



STATE OF CONNECTICUT

INSURANCE DEPARTMENT

Testimony of Insurance Commissioner Thomas B. Leonardi

Before
The Insurance and Real Estate Committee
March 13, 2012

Raised Bill No. 5484--An Act Concerning Credit Allowed a Domestic Ceding Insurer for Reinsurance.

Senator Crisco and Representative Megna, committee co-chairs, Senator Kelly and Representative Sampson, ranking members, and Members of the Committee, the Insurance Department appreciates the opportunity to submit testimony in support of Raised Bill 5484. I am Thomas B. Leonardi, Insurance Commissioner of the State of Connecticut, and I would like to thank the Committee for raising this initiative on our behalf.

I am pleased to have this opportunity to testify on Raised Bill 5484--An Act Concerning Credit Allowed a Domestic Ceding Insurer for Reinsurance. This proposal updates Connecticut's current statutes concerning credit for reinsurance and reflects the revisions to the *Credit for Reinsurance Model Law* and *Model Regulation* recently adopted by the National Association of Insurance Commissioners (NAIC). It is the Department's objective to adopt a substantially similar version of the NAIC Credit for Reinsurance Model Law, both in substance and structure, and join the other states of this country in having nearly identical wording of this model law as part of a national system of state-based insurance regulation. This objective is undermined when substantial revisions occur between the language which we submit to the committee and that which is ultimately introduced in bill form.

Background

The credit for reinsurance law specifies an accounting procedure for insurers transferring all or part of their insurance or reinsurance risk written to another insurer/reinsurer. Under this statutory accounting procedure, the insurer is permitted to treat amounts due from reinsurers as assets or reductions from liability based on the status of the reinsurer.

If the reinsurer is not authorized to do business in the state (i.e., it is not licensed or accredited to act as a reinsurer), the reinsurance obtained by the licensed insurer is considered to be unauthorized. A liability is established by the insurer to offset credit taken in various balance sheet accounts for reinsurance ceded to unauthorized reinsurers. Under current law, an insurer is permitted to take reserve credits for reinsurance with unauthorized companies only to the extent the insurer holds security by means of a trust, letter of credit, funds withheld, or other acceptable forms of collateral.

Raised Bill No. 5484

Raised Bill 5484 will expand the options under which a U.S. insurer is allowed to take credit for reinsurance on their financial statements when risk is ceded to a "certified reinsurer". That is, credit will be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the Insurance Commissioner as a reinsurer and secures its reinsurance obligations in

accordance with the requirements of this legislation (and regulations to be adopted by the Commissioner).

Under the bill, the Insurance Commissioner will evaluate a reinsurer that applies for certification, and will assign a rating based on the evaluation. The rating assigned by the Commissioner will determine the amount of collateral the certified reinsurer will be required to maintain to secure the obligations it assumes from U.S. ceding insurers. A certified reinsurer that secures its obligations at a level consistent with its rating will entitle the domestic ceding insurer to qualify for full financial credit for the reinsurance.

The collateral requirements will be determined on a sliding scale (as specified by regulations to be adopted), with ranges of "Secure -1" at 0% collateral to "Vulnerable-6" at 100% collateralization, and will be based on financial strength ratings from at least two ratings agencies determined to be acceptable by the Commissioner. Each state will have the authority to certify reinsurers, or a commissioner has the authority to recognize the certification issued by another NAIC accredited state. States will have the ability to evaluate a non-U.S. jurisdiction in order to determine if it is a "qualified jurisdiction" or defer to a NAIC list of qualified jurisdictions.

Both the recent adoption of the revised NAIC *Credit for Reinsurance Model Law and Model Regulation*, and Raised Bill 5484, reflect the longstanding effort to modernize reinsurance collateral requirements to facilitate cross-border reinsurance transactions and enhance competition within the U.S. market, while ensuring that U.S. insurers and policyholders are adequately protected against the risk of insolvency.

NAIC Accreditation

Contemporaneous with the development of the recent amendments to the NAIC model law and regulation, some states began moving forward with state-based reinsurance collateral reduction reforms. Such states include: Florida, New York, New Jersey and Indiana.

Under current NAIC accreditation standards, a state is not required to reduce its reinsurance collateral requirements. Since Connecticut's current 100% collateral requirements are more conservative than what is specified in the newly revised NAIC model law and regulation, Connecticut is not required at this time to amend its current credit for reinsurance laws. However, if Connecticut moves ahead to join the increasing number of other states that are adopting reinsurance collateral reduction reforms, it will be necessary to do so in conformance with the newly adopted NAIC standards in order for Connecticut to remain accredited. Raised Bill 5484 reflects Connecticut's intent to do so.

Dodd-Frank Act

The enactment of Dodd-Frank in July 2010, includes the Non-admitted and Reinsurance Reform Act (NRRA) which prohibits a state from denying credit for reinsurance if the domiciliary state of the ceding insurer recognizes the credit and is either an NAIC accredited state or has financial solvency requirements substantially similar to the NAIC accreditation requirements. What this means is that cedents will no longer need to comply with the toughest standards among the states in which they are licensed, and need only follow the requirements of the domiciliary state.

We believe one impact of NRRA is to potentially create competitive advantage and disadvantage among cedents based on where they are domiciled in terms of the availability and pricing of reinsurance to the extent unauthorized reinsurers are able to write reinsurance for cedents domiciled in states where less collateral is required of them. It is in this context that the Insurance Department believes that Raised Bill 5484 is in the public interest. This legislation will help to modernize Connecticut's reinsurance collateral requirements in a way that ensures that U.S. insurers and policyholders are adequately protected against the risk of insolvency and it will "level the playing field" with those states that have reduced their collateral requirements so as not to disadvantage Connecticut's domestic insurance industry.

For these reasons, the Insurance Department asks the Insurance and Real Estate Committee to support this initiative.