

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Committee on Rules

BILL: SB 728

INTRODUCER: Senator Broxson

SUBJECT: Credit for Reinsurance

DATE: March 16, 2021

REVISED: _____

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|----|---------------|----------------|-----------|------------------|
| 1. | <u>Arnold</u> | <u>Knudson</u> | <u>BI</u> | Favorable |
| 2. | <u>Davis</u> | <u>Cibula</u> | <u>JU</u> | Favorable |
| 3. | <u>Arnold</u> | <u>Phelps</u> | <u>RC</u> | Favorable |

I. Summary:

SB 728 provides insurers with credit for reinsurance and eliminates additional collateral requirements for reinsurers if the reinsurer is domiciled in a “reciprocal jurisdiction” and meets requirements set forth in the bill. The requirements include, but are not limited to:

- Minimum capital and surplus requirements;
- Minimum solvency or capital ratios;
- Annual confirmation from the domiciliary supervisory authority stating that the reinsurer meets the capital, surplus, and minimum solvency or capital ratio requirements; and
- Prompt claims payment practices.

The bill defines a reciprocal jurisdiction as:

- A non-United States jurisdiction that is subject to an in-force covered agreement¹ with the United States or, in the case of a covered agreement between the United States and the European Union,² an EU member state;
- A United States jurisdiction that meets the National Association of Insurance Commissioners’ requirements for accreditation; or
- Any other qualified jurisdiction that meets the Office of Insurance Regulation’s requirements as set forth in rule.

The bill also provides insurers with protections against reinsurer failure that include, but are not limited to, requiring the reinsurer to post collateral equal to all outstanding reinsurance liabilities

¹ The bill defines a “covered agreement” to mean an agreement entered into pursuant 31 U.S.C ss. 313 and 314 (The Dodd-Frank Wall Street Reform and Consumer Protection Act) which is effective or in a period of provisional application and addresses the elimination, under specified conditions, of collateral requirements as a condition for entering into any reinsurance agreement with a ceding insurer domiciled in this state or for allowing the ceding insurer to recognize credit for reinsurance.

² The United States entered into such an agreement on September 22, 2017, the Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance.

in the event the reinsurer enters into receivership; requiring the reinsurer to consent to the jurisdiction of courts of the State of Florida; and requiring the reinsurer to post collateral equal to all outstanding liabilities if the reinsurer resists enforcement of a court order from a jurisdiction in which it has consented.

The bill's revisions to Florida law governing credit for reinsurance enact 2019 revisions to the National Association of Insurance Commissioners (NAIC) Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).

The bill takes effect July 1, 2021.

II. Present Situation:

Reinsurance

Reinsurance is insurance that a primary insurance company purchases from a second insurance company to protect itself from major losses sustained by its policyholders. The large-scale losses are generally caused by natural disasters such as wildfires or hurricanes. The primary insurance company is referred to as the ceding insurer and the second insurance company is referred to as the reinsurer. In this contract of indemnity, the reinsurer agrees to compensate the ceding insurer for all or part of the losses and loss adjustment expenses the ceding insurer incurs under insurance policies it has issued to its policyholders.³ The vast majority of reinsurers, who are domiciled overseas, do not write insurance policies of their own to policyholders.

Through the reinsurance contract, the insurer reduces its probable maximum loss on either an individual risk (facultative reinsurance) or a specific class of insurance policies (treaty reinsurance) by ceding a portion of its liability to the reinsurer.⁴ Reinsurance serves to: (1) increase underwriting capacity; (2) stabilize underwriting results; (3) protect against catastrophic losses; (4) finance expanding volume; (5) withdraw from a class or line of business, or a geographic area, within a short time period; and (6) share large risks with other companies.⁵ Reinsurers may in turn further spread their assumed risk by purchasing reinsurance protection, which is called retrocession.⁶

Reinsurance creates privity of contract between the insurer and reinsurer, and does not modify the insured's policy with its insurer.⁷ Therefore, the reinsurance contract does not discharge the insurer from its primary liability to its policyholders or its obligation to pay policyholder claims.⁸

³ National Association of Insurance Commissioners, *Glossary of Insurance Terms* https://content.naic.org/consumer_glossary.htm#R (last visited Feb. 25, 2021).

⁴ Barron's Dictionary of Insurance Terms, 437 (6th ed. 2013).

