

SESSION OF 2017

SUPPLEMENTAL NOTE ON SENATE BILL NO. 19

As Recommended by Senate Committee on
Financial Institutions and Insurance

Brief*

SB 19 would replace current law relating to the regulation of reinsurance with model language from the National Association of Insurance Commissioners (NAIC) Credit for Reinsurance Model Code. Descriptions of specific bill provisions follow.

Credit for Reinsurance

The bill would specify the requirements for reinsurance credit. A domestic ceding insurer would be permitted a credit for reinsurance, as either an asset or a reduction from liability on account of reinsurance, ceded to an assuming insurer under certain conditions.

Licensed to Transact Business

Credit for reinsurance would be allowed when the reinsurance is ceded to an assuming insurer licensed to transact insurance or reinsurance in Kansas. The bill would permit this credit only with respect to cessions of kinds or classes of business the assuming insurer is licensed 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 in which the entity was entered and licensed to transact insurance or reinsurance.

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

*Accredited by the Kansas Insurance Commissioner
(Commissioner)*

Credit for reinsurance would be allowed by the bill when the reinsurance is ceded to an assuming insurer accredited by the Commissioner as a reinsurer in Kansas. The bill would permit this credit only with respect to cessions of kinds or classes of business the assuming insurer is licensed 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 in which the entity was entered and licensed to transact insurance or reinsurance. To be eligible for accreditation, an assuming insurer would be required to:

- File evidence of the assuming insurer's submission to Kansas' jurisdiction with the Commissioner;
- Submit to Kansas' authority to examine the assuming insurer's books and records;
- Be 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, be entered through and licensed to transact insurance or reinsurance in at least one state;
- Annually file a copy of the assuming insurer's annual statement filed with the insurance department of the assuming insurer's state of domicile and most recent audited financial statement with the Commissioner; and
- Demonstrate adequate financial capacity to meet the assuming insurer's reinsurance obligations and be otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer would be deemed to meet this requirement at the time of application if the assuming insurer maintains a surplus of at least \$20.0 million with regard to policyholders and accreditation has not been

denied by the Commissioner within 90 days after submission of the application.

Domiciled in States with Similar Reinsurance Standards

Credit for reinsurance would be allowed by the bill when the reinsurance is ceded to an assuming insurer domiciled in, or in the case of a U.S. branch of an alien assuming insurer is entered through, a state employing standards regarding reinsurance credit substantially similar to those applicable under the bill. The assuming insurer or U.S. branch of an alien assuming insurer under this qualification would maintain a surplus of at least \$20.0 million with regard to policyholders (this requirement would not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system) and submit to the authority of Kansas to examine the assuming insurer's books and records. Additionally, the bill would permit this credit only with respect to cessions of kinds or classes of business the assuming insurer is licensed 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 in which the entity was entered and licensed to transact insurance or reinsurance.

Maintaining a Trust Fund

Credit for reinsurance would be allowed by the bill when the reinsurance is ceded to an assuming insurer maintaining a trust fund in a qualified U.S. financial institution for the payment of the valid claims of the assuming insurer's U.S. ceding insurers.

The assuming insurer would be required to annually report information substantially the same as required on the NAIC annual statement form by licensed insurers. The assuming insurer would be required to submit for the Commissioner's examination the books and records, at the expense of the assuming insurer.

Further, the bill would require the form of the trust to be approved by either an insurance commissioner of the state where the trust is domiciled, or the insurance commissioner of another state who has accepted principal regulatory oversight of the trust; require the form of the trust to be filed with insurance commissioners of every state where the ceding insurer's beneficiaries of the trust are domiciled, and further specify the requirements of the trust instrument; specify the validity of a trust; and require the trustee of the trust to submit a report to the Commissioner, no later than February 28 of each year.

Additional categories of the assuming insurer would have the following requirements:

- The trust fund for a single assuming insurer would be required to consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers, in addition to a maintenance of a trusteed surplus of at least \$20 million, except for an authorized reduction in the required surplus;
- The state commissioner with principal regulatory oversight of the trust would be permitted to authorize a reduction in the required trusteed surplus any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three years. The state commissioner would be required to make a finding, based on assessment of risk, that the new required surplus level would be adequate for the protection of U.S. ceding insurers, policyholders, and claimants in light of foreseeable adverse loss development. The bill would state the risk assessment may involve an actuarial review, considering all material risk factors and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The bill would specify the minimum required trusteed surplus would not be

reduced to an amount less than 30 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust;

