

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 2522

SPONSOR: Banking and Insurance and Senator Holzendorf

SUBJECT: Reinsurance

DATE: March 30, 1999

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Deffenbaugh</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

I. Summary:

Committee Substitute for Senate Bill 2522 revises s. 624.610, F.S., relating to the types of reinsurance that are approved and reinsurers “accredited” in order for an insurer to obtain credit as an asset or a deduction from liability on its accounting and financial statements. These changes bring the Florida statute into closer conformity with the current National Association of Insurance Commissioners Model Act on Credit for Reinsurance.

The changes create uniform trust fund language for the three classes of trusts authorized and make consistent the regulatory authority with regard to these trusts. The changes also generally reinforce state action to compel security from alien reinsurers and to enforce state requirements that the claims against insolvent alien insurers be valued and paid in accordance with state law. It also conforms state law governing Lloyd’s of London reinsurance trust funds to the actual operation of the New York trusts as restructured by agreement between the New York Insurance Department and Lloyds in 1995.

This bill substantially amends section 624.610 of the Florida Statutes.

II. Present Situation:

Insurance companies authorized in Florida that buy reinsurance are allowed to receive credit on their financial statements only if the reinsurance is a type that is approved or acceptable, as specified in s. 624.610, F.S. For example, an insurer is limited by state law as to the amount of premiums it may write as a percentage of its surplus (“premium to surplus ratio”). By buying reinsurance and *ceding* premiums to an approved reinsurer, the insurance company may obtain credit on its financial statements and deduct the ceded premiums from its net premium to surplus limitations. The insurer buying the reinsurance is referred to as the *ceding insurer* and the reinsurer is referred to as the *assuming insurer*.

Florida's credit for reinsurance statute, s. 624.610, F.S., (1998 Supp.) has been subject to various amendments, most often to apply certain provisions of the National Association of Insurance Commissioners (NAIC) Model Law on Credit for Reinsurance as it has been amended from time to time. However, the piecemeal approach to amending the law has resulted in inconsistent terminology and incorrect cross-references and does not incorporate all of the substantive provisions of the model law.

Currently, the statute lists four types of "approved reinsurers" in paragraph (3)(a), which include:

- 1) an insurer authorized in Florida to transact such line of insurance or reinsurance;
- 2) an insurer approved by the Department of Insurance that meets the same criteria for solvency established for authorized insurers;
- 3) an underwriting member of an insurance exchange domiciled in the U.S. that was licensed and in operation on or before January 1, 1993, provided that the exchange meets the financial requirements for an authorized insurer; or
- 4) the Lloyd's of London provision that refers to a group of individual, unincorporated, or incorporated alien insurers which maintains funds of at least \$50 million held in trust for U.S. policyholders in a bank or trust company subject to supervision by any state or the U.S. or that is a member of the Federal Reserve System and which annually files evidence with the department that it can meet its obligations under its reinsurance agreements. (See additional trust requirements below.*)

In addition to the types of "approved" reinsurers listed above, paragraph (3)(b) allows insurers to take credit in their financial statements for reinsurance ceded to a "nonapproved reinsurer" if it satisfies any of the following categories:

- 1) a reinsurer that maintains the standards and meets the financial requirements applicable to an authorized insurer;
- 2) a reinsurer that deposits funds for a specific reinsurance agreement with a market value equal to the credit taken, pursuant to express provision in the reinsurance contract, as security for the payment of the obligations under the agreement, if such funds are subject to withdrawal by, and under the control of, the ceding insurer or such deposits are placed in trust for such purposes in a bank which is a member of the Federal Reserve System if withdrawals from the trust cannot be made without the consent of the ceding insurer. (See additional trust requirements below.*);
- 3) a clean, unconditional, evergreen, and irrevocable letter of credit issued for at least a one-year term that equals or exceeds the liability of the reinsurer for a specific reinsurance agreement for the unearned premiums, outstanding losses, and an adequate reserve for incurred but not reported losses. The letter must be issued by a banking institution which is a member of the Federal Reserve System and which has financial standing satisfactory to the department. The department may adopt rules requiring that the letter adhere to the format approved by the NAIC; or

