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## OLR Bill Analysis

**sHB 5484 (as amended by House "A")\***

### ***AN ACT CONCERNING CREDIT ALLOWED A DOMESTIC CEDING INSURER FOR REINSURANCE.***

#### **SUMMARY:**

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

This bill modifies and expands the options under which a U.S. ceding insurer is allowed to take credit for reinsurance on its financial statements. For example, it allows credit to be taken when the reinsurance is ceded to a reinsurer that (1) is certified or accredited by the insurance commissioner and (2) secures its reinsurance obligations in accordance with the bill and regulations to be adopted by the commissioner. The bill allows the commissioner to suspend or revoke a reinsurer's certification or accreditation, after notice and hearing, if he determines the reinsurer no longer meets the applicable requirements.

Under the bill, the commissioner evaluates a reinsurer that applies for certification and assigns a rating based on the evaluation. The commissioner's assigned rating determines the amount of collateral the certified reinsurer must maintain to secure obligations it assumes from U.S. ceding insurers. If a certified reinsurer secures its obligations at a level consistent with its rating, the ceding insurer will qualify for full financial credit for the reinsurance.

\*House Amendment "A" specifies that a reinsurer is deemed to meet accreditation requirements if it maintains at least \$20 million surplus and the insurance commissioner has not denied its

accreditation, instead of its application, within 90 days of receipt.

EFFECTIVE DATE: October 1, 2012

### **§ 1 – CREDIT FOR REINSURANCE**

The bill expands the scenarios under which credit for reinsurance is allowed a ceding insurer as either an asset or a deduction from liability. Under current law, credit is allowed only when the reinsurer meets one of the following requirements:

1. it is licensed as an insurer or reinsurer or accredited in Connecticut;
2. it is domiciled and licensed in a state with reinsurance standards similar to Connecticut's or, if a U.S. branch of a reinsurer chartered outside the United States (i.e., an "alien" reinsurer), conducts business through a state with reinsurance standards similar to Connecticut's, and meets certain capital surplus and other requirements;
3. it maintains a trust in a qualified U.S. financial institution for the payment of claims of U.S. policyholders and ceding insurers; or
4. the insurance is on a risk located in a jurisdiction where reinsurance is required by law or regulation.

The bill also allows credit for reinsurance when the reinsurer is certified by the commissioner under § 2 of the bill and maintains specified security.

By law, if the reinsurer does not meet any of these criteria, the ceding insurer can still reduce its liability if the reinsurer holds security in an amount adequate to cover claims that could arise pursuant to the reinsurance contract. The bill provides that the ceding insurer can also claim a credit if it agrees to specified conditions in the trust instrument.

#### ***Accredited Reinsurers***

By law, a credit for reinsurance is allowed when the reinsurer is accredited in Connecticut. Under current law, an accredited reinsurer

is one that:

1. files evidence of its submission to this state's jurisdiction;
2. allows the state to examine its books and records;
3. is licensed to transact insurance or reinsurance business in at least one state, or if a U.S. branch of an alien reinsurer, conducts business and is licensed in at least one state;
4. files a copy of its annual statement and most recent audited financial statement with the Insurance Department; and
5. maintains a surplus of (a) at least \$20 million if the commissioner has not denied its accreditation application within 90 days of receipt or (b) less than \$20 million if the commissioner has approved its accreditation application.

The bill retains the first four criteria. In place of the fifth criterion, it adds a requirement that the insurer demonstrate to the commissioner's satisfaction that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from a domestic insurer.

The bill specifies that a reinsurer is deemed to meet the accreditation requirements if it maintains a surplus of at least \$20 million and the commissioner has not denied its accreditation within 90 days of receipt.

### ***Trust Requirements***

By law, a credit for reinsurance is allowed when the reinsurer maintains a trust in a qualified U.S. financial institution. The reinsurer must annually report to the commissioner information to enable him to determine the sufficiency of the trust.

The bill requires the reinsurer also to allow the commissioner to examine, at the reinsurer's expense, its books and records.