- For a group including incorporated and individual unincorporated underwriters, the following would be required:
 - For reinsurance ceded under reinsurance agreements with an inception, amendment, or renewal date on or after January 1, 1993, the trust would be required to consist of a trusteed account in an amount not less than the underwriters' several liabilities attributable to business ceded by U.S.-domiciled ceding insurers to any underwriter of the group;
 - For reinsurance ceded under reinsurance agreements with an inception date on or before December 31, 1992, the trust would be required to consist of a trusteed account in an amount not less than the underwriters' several insurance and reinsurance liabilities attributable to business written in the United States;
 - The group would be required to maintain a trusteed surplus of which \$100.0 million would be held jointly for the benefit of the U.S.-domiciled ceding insurers of any member of the group for all years of account;
 - Incorporated members of the group would not be permitted to engage in any business other than underwriting as a member of the group and would be subject to the same level of regulation and solvency control by the group's domiciliary regulator as the unincorporated members of the group; and
 - The group would be required to provide the Commissioner, within 90 days after the

financial statements are due to be filed with the group's domiciliary regulator, an annual certification by the group's domiciliary regulator of the solvency of each underwriter member, or the financial statements prepared by independent public accountants of each underwriter member of the group.

- For a group of incorporated underwriters under common administration, the group would be required to have continuously transacted an insurance business outside the United States for at least three years immediately prior to applying for accreditation; maintain an aggregate policyholders' surplus of at least \$10.0 billion; maintain a trust fund in an amount not less than the group's several liabilities attributable to business ceded by the U.S.-domiciled ceding insurers to any member of the group according to reinsurance contracts issued in the name of the group; maintain a joint trusteed surplus of \$100.0 million held jointly for the benefit of U.S.-domiciled ceding insurers of any member of the group as additional security for these liabilities; and provide the Commissioner with annual certification of each underwriter member's solvency.

Certified Reinsurer

Credit for reinsurance would be allowed by the bill when the reinsurance is ceded to an assuming insurer certified by the Commissioner as a reinsurer in Kansas and the reinsurer secures its obligations.

To be eligible for certification, the assuming insurer would be required to:

- Be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the Commissioner;

- Maintain minimum capital and surplus, or equivalent, in an amount determined by the Commissioner pursuant to regulation;
- Maintain financial strength ratings from two or more rating agencies deemed acceptable by the Commissioner by regulation;
- Agree to submit to the jurisdiction of Kansas, appoint the Commissioner as the assuming insurer's agent for service of process in Kansas, and agree to provide security for all of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers, if the assuming insurer resists enforcement of a final U.S. judgment;
- Agree to meet the applicable information filing requirements for the initial application and ongoing certification, as determined by the Commissioner; and
- Satisfy any other requirements for certification deemed relevant by the Commissioner.

An association including incorporated and individual unincorporated underwriters would be permitted to be certified as a reinsurer by, in addition to meeting the requirements listed above, satisfying minimum capital and surplus requirements, including a joint central fund; not be engaged in any business other than underwriting as a member of the association; and submitting an annual certification to the Commissioner, or financial statements.

The bill would require the Commissioner to create and publish a list of qualified jurisdictions under which an assuming insurer licensed and domiciled in that jurisdiction is eligible for consideration of reinsurer certification. A list of qualified jurisdictions would be published through the NAIC process. The bill would prescribe the duties of the

Commissioner relating to listing a jurisdiction as qualified, and it would authorize the Commissioner to suspend a reinsurer's certification indefinitely, if the domiciliary jurisdiction ceases to exist.

The bill would require the Commissioner to assign a rating to each certified reinsurer and publish a list of all certified reinsurers and their ratings.

The bill also would require the certified reinsurer to secure obligations at a rating specified in rules and regulations promulgated by the Commissioner and maintain security in an acceptable form. The Commissioner would have the discretion to defer to a rating assigned by another jurisdiction in which the reinsurer was certified.

Additionally, the bill would outline the requirements for minimum trusted surplus requirements if a certified reinsurer maintains a trust; require the Commissioner to reduce allowable reinsurance credit if the security is insufficient and permit the Commissioner to impose further reductions; and permit a certified reinsurer ceasing to assume new business in the state to request to maintain certification in an inactive status.