- 4) When the reinsurance is ceded to a reinsurer that maintains a trust fund in a bank or trust company that is subject to supervision by any state or that is a member of the Federal Reserve System, for the payment of the valid claims for its U.S. business. The trust must have an amount not less than the reinsurer's liabilities for its U.S. business and, in addition, a surplus of not less than \$20 million. The trust must be in a form approved by the insurance commissioner where the trust is domiciled or the insurance commissioner of another state who, pursuant to the terms of the trust agreement, has accepted principal regulatory oversight. The reinsurer must report quarterly to the insurance commissioner information required to be reported on the NAIC Annual Statement form, and the trust and reinsurer must be subject to examination by the commissioner.

*The statute applies additional requirements for the trust agreements that are referred to in subparagraphs (3)(a)4. and (3)(b)2. If the trust fund is less than the amount required by the department or if the grantor of the trust has been declared insolvent, the reinsurer must agree to comply with orders of the commissioner with regulatory oversight or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner all of the assets of U.S. trust beneficiaries. Other related requirements apply.

Subsection (1) sets out the purpose of this section, which includes legislative intent and a requirement that upon the insolvency of a non-U.S. insurer or reinsurer which provides security to fund its U.S. obligations, the security must be maintained in the U.S. and claims must be filed with and valued by the State Insurance Commissioner with regulatory oversight, and the assets distributed in accordance with the insurance laws of the state in which the trust is domiciled. The Legislature declares that these matters are fundamental to the business of insurance. Such findings and requirements are intended to assert jurisdiction over such an insolvency to the maximum legal extent to prevent a federal bankruptcy court or foreign country from having jurisdiction and control over the assets.

A broad grant of authority is provided in subsection (5) to the department relative to reinsurance obtained by a domestic insurer (an insurer formed under the laws of Florida), to "disallow any credit which it finds would be contrary to the proper interests of the policyholders or stockholders of a ceding domestic insurer." Under subsection (12), if the department finds that a reinsurance agreement creates a substantial risk of insolvency to either insurer, the department may by order require a cancellation of the reinsurance agreement. Under subsection (11), the department may disallow any credit if a ceding direct insurer increases its surplus as a result of payment of consideration to an assuming reinsurer for underwriting any loss obligation already incurred in excess of the consideration paid; or where the consideration paid is derived from present value or discounting concepts based upon anticipated investment income. Under subsection (13), no credit is allowed for reinsurance that does not create a meaningful transfer of risk of loss to the reinsurer, pursuant to department rules that must substantially conform with the 1991 NAIC Practices and Procedures Manual(s).

Subsection (7) specifies that for credit to be allowed, the reinsurance must be payable without diminution because of insolvency of the ceding insurer, except when the reinsurance contract specifically provides payment to the named insured, assignee, or named beneficiary or the reinsurer (assuming insurer) has directly assumed the policy obligations of the ceding insurer.

Subsection (10) requires authorized Florida insurers to file with the department a copy of a summary statement regarding each reinsurance “treaty” (contract) within 30 days of receipt of a cover note or similar confirmation of coverage, but in no event later than 6 months after the effective date of the reinsurance treaty. The statute specifies the information that must be included in the summary statement and provides exceptions from this requirement.

III. Effect of Proposed Changes:

The bill substantially rewrites s. 624.610, F.S., primarily relating to the types of reinsurance that are approved and reinsurers “accredited” in order for an insurer to obtain credit as an asset or a deduction from liability on its accounting and financial statements. These changes bring the Florida statute into closer conformity with the NAIC Model Act on Credit for Reinsurance.

The bill, in subsection (1), retains the current law’s purpose and intent provisions, related to the insolvency of a non-U.S. insurer or reinsurer which provides security to fund its U.S. obligations and that assets be distributed in accordance with the insurance laws of the state in which the trust is domiciled, which matters are fundamental to the business of insurance.