The bill requires the trust to be approved by the insurance

regulatory official (1) of the trust's home state or (2) of another state that has accepted principal regulatory oversight of the trust. It also requires the trust forms and amendments to be filed with the insurance regulatory officials of each state in which ceding insurer trust beneficiaries are domiciled.

**Single Reinsurer.** By law, in the case of a single reinsurer, the trust must consist of an account covering its U.S. liabilities and a surplus of at least \$20 million. The bill instead requires the trust to cover at least the reinsurer's U.S. reinsurance liabilities and a surplus of at least \$20 million; but the commissioner may, in certain circumstances, reduce the surplus amount for a trust over which he has principal regulatory oversight.

The commissioner may authorize a reduction in the surplus if the reinsurer, for at least three years, has permanently discontinued underwriting new business secured by the trust. The commissioner must conduct a risk assessment to determine that the reduced surplus level is adequate. The assessment (1) may involve an actuarial review and (2) must consider all material risk factors. The minimum required surplus cannot be less than 30% of the reinsurer's U.S. reinsurance liabilities.

**Group of Reinsurers.** Under current law, in the case of a group of reinsurers, including incorporated and individual unincorporated underwriters, the trust must consist of an account covering its U.S. liabilities and a surplus of at least \$100 million. The bill retains this requirement for reinsurance ceded before January 1, 1993. For reinsurance ceded on or after January 1, 1993, the bill instead requires the trust to cover at least the reinsurer's U.S. reinsurance liabilities and a surplus of at least \$100 million.

Under current law, the group must annually certify each member's solvency to the commissioner through the regulator of their place of domicile and their independent public accountants. The bill requires the group to provide the commissioner information within 90 days after the group's financial statements are due to its domiciliary

regulator. The information must be (1) a solvency certification from the group's domiciliary regulator or (2) financial statements prepared by each member's independent public accountants.

**Group of Incorporated Underwriters.** The bill requires, in the case of a group of incorporated underwriters under common administration, the trust to consist of an account covering its U.S. reinsurance liabilities and a (1) policyholders' surplus of at least \$10 billion and (2) joint trusteed surplus, of which \$100 million must be held jointly for the benefit of U.S. ceding insurers of any member of the group as additional security for these liabilities. The group must be accredited and have continuously transacted insurance outside the United States for at least the three years before applying for accreditation.

The bill requires the group to provide the commissioner information within 90 days after the group's financial statements are due to its domiciliary regulator. The information must be (1) a solvency certification from the group's domiciliary regulator or (2) financial statements prepared by each member's independent public accountants.

### ***Certified Reinsurers***

The bill allows a ceding insurer to take credit for reinsurance when the reinsurer is certified by the commissioner (see § 2) and maintains security in the form and amounts specified for trusts.

Under the bill, if the security is not sufficient to cover the certified reinsurer's obligations, the commissioner (1) must reduce the credit allowed proportionately to the deficiency and (2) may further reduce the credit allowed if he finds there is a material risk that obligations will not be paid in full when due.

### ***Additional Trust Requirements for Certain Reinsurers***

The bill allows credit for reinsurers who are not licensed or accredited in Connecticut or conducting business through a state with reinsurance standards similar to Connecticut's if they satisfy additional

trust requirements.

If the trust contains less than the amount required or if the trust grantor is insolvent or in receivership or similar proceeding in its domiciliary jurisdiction, the trustee must comply with the principal regulator's or court's order requiring the trustee to transfer the trust assets to the regulator. The regulator must distribute the assets in accordance with the domicile's liquidation laws. If the regulator returns any assets to the trustee after liquidation, the trustee must distribute them in accordance with the trust instrument.

The bill requires the trust grantor to waive any right under law that is inconsistent with these provisions.

***Accreditation or Certification Suspension or Revocation***

Current law allows the commissioner to revoke a reinsurer's accreditation after notice and a hearing. The bill instead authorizes the commissioner to suspend or revoke a reinsurer's accreditation or certification, after notice and hearing, if he determines the reinsurer no longer meets the applicable requirements.

If a certified reinsurer's domiciliary jurisdiction stops being a qualified jurisdiction (see § 2), the commissioner may suspend the reinsurer's certification indefinitely, instead of revoking it.