Other Assuming Insurers

Credit for reinsurance would be allowed by the bill when reinsurance is ceded to an assuming insurer other than the above-listed categories, but only relating to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

Assuming Insurer Not Licensed, Accredited, or Certified

Generally, credit for reinsurance would not be permitted for assuming insurers domiciled in states with similar reinsurance standards or maintaining a trust if those assuming insurers are not licensed, accredited, or certified to

transact insurance or reinsurance in Kansas. However, credit for reinsurance would be permitted if the assuming insurer, in the reinsurance agreement, agrees to submit to the jurisdiction of any court of competent jurisdiction in any state and comply with any judgments, and designates the Commissioner or a designated attorney to receive lawful process. These criteria for unlicensed, unaccredited, or non-certified assuming insurers would not conflict with or override the obligation of parties to a reinsurance agreement to arbitrate disputes.

Assuming Insurer is Not Licensed, Accredited, or Meeting Requirements of Domicile

An assuming insurer who is not licensed, accredited, or meeting the requirements of domicile would not be permitted a credit permitted for assuming insurers maintaining a trust fund or certified with secured obligations, unless the assuming insurer agrees to the following in a trust agreement:

- Comply with an order of the state commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer assets of the trust fund to the state commissioner with oversight, if that trust fund is inadequate, insolvent, or placed in receivership, rehabilitation, or liquidation;
- Distribute the assets and file claims with and valued by the state commissioner with regulatory oversight in accordance with the laws of the state where the trust is domiciled that are applicable to the liquidation of domestic insurance companies;
- Distribute assets in accordance with the trust agreement in the case of a state commissioner with regulatory oversight finding the trust fund assets are not necessary to satisfy claims; and

- Waive any right otherwise available under U.S. law if the law is inconsistent with these requirements.

Suspension or Revocation Authority

The bill would permit the Commissioner to suspend or revoke a reinsurer's accreditation or certification under certain circumstances. The Commissioner would be required to give notice and opportunity for a hearing to the reinsurer, prior to suspension or revocation. A suspension or revocation would not take effect until after the Commissioner's order on a hearing, unless the reinsurer waives the right to a hearing; the order is based on a regulatory action by the reinsurer's domiciliary jurisdiction, or the reinsurer voluntarily surrendered or terminated the ability to transact insurance or reinsurance in the domiciliary jurisdiction; or the Commissioner finds an emergency requires immediate action. Additionally, reinsurance credit would not be permitted after the date of revocation or suspension, except to the extent the reinsurer's obligations under the contract are secured.

Management of Reinsurance Recoverables, Diversification, and Notification

The bill would require the domestic ceding insurer to manage its reinsurance recoverables proportionate to the book of business,; diversify the reinsurance program, and provide notification to the Commissioner.

Assuming Insurer Not Meeting Requirements

The bill would specify that when a domestic insurer cedes reinsurance not meeting the above requirements, an asset or reduction from liability would be allowed only in an amount not exceeding the liabilities carried by the ceding insurer. The reduction would be required to be in the amount of funds held by or on behalf of the ceding insurer under a

reinsurance contract with the assuming insurer as security for payment of obligations under the contract. The bill also would list the acceptable forms of security.

Definition of Qualified U.S. Financial Institution

The bill would define a qualified U.S. financial institution for letters of credit issued or confirmed by that institution to mean an institution organized or licensed under the laws of the United States or any state; regulated, supervised, and examined by the U.S. federal or state authorities having the regulatory authority over banks and trust companies; and determined by either the Commissioner or the securities valuation office of the NAIC to meet the standards of financial condition and standing. The bill also would define “qualified U.S. financial institution” pertaining to any institution eligible to act as a fiduciary of a trust.

Rules and Regulations Authority

The Commissioner would be granted the authority to adopt, no later than January 1, 2019, rules and regulations necessary to administer reinsurance provisions.

Effective Date

The bill would apply to all cessions under reinsurance contracts occurring on or after January 1, 2018.

Background

The bill was introduced by the Senate Committee on Financial Institutions and Insurance at the request of the Kansas Insurance Department (Department). At the Senate Committee hearing, a representative of the Department testified in favor of the bill, stating the bill would update reinsurance law to assure that customers are adequately

protected in Kansas. The representative noted the bill would give the Department the tools needed to determine qualified reinsurers. No other testimony was provided.

According to the fiscal note prepared by the Division of the Budget, enactment of the bill would allow the Department to assess a fee for application for qualified reinsurers that would be used to cover the expenses necessary for review by the Department's Division of Financial Surveillance (Division). However, the Department cannot estimate how much revenue would be generated from the fee, or the additional costs borne by the Division. Any fiscal effect associated with the bill is not reflected in *The FY 2018 Governor's Budget Report*.