⁵ *Id.*

⁶ The Center for Insurance Policy and Research, National Association of Insurance Commissioners, *Reinsurance*, (last updated Feb. 26, 2020), available at https://content.naic.org/cipr_topics/topic_reinsurance.htm (last visited Feb. 25, 2021).

⁷ U.S. Department of Treasury, Federal Insurance Office, *The Breadth and Scope of the Global Reinsurance Market and the Critical Role Such Market Plays in Supporting Insurance in the United States*, 7 (December 2014), available at <https://www.treasury.gov/initiatives/fio/reports-and-notice/Documents/FIO%20-Reinsurance%20Report.pdf> (last visited Feb. 25, 2021).

⁸ *Id.*

Similarly, only the insurer has direct rights to recover from the reinsurer unless expressly provided for in the reinsurance contract.⁹

Florida regulates reinsurance under s. 624.610, F.S., and rule 69O-144, F.A.C.

Regulation of Reinsurance

The United States (U.S.) is both the largest insurance market and reinsurance market in the world by premium volume.¹⁰ Furthermore, roughly half of all business originates from North America.¹¹ In support of U.S. domestic insurers, non-U.S. reinsurers provide a majority of the available reinsurance protection to fulfill the needs of the U.S. insurance market. In 2018, offshore reinsurers assumed 65.7 percent of U.S. ceded premiums.¹² Together, offshore reinsurers and alien-owned¹³ U.S. reinsurers assumed 88.9 percent of U.S. ceded premiums during the same year.¹⁴ Such access to alien reinsurance contributes to the global diversification of risk, provides claims burden relief to U.S. reinsurers, and mitigates financial impacts of catastrophes.¹⁵

The purchase of reinsurance from reinsurers not domiciled or licensed in the U.S. may expose U.S. domestic insurers to additional credit risk to the extent that any reinsurer is unable to meet the obligation assumed in the reinsurance contract. It similarly presents significant challenges to U.S. state insurance regulators charged with regulating insurer solvency.

Direct Regulation of Authorized Reinsurers

The Office of Insurance Regulation (OIR) directly regulates authorized reinsurers¹⁶ domiciled and licensed in Florida as well as reinsurers licensed in Florida, but domiciled in a foreign state.¹⁷ When an insurer cedes business to a licensed reinsurer, the insurer is permitted under statutory accounting rules to recognize a reduction in its liabilities for the amount of ceded liabilities, without a regulatory requirement for the reinsurer to post collateral to secure the reinsurer's ultimate payment of the reinsured liabilities.¹⁸ A reinsurer licensed in a state is subject to solvency and other regulations imposed by the state which are applicable to insurance companies generally.

⁹ *Morris & Co. v. Skandinavia Ins. Co.*, 279 U.S. 405, 408 (1929); *Citizens Cas. Co. v. Am. Glass. Co.*, 166 F.2d 91, 95 (7th Cir. 1948).

¹⁰ See *supra* note 7, at 1.

¹¹ *Id.*

¹² Reinsurance Association of America, *Offshore Reinsurance in the U.S. Market: 2018 Data*, 13, available at https://www.reinsurance.org/RAA/Industry_Data_Center/Offshore_Report/Offshore_Report_2018_Data.html (last visited Feb. 25, 2021).

¹³ In the insurance context, "alien" means domiciled in a foreign country. "Alien" is distinguishable from "foreign," which means domiciled in a state other than the one in which the company is writing business.

¹⁴ See *supra* note 12, at 14.

¹⁵ International Association of Insurance Supervisors, *Reinsurance and Financial Stability*, 8 (July 2012), available at <https://www.iaisweb.org/file/34046/reinsurance-and-financial-stability> (last visited Feb. 25, 2021).

¹⁶ An "authorized" reinsurer is one that is licensed or accredited in a given state.

¹⁷ Section 624.610(3)(a) and (b), F.S.