The bill authorizes the commissioner to suspend or revoke a reinsurer's accreditation or certification without notice and a hearing if the:

1. reinsurer waives its right to a hearing;
2. reinsurer's home state took regulatory action against the reinsurer;
3. reinsurer voluntarily surrenders or terminates its eligibility to transact business in its home state or primary certifying jurisdiction; or
4. commissioner determines that immediate action is needed to

protect the public and a court has not blocked the action.

No credit for reinsurance is allowed if the reinsurer's accreditation or certification is suspended or revoked, except to the extent that the reinsurer's obligations are secured in accordance with the bill.

A reinsurer whose certification has been suspended, revoked, or voluntarily surrendered or is inactive must be treated as a certified reinsurer required to secure 100% of its obligations. But this does not apply to a reinsurer whose certification has been suspended or is inactive if the commissioner continues to assign a high rating to the reinsurer under § 2 of the bill.

Anyone aggrieved by the commissioner's action to suspend or revoke an accreditation or certification may appeal the order to the commissioner within 30 days after receiving the order. By law, the commissioner must hold a hearing on an appeal within 30 days after receiving the request and make a decision within 45 days after the hearing.

***Ceding Insurer Must Manage Reinsurance Program***

The bill requires a ceding insurer to safely manage its reinsurance program.

Specifically, the ceding insurer must manage its reinsurance recoverables in proportion to its own book of business. It must notify the commissioner within 30 days after (1) reinsurance recoverables from any one reinsurer or group of reinsurers exceeds 50% of the ceding insurer's last reported surplus to policyholders or (2) it determines the recoverables are likely to exceed that limit.

The ceding insurer also must manage its reinsurance program to ensure diversification. It must notify the commissioner within 30 days after it (1) has ceded to any one reinsurer or group of reinsurers more than 20% of its gross written premiums in the prior calendar year or (2) determines that the reinsurance ceded is likely to exceed that limit.

A notification to the commissioner must demonstrate that the

ceding insurer is safely managing its exposure.

## **§ 2 – CERTIFICATION**

### ***Certification Eligibility***

Under the bill, to be eligible for certification, a reinsurer must:

1. be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction (see below);
2. maintain minimum capital and surplus in amounts the commissioner prescribes in regulations;
3. maintain financial strength ratings from at least two rating agencies the commissioner deems acceptable in regulations; and
4. comply with any other requirements the commissioner determines necessary for certification.

To be eligible for certification, a reinsurer must also agree to:

1. submit to Connecticut's jurisdiction and appoint the commissioner as its agent for service of process;
2. provide security for 100% of its U.S. reinsurance liabilities if it resists enforcement of a final court judgment;
3. if it secures its obligations in a multibeneficiary trust, upon the termination of any trust account within the trust, fund any deficiency out of the remaining trust surplus; and
4. meet applicable filing requirements the commissioner prescribes.

If an applicant has been certified as a reinsurer in a jurisdiction accredited by the National Association of Insurance Commissioners (NAIC), the commissioner may (1) certify the applicant as a certified reinsurer in Connecticut and (2) accept the rating assigned to the reinsurer by that jurisdiction.

If the applicant is a group of reinsurers, including incorporated and individual unincorporated underwriters, it must also comply with the

following requirements:

1. The group must comply with the minimum capital and surplus requirements through the capital and surplus equivalents, less current liabilities, of the group and its members. The equivalents must include a joint central fund in an amount the commissioner determines to provide adequate financial protection for any unsatisfied obligations.
2. The incorporated members of the group (a) cannot be engaged in any business other than underwriting as a group member and (b) must be subject to the same level of regulatory and solvency control as the unincorporated members.
3. The group must provide the commissioner information within 90 days after the group's financial statements are due to its domiciliary regulator. The information must be (a) a solvency certification from the group's domiciliary regulator or (b) financial statements prepared by each member's independent public accountants.