The bill provides that credit for reinsurance must be allowed a ceding insurer as either an asset or a deduction from liability only when the reinsurer meets the requirements of paragraphs (3)(a), (b), or (c), as set out below. For paragraphs (3)(a) and (b), the credit must be allowed only for those kinds of insurance that the assuming insurer is licensed, authorized, or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. The cited paragraphs refer to the following types of assuming reinsurers:

- (a) An insurer that is authorized to transact insurance or reinsurance in Florida.
- (b) An insurer that is “accredited” as a reinsurer in Florida, which must submit to the state’s jurisdiction; submit to the state’s authority to examine books and records; is licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, is entered through or licensed to transact insurance in at least one state; files copies of its annual and quarterly statements filed with the insurance department of its state of domicile and its most recent audited financial statement; and maintains a surplus of not less than \$20 million.

To be an accredited insurer as provided in paragraph (b), above, the insurer must have its accreditation approved by the department, or not denied within 90 days of its submission for approval. The provisions of s. 120.60, F.S., would not apply to the accreditation applications or procedures, which are the general license application procedures that apply to state agencies. The department may deny or revoke an assuming insurer’s accreditation if the insurer does not submit the required documentation (specified above), fails to meet all of the required standards, or if the accreditation would be hazardous to the policyholders of the state. Various factors are listed that the department may consider. The costs incurred by the department to review a reinsurer’s request for accreditation must be charged to the requesting reinsurer.

- (c) An insurer that maintains a trust fund in a qualified U.S. financial institution, as defined, for the payment of the valid claims of its U.S. ceding insurers. The insurer must report annually to the department information substantially the same as that required to be reported on the NAIC Annual Statement for by authorized insurers, and the insurer must submit to examination of its records and bear the expense of examination. The form of the trust must be approved by the commissioner of the state where the trust is domiciled or of another state who, pursuant to the trust agreement, has accepted principal regulatory oversight of the trust. The form of the trust and any amendments must be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled, must provide that contested claims are valid and enforceable upon the final order of any court of competent jurisdiction in the U.S., and must vest legal title to its assets in its trustees for the benefit of the assuming insurer's U.S. ceding insurers. Each year the trustee must report to the commissioner in writing the balance of the trust.

The amount of funds required for the trust of an insurer specified in paragraph (c), above, depend upon the type of assuming insurer, as follows: 1) The trust fund for a single assuming insurer must consist of an amount not less than the insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers and, in addition, a trusteed surplus of not less than \$20 million. 2) The trust fund for a group including incorporated and individual unincorporated underwriters must consist of an amount not less than the groups' several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group; however, for reinsurance agreements with an inception date on or before July 31, 1995, this amount must be not less than the group's several insurance and reinsurance liabilities attributable to business written in the U.S.; in both cases (before or after July 31, 1995) the group must additionally maintain in trust a surplus of \$100 million held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account. The changes essentially conform the law governing Lloyd's of London reinsurance trust funds to the actual operation of the New York trusts as restructured by agreement between the New York Insurance Department and Lloyds in 1995.

The credit permitted by paragraph (c), above, must not be allowed unless the reinsurance agreement provides that assuming insurer agrees to submit to the jurisdiction of any court of competent jurisdiction if the insurer fails to perform its obligations under the terms of the agreement, and to designate the commissioner or a designated attorney to be served any lawful process on behalf of the ceding company. The assuming insurer must also agree to the following conditions: 1) if the trust fund is inadequate or if the grantor of the trust has been declared insolvent, the trustee must comply with an order of the commissioner with regulatory oversight or with an order of a U.S. court of competent jurisdiction directing the trustee to transfer to such commissioner all of the assets of the trust fund, to be distributed in accordance with the laws of the state in which the trust is domiciled; 2) if the commissioner with regulatory oversight determines that the assets of the trust are not necessary to satisfy the claims of the U.S. ceding insurer, the assets must be returned by the commissioner to the trustee for distribution in accordance with the trust agreement; and 3) the grantor must waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

Credit must be allowed when the reinsurance is ceded to an assuming insurer *not* meeting the requirements of paragraphs (a), (b), or (c), above but only as to the insurance of risks located in jurisdictions where the reinsurance is required to be purchased by a particular entity by applicable

law. For example, Florida law itself has such a requirement, by requiring residential property insurers to purchase coverage (essentially, reinsurance) from the Florida Hurricane Catastrophe Fund.

