related to the trust fund is not allowed unless the assuming insurer agrees to certain conditions in the trust agreement. Under the bill, this provision would also apply to the credit related to a certified reinsurer in Michigan.

Suspension or Revocation of Accreditation or Certification

Under the bill, if an accredited or certified reinsurer ceased to meet the requirements for accreditation or certification, the director could suspend or revoke the reinsurer's accreditation or certification. The director would give notice to the reinsurer and an opportunity for hearing. The suspension or revocation could not take effect until after the director's order on hearing, unless one of the following applies:

- The reinsurer waives its right to hearing.
- The director's order is based on regulatory action by the reinsurer's domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer's eligibility to transact insurance or reinsurance in its domiciliary jurisdiction or in its primary certifying state.
- The director finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the director's action.

While a reinsurer's accreditation or certification is suspended, a reinsurance contract issued or renewed after the suspension would not qualify for the credit, except to the extent that the reinsurer's obligations are secured in a manner under the Code. If accreditation or certification is revoked, the credit may not be granted except to the extent that the obligations are secured.

Ceding Insurer Requirements

Under the bill, a ceding insurer would be required to manage its reinsurance recoverable assets proportionate to its book of business. It would have to notify the director within 30 days after reinsurance recoverable assets from any single assuming insurer, or group of affiliated assuming insurers, exceeded 50% of its last reported surplus to policyholders, or after it had determined that reinsurance recoverable assets from any insurer are likely to exceed the limit. The notification would have to demonstrate that the exposure is safely managed by the domestic ceding insurer.

A ceding insurer would also be required to take steps to diversify its reinsurance program. It would have to notify the director within 30 days after ceding to any single assuming insurer, or group of assuming insurers, more than 20% of its gross written premium in the prior calendar year, or after it determined that it is likely to exceed this limit. Again, the notification would have to demonstrate that the exposure is safely managed by the domestic ceding insurer.

Credit Allowed for Assuming Insurers not Meeting Requirements

Currently under the Code, an asset or reduction from liability for the reinsurance ceded by a ceding insurer to an assuming insurer that does not meet the above requirements is still allowed in a specific amount. The bill would add to this provision that any asset or reduction from liability is allowed only to the extent that it is consistent with rules promulgated by the director regarding the valuation of reserve credits or assets, the amount and forms of security supporting reinsurance agreements, or the circumstances under which credit will be reduced or eliminated.

The asset or reduction from liability is set at the amount of funds held by or on behalf of the ceding insurer, including funds held in trust, if the security is held in the U.S. The Code lists allowable forms for the security. To the list, the bill would add securities including those considered exempt from filing as defined by the purposes and procedures manual of the securities valuation office of the NAIC.

DIFS Rule Promulgation

The bill would add a new section to the chapter to allow the DIFS director to promulgate rules regarding reinsurance agreements under the Administrative Procedures Act. The rules could be in regard to:

- Life insurance policies with nonlevel gross premiums or guaranteed nonlevel benefits, if the reinsurance treaty contains policies issued during certain time periods.
- Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, again if the reinsurance treaty contains policies issued during certain time periods.
- Variable annuities with guaranteed death or living benefits.
- Long-term care insurance policies.
- Other life and health insurance and annuity products as the director considers necessary for the administration of the reinsurance sections of the Code.

Any rule promulgated under the new section could require a ceding insurer to use the valuation manual adopted by the NAIC under the NAIC standard valuation law when calculating amounts or forms of security required to be held.

Finally, a rule promulgated under the new section would not apply to cessions to an assuming insurer that meets either of the following:

- The assuming insurer is certified as a reinsurer in Michigan
- The assuming insurer maintains at least \$250.0 million in capital and surplus determined under the NAIC accounting practices and procedures manual and meets either of the following:
 - The assuming insurance is licensed to transact insurance or reinsurance in at least 26 states.

- The assuming insurer is licensed to transact insurance or reinsurance in at least 10 states, and is licensed to transact insurance or reinsurance or accredited as a reinsurer in a total of at least 35 states.

MCL 500.1103 and 500.1105 and proposed MCL 500.1106

FISCAL IMPACT:

Senate Bill 638 would likely lead to minor cost increases for the Department of Insurance and Financial Services, due to expanded departmental responsibilities. Under the bill, the Director of the Department of Insurance and Financial Services and, by extension, the department itself would assume responsibility for the following: publishing a list of qualified jurisdictions under which an assuming insurer would be eligible to be considered for certification as a reinsurer, evaluating the effectiveness of reinsurance supervisory systems of non-United States jurisdictions, providing documented justifications to entities as required by the bill, publishing a list of all certified reinsurers and their ratings, adjusting allowable credit as it pertains to reinsurers, providing notice and holding hearings before suspending or revoking a reinsurer's certification, and promulgating rules as required by the bill. Any increase in costs for the department would likely be supported by existing departmental appropriations.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.