### ***Qualified Jurisdictions***

The bill requires the commissioner to publish a list of qualified jurisdictions from which a reinsurer is eligible for certification in Connecticut. In developing the list, the commissioner must consider the NAIC's list of qualified jurisdictions. Any state that is NAIC-accredited must be a qualified jurisdiction.

If the commissioner qualifies a jurisdiction that is not on the NAIC list, he must publish a justification. The bill requires the commissioner to adopt regulations to establish criteria for justifying a qualification.

The bill requires the commissioner, when deciding if the home country of an alien reinsurer is a qualified jurisdiction, to (1) evaluate the appropriateness and effectiveness of that country's reinsurance regulatory system; (2) consider the rights, benefits, and extent of reciprocity that country provides to U.S. reinsurers, including whether the country shares information and cooperates with the commissioner

regarding certified reinsurers; and (3) consider any other factors he deems relevant.

The bill prohibits the commissioner from qualifying a country that does not adequately and promptly enforce final U.S. judgments of arbitration awards.

### ***Rating System***

The bill requires the commissioner, after considering the financial strength ratings assigned by acceptable rating agencies, to assign a rating to each certified reinsurer. He must publish a list of certified reinsurers and their assigned ratings.

The bill requires the commissioner to adopt regulations to identify the acceptable rating agencies, establish the rating system methodology, and set the level of security required for each rating.

Under the bill, a certified reinsurer must secure its U.S. reinsurance obligations at a level consistent with its assigned rating.

If the certified reinsurer secures obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer in the form of a multibeneficiary trust, it must maintain separate trust accounts for (1) such obligations incurred and (2) obligations subject to the trust requirements contained in § 1 (see above). The bill specifies that the minimum trustee surplus requirements of § 1 do not apply to a multibeneficiary trust. Rather, such a trust must maintain a surplus of at least \$10 million.

If a certified reinsurer stops reinsuring new business in Connecticut, it may ask the commissioner to move its certification to an inactive status, allowing it to still qualify for reduced security for its in-force business. An inactive certified reinsurer must still comply with the bill's applicable certification requirements. The commissioner must assign a new rating to the inactive certified reinsurer to account for any relevant reasons why the reinsurer is not reinsuring new business.

### **§ 3 – CREDIT FOR ASSET OR REDUCTION IN LIABILITY**

Current law permits one final method for a ceding insurer to reduce liability through reinsurance. It allows the ceding insurer to take a reduction up to the amount of the liability carried by the ceding insurer when the reinsurer does not meet any of the other requirements specified in the law but meets certain security requirements. The bill expands this to allow the ceding insurer to take either a credit for an asset or a reduction in liability and broadens the eligible securities to include securities listed by the NAIC Securities Valuation Office that are exempt from filing.

Thus, under the bill, the credit or reduction must equal the amount of funds held by or on behalf of the ceding insurer as security for the payment of the reinsurance obligations. It must be (1) held in the United States, subject to withdrawal solely by, and under the exclusive control of, the ceding insurer or (2) held in trust in a qualified U.S. financial institution. The security may be in:

1. cash;
2. securities listed by the NAIC Securities Valuation Office, including those deemed exempt from filing, and qualifying as admitted assets;
3. a clean, irrevocable, and unconditional letter of credit issued by a qualified institution that is effective by December 31 of the year in which the filing is made and in the ceding insurer's possession before the filing date of its annual statement; or
4. any other form of security acceptable to the commissioner.

Letters of credit meeting standards of acceptability on the date of issuance will continue to be accepted as security until their expiration, extension, renewal, modification, or amendment despite the issuing institution's failure to meet such standards.

#### **§§ 4 - 6 – TECHNICAL AND CONFORMING CHANGES**

These sections make technical and conforming changes.

## **BACKGROUND**

### ***Reinsurance***

Reinsurance is a transaction between two or more insurance companies to apportion risk so that a large loss does not fall on any one company. The insurer transferring part of the risk to another insurer is called the ceding or domestic insurer. The insurer accepting the risk is called the assuming insurer or reinsurer.

## **COMMITTEE ACTION**

Insurance and Real Estate Committee

Joint Favorable Substitute

Yea 20 Nay 0 (03/20/2012)