The NAIC Moves To Implement the Covered Agreement

By: Roland C. Goss

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On July 31, 2017 we posted a Special Focus article on the final approval of the Covered Agreement ("the Agreement") negotiated and entered into by U.S. and E.U. dealing with reinsurance collateral reform and insurance supervision-related issues. That article described the preliminary process and the extended timing for the implementation of the Covered Agreement. On February 20, 2018, the National Association of Insurance Commissioners ("NAIC") and its Reinsurance (E) Task Force held a public hearing to address issues relating to the implementation of the reinsurance collateral reform provisions of the Covered Agreement, which is but one aspect of the Covered Agreement.

THE HEARING

The hearing was announced by a Notice of Public Hearing and Request for Comments ("Notice"), which stated that the purpose of the hearing was to "begin discussions on how to proceed with reinsurance collateral reform." The Notice solicited formal written comments, in advance of the hearing, on the following issues and approaches to reinsurance collateral reform:

- Amending the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786) to eliminate reinsurance collateral requirements for E.U.-based reinsurers meeting the conditions of the Covered Agreement;
- Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements;
- Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction;
- Considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral; and
- Any other considerations to weigh as part of the states' implementation of the Covered Agreement.

Prior to the hearing, the NAIC received written comments from 20 entities:

- ABIR (Association of Bermuda Insurers and Reinsurers);
- ACLI;
- Allstate;

- American Academy of Actuaries;
- American Insurance Association;
- Aon;
- California Department of Insurance;
- Chubb;
- Cincinnati Insurance Companies;
- CNA Insurance;
- GDV (German Insurance Association);
- General Insurance Association of Japan;
- International Underwriting Association;
- Liberty Mutual Insurance;
- Lloyd's America;
- NAMIC (National Association of Mutual Insurance Companies);
- RAA (Reinsurance Association of America);
- Swiss Re Americas and Zurich North America;
- Switzerland Federal Department of Finance; and
- XL Catlin.[1]

The NAIC has not made a recording or a transcript of the February 20 hearing available.[2] According to the published agenda for the meeting, after initial comments, oral presentations were received from many of the entities that had submitted written comments, followed by a discussion of how the implementation process might unfold.

Probably the most complicated part of the implementation of the Covered Agreement will be the amendment of the credit for reinsurance laws and regulations of all U.S. states and territories so that they are in compliance with the requirements of the Covered Agreement. Laws and regulations that are not in compliance with the requirements of the Covered Agreement may eventually be preempted by federal law.

It has been anticipated that the most likely way to implement the reinsurance collateral provisions of the Covered Agreement would be through a revised Model Credit for Reinsurance Law and Regulation, which would be revised to be in compliance with the provisions of the Covered Agreement and then adopted by the states. As has been the case with virtually all Model Acts and Regulations, the Model Credit for Reinsurance Law and Regulation has not to date been adopted uniformly by all states. A small number of states have not adopted any

[1] The individual written comment submissions are available on the NAIC's web site at http://www.naic.org/cmte_e_reinsurance.htm.

[2] The NAIC did issue a press release after the hearing, which did not contain significant substantive discussion of the hearing. *See* http://www.naic.org/Releases/2018_docs/naic_holds_public_hearing_on_covered_agreement.htm.

version of the Model, other states have adopted a version of the Model that is not current, other states have made unique modifications to the Model, and other states are in the process, this legislative season, of moving to update their adopted statutes and regulations to be consistent with the current version of the Model.[3]

The mere revision of the Model to comply with the requirements of the Covered Agreement will not avoid the preemption of particular provisions of the laws of particular states with respect to reinsurance collateral issues. Revisions to the Model would be only the first step in this route to compliance with the Covered Agreement. Ultimately, whether the laws of any state comply with the requirements of the Model or face possible preemption will depend upon whatever action is taken with respect to this topic by each state's legislature. The key question will be whether the provisions of the law of the state with respect to reinsurance collateral, whatever its source and ancestry, complies with the requirements of the Covered Agreement. Adopting a revised Model that complies with the requirements of the Covered Agreement of course is not the only route a state may take to achieve compliance with the requirements of the Covered Agreement and the avoidance of preemption. Yet, perhaps the prospect of federal preemption may be the incentive that is needed finally to achieve at least substantial uniformity in the aspects of credit for reinsurance and collateral requirements that are the subject of the Covered Agreement.

The main issues treated in many of the written comments, and noted in reports on the hearing, are not surprising, and have been the subject of comment in our prior postings as well as by other commentators. These issues include: (1) the extent to which compliance with the Covered Agreement can be achieved through revisions to the Model as opposed to a more basic revision of regulatory requirements; (2) the extent to which reinsurers not subject to the Covered Agreement will be extended the same concessions now available to E.U.-domiciled reinsurers, and if so whether and how their domiciliary jurisdictions will agree to the same conditions for collateral reduction agreed to by the E.U. in the Covered Agreement; and (3) whether the elimination of collateral requirements exposes U.S.-domiciled ceding insurers to additional credit or collection risks that merit regulatory attention through what have been referred to as "guardrails."

Some of the written comments, particularly those received from non-U.S. reinsurers or trade associations, advocate for equal treatment for reinsurers domiciled in the E.U. and those domiciled elsewhere, such as London or Bermuda. Such treatment might be achieved by applying the reinsurance collateral provisions of the Covered Agreement to non-U.S. reinsurers domiciled in what the NAIC has found to be Qualified Jurisdictions. Others have advocated for expanding the applicability of the reduced collateral provisions through the establishment of a new category in the Model for certain non-U.S. reinsurers. Concern has been voiced that if the reduced collateral benefits of the Covered Agreement are extended to non-E.U. reinsurers, that

[3] *See e.g.*, Michigan Senate Bill 638 (bill text – sent to Governor for signature March 15, 2018; legislative analysis) and a Notice of Proposed Rulemaking from the New Mexico Office of Superintendent of Insurance.

such an accommodation should be conditioned upon the domiciles of such reinsurers agreeing to the other provisions of the Covered Agreement, such as those concerning group supervision, capital regimes, and local presence.

With respect to the NAIC's question concerning "guardrails," the comments were pretty uniform that the elimination of collateral requirements would not, in and of itself, indicate the need for guardrails or other financial regulation beyond that already in place. If additional financial-related regulations were put in place, some voiced the position that such provisions should be applied equally to U.S. and non-U.S. domiciled reinsurers.

These issues, and others, have merely been called out in the pre-hearing written comments and the oral presentations at the hearing. Resolution has not been reached on the issues highlighted in the Notice, and considerable discussions with be required between and among a variety of constituencies before those issues, and others related to the implementation of the Covered Agreement, are resolved.

CONCLUSION

There is no doubt that the implementation of the Covered Agreement will be a complicated and drawn out affair. The NAIC has expressed a commitment to moving quickly to revise the Model as one route for states to comply with the requirements of the Covered Agreement concerning reinsurance collateral. However, speed has not been the hallmark of the history of the NAIC's consideration of reinsurance collateral issues over many years. Only time will tell how these issues develop within the framework for the implementation of the Covered Agreement.

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 This article appeared on the firm's reinsurance and arbitration blog, www.ReinsuranceFocus.com.

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