¹⁸ *Id.*

Indirect Regulation of Unauthorized Reinsurers

In the absence of direct supervisory authority, OIR indirectly regulates unauthorized reinsurers¹⁹ by limiting the ceding insurer's credit for reinsurance unless the reinsurer posts collateral to secure the reinsurer's ultimate payment of the reinsured liabilities.²⁰

The 2007 Legislature reduced the collateral requirements for insurers to receive credit for reinsurance commensurate with the financial strength of the reinsurer and the quality of the regulatory regime, and authorized OIR to enact rulemaking to implement corresponding regulatory changes.²¹ In considering whether to allow credit for reinsurance, the reinsurer must hold surplus in excess of \$250 million and have a secure financial strength rating (SFSR) from at least two statistical rating organizations deemed acceptable by the Commissioner of OIR (Commissioner).²² The Commissioner must also consider:

- The domiciliary regulatory jurisdiction of the reinsurer;
- The structure and authority of the domiciliary regulator with regard to solvency regulation and the financial surveillance of the reinsurer;
- The substance of financial and operating standards for reinsurers in the domiciliary jurisdiction;
- The form and substance of financial reports required to be filed by the reinsurers in the domiciliary jurisdiction or other public financial statements filed in accordance with generally accepted accounting principles;
- The domiciliary regulator's willingness to cooperate with U.S. regulators in general and OIR in particular;
- The history of performance by reinsurers in the domiciliary jurisdiction;
- Any documented evidence of substantial problems with the enforcement of valid U.S. judgments in the domiciliary jurisdiction; and
- Any other matters deemed relevant by the Commissioner.²³

¹⁹ An "unauthorized" reinsurer fails to meet the definition of an authorized reinsurer. *See supra* note 13. Furthermore, "unauthorized" is distinguishable from "non-U.S." A U.S. reinsurer that does not meet the definition of "authorized" reinsurer is considered "unauthorized." However, non-U.S. reinsurers cannot become accredited in a U.S. state based on their own domestic license.

²⁰ Historically, in order to receive financial statement credit for unauthorized reinsurance, a U.S. insurer must have been the beneficiary of security posted by the unauthorized reinsurer, providing collateral equal to 100 percent of the actuarially-estimated liabilities under the reinsurance contract.

²¹ Chapter 2007-1, s. 15, Laws of Fla.

²² Section 624.610(3)(e), F.S.

²³ Section 624.610(3)(e)(1)-(8), F.S.

The collateral required to allow 100 percent credit shall be no less than the percentage specified for the lowest rating as indicated in the SFSR below:²⁴

| Rating | Collateral Required | AM Best | S&P | Moody's | Fitch | Demotech |
|----------------|---------------------|--------------------------------|---|---------------------------------------|---|----------|
| Secure – 1 | 0% | A++ | AAA | Aaa | AAA | A" |
| Secure – 2 | 10% | A+ | AA+, AA, AA- | Aa1, Aa2, Aa3 | AA+, AA, AA- | A' |
| Secure – 3 | 20% | A | A+, A | A1, A2 | A+, A | A |
| Secure – 4 | 50% | A- | A- | A3 | A- | n/a |
| Secure – 5 | 75% | B++, B+ | BBB+, BBB, BBB- | Baa1, Baa2, Baa3 | BBB+, BBB, BBB- | n/a |
| Vulnerable – 6 | 100% | B, B-, C++, C+, C, C-, D, E, F | BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R | Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C | BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD | n/a |

Revisions to NAIC Model Law 785 and Regulation 786

The 2019 revisions to the National Association of Insurance Commissioners (NAIC) Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) incorporate substantive provisions from the 2017 Bilateral Agreement between the United States and European Union on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement) reached between the U.S. Department of the Treasury, U.S. Trade Representative, and the European Union (EU).

The Covered Agreement, in part, commits the U.S. to phasing-out state-based reinsurance collateral requirements for EU reinsurers by 2022.²⁵ It further exempts EU reinsurers from current U.S. domiciliary requirements for authorized reinsurer status by creating a new, broader classification of jurisdiction called “reciprocal jurisdiction.”²⁶ Credit for Reinsurance Model Law (#785) defines a “reciprocal jurisdiction” as a jurisdiction that meets one of the following requirements:

- “A non-U.S. jurisdiction that is subject to an in-force covered agreement with the United States, each within its legal authority, or in the case of a covered agreement between the United States and European Union, is a member state of the European Union”;²⁷
- “A U.S. jurisdiction that meets the requirements for accreditation under the NAIC financial standards and accreditation program; or
- A qualified jurisdiction, as determined by the commissioner²⁸

²⁴ Rule 69O-144.007(4), F.A.C.

²⁵ United States Department of Treasury, Federal Insurance Office, *Statement of the United States on the Covered Agreement with the European Union*, 1 (September 22, 2017), available at https://home.treasury.gov/system/files/311/US_Covered_Agreement_Policy_Statement_Issued_September_2017_1.pdf (last visited Feb. 25, 2021).

