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US CREDIT FOR REINSURANCE REQUIREMENTS

A. State Regulation

Reinsurance in the US is overseen by individual states through the use of credit for reinsurance laws and regulations. With some variation, all US states have enacted credit for reinsurance laws and regulations based on the "Model Laws and Regulations" published by the National Association of Insurance Commissioners (NAIC).

Rather than directly regulate reinsurers, states indirectly regulate reinsurers through these credit for reinsurance laws and regulations by requiring the ceding insurers to have certain provisions in their contracts with reinsurers in order for the ceding insurer to receive credit for reinsurance, for example, to receive a deduction from the ceding company's liabilities listed in their financial Annual Statement the ceding insurers are required to file each year with state insurance departments.

Whether a ceding insurer can take such credit for reinsurance depends on the licensing status of the reinsurer in the ceding insurer's state of "domicile". Every ceding insurer must have a home state (often where the ceding insurer has its principal place of business) whose insurance regulator is responsible for all oversight. This "home state" is known as the domicile. All regulation of credit for reinsurance is done by the regulator in the state of domicile regardless of where the cedent writes business. The insurance regulator typically understands its role as protecting the interests of individual policyholders, and so the current and future financial condition of the ceding company is its main concern.

Reinsurers are divided into two categories - authorized and unauthorized. Credit for reinsurance may be taken in both cases. If the reinsurer is authorized, the reinsurer has agreed to submit to the oversight by the insurance regulator including disclosing its financial condition. However, if a reinsurer is unauthorized in the cedent's domicile, then the reinsurer must provide individual collateral to the ceding company as a form of protection of the financial condition of the ceding company to be able to pay claims to individual policyholders.

B. Authorized Reinsurer

"Authorized Reinsurer" is not a term found in most state statutes, but it is a shorthand phrase used in the Annual Statement and Examiner's Handbook in order to clarify whether credit for reinsurance can be taken for a contract with a reinsurer without individual collateral.

Within this category, there are 3 sub-categories or types of authorized reinsurers:

1. ***Licensed*** – a reinsurer permitted to conduct insurance or reinsurance business in the state;
2. ***Accredited*** – a reinsurer that is permitted to conduct only reinsurance business in the state;
3. ***Trusteed*** – a reinsurer with a domicile in another country that is permitted to conduct insurance or reinsurance business in the US, but only after establishing a multi-beneficiary trust (MBT) that covers all the reinsurer's "Obligations" to <u>all</u> its US ceding insurers, plus $20 million. In this type of arrangement, the state regulator for the reinsurer is the regulator in the state where the MBT is established.

Sometimes a reinsurer may be licensed to conduct insurance business in its state of domicile but also may be accredited to conduct reinsurer business in other states. However, <u>reinsurers must be either licensed, accredited or trusteed in a ceding insurer's state of domicile</u> in order for the ceding insurer to take credit for the liabilities ceded to reinsurers without the requirement that the reinsurer provide individual collateral as security for its Obligations.

Under the credit for reinsurance laws and regulations, the term "Obligations" means:

a) losses and allocated loss expenses paid by the ceding insurer but not recovered from the reinsurer;

b) outstanding reserves for loss and allocated loss expenses;

c) reserves for incurred but not reported losses (IBNR), and

d) reserves and unearned premiums; plus

e) any other amounts due under the reinsurance contract (not included in the regulations of all states)

C. Unauthorized Reinsurer

If a reinsurer is unauthorized (not licensed, accredited or trusteed in the ceding insurer's state of domicile), then the reinsurer must provide individual (single beneficiary) collateral in the form of:

1. a letter of credit (LOC) issued by a bank; or
2. a trust account established at a bank in which assets (cash, stocks, bonds, etc.) of the unauthorized reinsurer are placed in an account subject to a trust agreement (not the same as an MBT because here the ceding insurer is the sole beneficiary); or
3. funds withheld (premium otherwise paid to the reinsurer under the reinsurance contract) that are retained by the ceding insurer; or
4. any other form of security approved by the regulator in the ceding insurer's state of domicile.

The credit for reinsurance regulations adopted by US states specify in considerable detail the requirements for LOCs and trust agreements to be compliant and, thus, acceptable to the regulator. In general, these requirements prohibit the reinsurer from imposing any conditions on the ability of the ceding insurer to withdraw amounts to satisfy the unauthorized reinsurer's Obligations. In other words, the ceding insurer is to have unfettered right to withdraw amounts if the unauthorized reinsurer's Obligations are due or if the unauthorized reinsurer has notified the ceding insurer that the LOC or trust account will be terminated while the unauthorized reinsurer's Obligations remain outstanding.

1. Reciprocal Jurisdiction Reinsurer Status

One exception to an unauthorized reinsurer being required to provide individual collateral is where the unauthorized reinsurer has ***qualified as a "reciprocal jurisdiction reinsurer" ("RJR")*** in a US jurisdiction. The first requirement for qualification is that the unauthorized reinsurer must be:

1. domiciled (or have its head office) in countries that have entered into "covered agreements" with the US (currently the EU and UK); or
2. domiciled in the US; or
3. domiciled (or have its head office) in a "reciprocal jurisdiction" (currently Bermuda, Japan and Switzerland).