An asset allowed or a deduction from liability taken for the reinsurance ceded by an insurer to an assuming insurer *not* meeting the requirements of subsections (2) and (3) (which are all of the types of approved reinsurance and accredited reinsurers discussed above), *is allowed* in an amount not exceeding the liabilities carried by the ceding insurer. The deduction must be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the U.S. subject to withdrawal solely by, and under the exclusive control of, the ceding insurer, or in the case of a trust, held in a qualified U.S. financial institution, as defined. This security may be in the form of cash; securities qualifying as admitted assets under the Insurance Code; clean, irrevocable, unconditional letters of credit issued by a qualified U.S. financial institution; or any other form of security acceptable to the department.

Two different definitions are provided for a “qualified U.S. financial institution” for two different purposes. The first definition applies for purposes of paragraph (4)(c) regarding issuing a letter of credit, which is discussed in the immediately preceding paragraph, above, of this analysis. This definition means an institution that is organized, or in the case of a U.S. office of a foreign banking organization, is licensed under the laws of the U.S. or any state; is regulated, supervised, and examined by U.S. or state authorities having regulatory authority over banks and trust companies; and has been determined by either the department or the Securities Valuation Office of the NAIC to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the department.

The other definition of qualified U.S. financial institution applies to the provisions which specify institutions that are eligible to act as a fiduciary of a trust. The definition is substantially the same as the first definition relating to licensure and regulatory supervision, but it does not include the requirement that the institution be determined by either the department or the Securities Valuation Office of the NAIC to meet certain standards of financial condition and standing.

The bill retains the current law provision that includes health maintenance organizations within the definition of ceding insurer.

The bill authorizes the department to disallow any credit, after notice and an opportunity for a hearing, that it finds would be contrary to the proper interest of the policyholders or stockholders, but unlike the current law, this would be limited to ceding *domestic* insurers.

The bill contains similar provisions to the current law that for credit to be allowed, the reinsurance must be payable without diminution because of insolvency of the ceding insurer, subject to certain exceptions.

The current law’s requirements for authorized Florida insurers to file with the department a copy of a summary statement regarding each reinsurance “treaty” is limited by the bill to domestic

insurers and commercially domiciled insurers. A “commercially domiciled insurer” is defined in s. 624.075, F.S., as a foreign or alien insurer that has written an average of 25 percent or more direct premiums in this state than it has written in its state of domicile during the preceding 3 years and the direct premiums written constitute more than 55 percent of its total direct premiums written in the U.S.

The bill retains the current law that authorizes the department to order cancellation of a reinsurance agreement if the department finds that the agreement creates a substantial risk of insolvency to either insurer. It also retains the current law that no credit is allowed for reinsurance that does not create a meaningful transfer of risk of loss to the reinsurer, but deletes the specific authority for the department to adopt rules in this regard (which currently must substantially conform with the 1991 NAIC Practices and Procedures Manuals).

The bill authorizes the department to adopt rules implementing the provisions of this section, which must be in substantial compliance with the NAIC model regulations relating to credit for reinsurance, the 1998 NAIC Accounting Practices and Procedures Manual(s).

Any reinsurer approved pursuant to existing s. 624.610(3)(a)2., F.S., as of December 31, 1999, which fails to obtain accreditation pursuant to this section prior to December 30, 2002, shall have its approval terminated by operation of law on that date.

This act applies to all cessions (reinsurance ceded) on or after January 1, 2000, under reinsurance agreements that have an inception, anniversary, or renewal date on or after January 1, 2000.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Insurers and reinsurers should benefit by conforming Florida's credit for reinsurance laws more closely to the NAIC Model Act and to the laws of most other states. The types of reinsurance transactions that would be permitted would be less likely to be subject to unique requirements in the state and would, therefore, reduce costs to insurers to ensure credit on their financial statements.

Insurers and their policyholders should benefit by provisions that strengthen the state's authority to compel security from alien reinsurers and to enforce state requirements that the claims against insolvent alien insurers be valued and paid in accordance with state law.

C. Government Sector Impact:

None

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.