

New York Releases Proposed Changes to Credit for Reinsurance Regulation

July 30, 2010

Introduction

The New York Insurance Department (the "NYID") has released an "outreach" draft of proposed amendments to Regulation 20, *Credit for Reinsurance* (the "Proposal"). The Proposal would, among other things, provide the Superintendent with discretion to reduce the collateral that unauthorized reinsurers must provide to New York domestic ceding insurers in order for such ceding insurers to receive financial statement credit for the reinsurance. The Proposal is similar to proposed amendments to Regulation 20 that were published in the New York Register on December 24, 2008 for a formal 45-day comment period. No action was taken on these proposed amendments which were never promulgated.

The collateral reduction provisions apply to property and casualty and life insurers. Contracts entered into, renewed or having an anniversary date on or after January 1, 2011 are eligible. As currently proposed, it appears the reductions apply to all reserves under eligible contracts, whenever ceded.

No Extra-Territorial Application of New York Rules

The Proposal eliminates New York's longstanding practice of applying its credit for reinsurance rules on an extraterritorial basis to foreign licensed ceding insurers. In practical effect, New York is not conceding much because the Non-admitted and Reinsurance Reform Act that was recently enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act gives primacy to the credit for reinsurance rules of a ceding insurer's domiciliary regulator and preempts all other states' rules.

Reduced Collateral for Reinsurers

The centerpiece of the Proposal is a grant to the Superintendent discretion to allow a reduction in collateral that qualifying reinsurers must post in order for the ceding insurer to receive full financial statement credit. The Proposal is consistent with the approach taken in Florida, as well as with proposed collateral reduction legislation currently pending in New Jersey.

Baseline Eligibility for Reinsurers

For an unauthorized reinsurer to be eligible to provide reinsurance subject to reduced collateral requirements, it must:

- maintain policyholders' surplus in excess of \$250 million calculated on a US GAAP or US SAP basis;
- be rated by at least two rating agencies recognized by the Superintendent;
- file with the Superintendent information specified in the regulation (described below); and
- if a non-US reinsurer, be organized in a jurisdiction recognized by the Superintendent as providing access to US reinsurers equivalent to access provided in New York; there must also be a memorandum of understanding ("MOU") between the Superintendent and the applicant's domiciliary regulator that addresses matters that the Superintendent deems relevant.

MOUs covering the exchange of information are already in place for a number of foreign jurisdictions, including the UK, Germany, France and Bermuda. It remains to be seen whether these MOUs will serve as the MOUs under the new regulation.

Collateral Reduction Tied to Factors/Ratings

The Proposal requires the Superintendent to assign a reinsurer one of five ratings (i.e., Secure-1 to Vulnerable-5). The Superintendent's rating (and therefore, the reduction in the amount of collateral required) can be no greater than the company's lowest rating from any of the four rating agencies listed below:

Ratings	Collateral Required	Best	S&P	Moody's	Fitch
Secure-1	0%	A++	AAA	Aaa	AAA
Secure-2	10%	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure-3	20%	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
Secure-4	75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable-5	100%	B, B-, C++, C+, C, C-, D, E, F	BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R, NR	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, DD

The "collateral required" percentages and the financial strength rating bands in the chart shown above are consistent with the NAIC Reinsurance Regulatory Modernization Act of 2009. However, the financial strength rating of the reinsurer is only one factor, among others, to be considered as part of the Superintendent's determination for collateral reduction. As part of the evaluation process for both US and non-US reinsurers, several additional factors will be considered, including:

- compliance with reinsurance contractual terms and obligations;
- the business practices of the reinsurer in dealing with its ceding insurers;
- the reinsurer's reputation for prompt payment of claims under reinsurance agreements;
- for US reinsurers, a review of the most recent Annual Statement;
- regulatory actions against the reinsurer;
- an independent audit opinion of the reinsurer;

- audited financial statements;
- the liquidation preference of obligations to the ceding insurer in the reinsurer's domicile;
- a reinsurer's participation in any solvent scheme of arrangement, or similar procedure that involves US cedents; and
- any other information deemed relevant by the Superintendent.

Requirements Applicable to Reinsurance Agreements

In order to take advantage of reduced collateral under the Proposal, reinsurance contracts between cedents and the reinsurer must:

- require the reinsurer to notify the cedent in writing within 30 days of any change in domiciliary license status or its rating status;
- include an insolvency clause; and
- require the reinsurer to appoint a US agent for service of process and consent to the jurisdiction of US courts.

Annual/Filing Requirements

Audited financials of the reinsurer will be required to be filed annually with the Superintendent. Other required annual documentation includes the following:

- a report in the form of Schedule F or Schedule S to the Annual Statement blank;
- certificate of Good Standing from the domiciliary regulator; and
- a list of disputed recoverables with ceding insurers.

Prudent Reinsurance Credit Risk Management

The Proposal requires ceding insurers to act "with financial prudence" when entering into any reinsurance arrangement. The ceding insurer is required to "consider and account for" all risks associated with its agreement including net retained risk, risk concentration and credit risk. The Proposal includes new requirements to notify the Superintendent if reinsurance recoverables from a single reinsurer or affiliated group of insurers exceeds 50% of policyholder surplus or if ceded premiums are more than 20% of the ceding insurer's gross written premium in the prior

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

No part of this publication may be reproduced, in whole or in part, in any form, without our prior written consent.

© 2010 Dewey & LeBoeuf LLP
All rights reserved.

For further information on Dewey & LeBoeuf, please visit www.dl.com

calendar year. The notification "shall demonstrate that the exposure is safely managed by the ceding insurer."

Multi-Beneficiary Reinsurance Trusts ("MBRTs")

Under the Proposal, the Superintendent may approve a reduction in MBRTs to less than \$20,000,000 if the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years and finds, based on an assessment of the risk, that the new required surplus level is adequate for the protection of US cedents. The minimum trusted surplus may not be reduced to less than 30% of the reinsurer's liabilities attributable to reinsurance ceded by US cedents.

Comment Period

The NYID is requesting comments on the Proposal through August 4, 2010.

For more information, please contact Jane Boisseau at + 1 212 259 8644 or jboisseau@dl.com, John S. Pruitt at + 1 212 259 8574 or jpruitt@dl.com, Thomas M. Dawson at + 1 212 259 8011 or tdawson@dl.com, John Mulhern at + 1 212 259 8630 or jmulhern@dl.com, Don Henderson at + 1 212 259 8694 or dhenderson@dl.com, or your Dewey & LeBoeuf relationship attorney.