The law also imposes additional requirements on surplus (a minimum policyholders' surplus of $250 million), solvency, minimum risk based capital, governance, and other requirements to protect the financial condition of the ceding insurer and its ability to pay claims of individual policyholders. Where a cedent obtains reinsurance from an RJR, the following are also applicable:

1. elimination of the requirement to provide security applies prospectively only to those reinsurance contracts entered into, renewed or amended on and after the date the unauthorized reinsurer obtained RJR status in the ceding insurer's state of domicile;
2. each reinsurance contract must include a provision requiring the reinsurer to provide security in an amount equal to one hundred percent (100%) of the reinsurer's Obligations *"if the reinsurer resists enforcement of a final judgment that is enforceable under the law of the jurisdiction in which it was obtained or a properly enforceable arbitration award, whether obtained by the ceding insurer or by its legal successor on behalf of its estate, if applicable"*;
3. each state insurance department must publish on its website a list of reciprocal jurisdictions and a list of RJRs who have qualified for RJR status.
4. RJRs are permitted to qualify in one US state jurisdiction and then "passport" to other states (which means that other state regulators will rely on the review of the reinsurer performed by the first state regulator).

2. Certified Reinsurer Status

Another exception applies if reinsurers qualify as "certified reinsurers." This status reduces but does not eliminate the amount of collateral that an unauthorized reinsurer must provide and is based on a "rating" assigned to the reinsurer by each US state regulator. This certification is done on a state-by-state basis, but once an unauthorized reinsurer has qualified as "certified" in one state, it may "passport" the certified status to other states. In order to become certified, the unauthorized reinsurer must comply with a number of financial and disclosure requirements including the following:

1. a minimum policyholders surplus of $250 million;
2. domiciled in a "qualified jurisdiction" (currently: Bermuda, UK, Germany, Switzerland, Ireland, Japan, France); and
3. a minimum financial strength ratings from at least two of the five major rating agencies: Standard & Poor's, Moody's, Fitch Ratings, A.M. Best, or any other rating agency recognized by the NAIC's Securities Valuation Office as follows:

Ratings	Best	S&P	Moody's	Fitch
Secure – 1 0 funding	A++	AAA	Aaa	AAA
Secure – 2 10% funding	A+	AA+, AA,	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure – 3 20% funding	A	A+, A	A1, A2	A+, A
Secure – 4 50% funding	A-	A-	A3	A-
Secure – 5 75% funding	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable – 6 100% funding	B, B-,C++, C+, C, C-, D, E, F	BB+, BB, BB-,B+, B, B-, CCC, CC, C, D, R	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, DD

Most unauthorized reinsurers – if they can qualify - prefer the RJR status rather than the certified status, since the RJR status eliminates any requirement to provide individual (single beneficiary) collateral while the certified status does not. While, technically, a reinsurer can be assigned a Secure 1 status which allows zero funding, no certified reinsurers have been awarded Secure 1 status and all qualifying reinsurers have been required to provide at least 10% collateral. Those unauthorized reinsurers, who previously qualified as certified status and now qualify for RJR status, continue to maintain both as both RJR and certified status are prospective only. In all cases, however, state statutes and regulations permit ceding insurers to negotiate individual collateral with certified reinsurers and RJRs even though not required by law.

D. Summary

The credit for reinsurance laws and regulation provide clear guidance on whether or not a ceding insurer can take credit for reinsurance for liability ceded to a reinsurer under a reinsurance contract. Each state insurance department website publishes lists of authorized reinsurers as well as unauthorized reinsurers that have obtained RJR status or certified status, in part for the convenience of ceding insurers to verify a reinsurer's category and status. Where a reinsurer is unauthorized, the law and regulation specify what kind of collateral may be used and the required contents of the documents that provide evidence of the collateral. The new RJR status now appears in all US state laws and regulations and fundamentally changes the use of MBTs or individual collateral to protect the financial condition of ceding insurers as these state laws and regulations allow ceding insurers to obtain credit for reinsurance for liabilities ceded by contract to unauthorized reinsurers without a requirement such unauthorized reinsurers provide a MBT or individual collateral, provided such unauthorized reinsurers have obtained RJR status.

About Guy Carpenter

Guy Carpenter & Company, LLC is a leading global risk and reinsurance specialist with 3,400 professionals in over 60 offices around the world. Guy Carpenter delivers a powerful combination of broking expertise, trusted strategic advisory services and industry-leading analytics to help clients adapt to emerging opportunities and achieve profitable growth. Guy Carpenter is a business of Marsh McLennan (NYSE: MMC), the world's leading professional services firm in the areas of risk, strategy and people. The Company's more than 85,000 colleagues advise clients in 130 countries. With annual revenue of over $20 billion, Marsh McLennan helps clients navigate an increasingly dynamic and complex environment through four market-leading businesses including Marsh, Mercer and Oliver Wyman. For more information, visit www.guycarp.com and follow us on LinkedIn and Twitter.