²⁶ *Id.*

²⁷ National Association of Insurance Commissioners, *Credit for Reinsurance Model Law-785*, 7 (Summer 2019), available at <https://www.naic.org/store/free/MDL-785.pdf> (last visited Feb. 25, 2021).

²⁸ *Id.*

“Covered agreements” are authorized under 31 U.S.C. ss. 313 and 314 where the term is defined. The term means:

a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that—

(A) is entered into between the United States and one or more foreign governments, authorities, or regulatory entities; and

(B) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.²⁹

NAIC Accreditation and Adoption of Model Laws

NAIC accreditation is a certification that legal, regulatory, and organizational oversight standards and practices are being fulfilled by a state insurance department to promote sound insurer financial solvency regulation. The accreditation program is also designed to allow for interstate cooperation and reduces regulatory redundancies.³⁰ For example, the OIR’s examinations may be recognized by other member states, thereby avoiding the need to have a Florida domestic insurer examined by multiple states.³¹

Presently, each of the 50 states, the District of Columbia, and Puerto Rico are accredited. Once accredited, a state is subject to a full accreditation review every 5 years, as well as interim reviews.³² One major component of NAIC accreditation standards is the adequacy of “solvency laws and regulations in each accredited state to protect consumers” and guaranty funds, through the adoption of model laws.³³

Effective January 1, 2019, NAIC included the 2011 revisions to the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) as accreditation standards.³⁴ It subsequently included the 2019 revisions to Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) as accreditation standards to be effective October 1, 2022.³⁵

²⁹ 31 U.S.C. s. 313(r)(2).

³⁰ National Association of Insurance Commissioners, *Financial Regulation Standards and Accreditation Program*, 2 (December 2019), available at https://content.naic.org/sites/default/files/inline-files/FRSA%20Pamphlet%202012-2019_0.pdf (last visited Feb. 25, 2021).

³¹ *Id.*

³² National Association of Insurance Commissioners, *State Legislative Brief: The NAIC Accreditation Program* (November 2019), available at https://www.naic.org/documents/cmte_legislative_liaison_brief_accreditation.pdf (last visited Feb. 25, 2021).

³³ See *supra* note 29.

³⁴ *Id.*

³⁵ National Association of Insurance Commissioners, *CIPR Topics: Reinsurance* (September 1, 2019), available at https://content.naic.org/cipr_topics/topic_reinsurance.htm (last visited Feb. 25, 2021).

III. Effect of Proposed Changes:

Section 1 amends s. 624.610, F.S., which provides the criteria under which an insurer is given credit for reinsurance. The bill provides insurers with credit for reinsurance if the reinsurer is domiciled in a “reciprocal jurisdiction” and meets the requirements of this section. It defines “reciprocal jurisdiction” as a jurisdiction that is:

- A non-U.S. jurisdiction that is subject to an in-force covered agreement³⁶ with the U.S. or, in the case of a covered agreement between the United States and the European Union,³⁷ an E.U. member state;
- A U.S. jurisdiction that meets the NAIC’s requirements for accreditation; or
- Any other qualified jurisdiction that meets the OIR’s requirements as set forth in rule.

Additional requirements of the qualified jurisdiction to be specified by Financial Services Commission (FSC)³⁸ rule include:

- The jurisdiction allows an insurer domiciled, or having its head office, in the jurisdiction to take credit for reinsurance ceded to an insurer domiciled in the United States in the same manner as reinsurance ceded to insurers domiciled in that jurisdiction.
- The jurisdiction does not require an assuming insurer domiciled in the United States to establish or maintain a local presence as a condition for entering into a reinsurance agreement with any ceding insurer subject to regulation by the jurisdiction or as a condition for allowing the ceding insurer to take credit for the ceded risk.
- The jurisdiction provides written confirmation that it recognizes the state regulatory approach to group supervision and group capital and that insurers and insurance groups domiciled, or maintaining their headquarters, in a jurisdiction accredited by the National Association of Insurance Commissioners are subject only to worldwide prudential insurance group supervision by the domiciliary state and are not subject to group supervision at the level of the worldwide parent undertaking of the insurance or reinsurance group by the qualified jurisdiction.
- The jurisdiction provides written confirmation that information regarding insurers and their parent, subsidiary, or affiliated entities shall be provided to the office in accordance with a memorandum of understanding or similar document between the office and such qualified jurisdiction.

A reinsurer domiciled in a reciprocal jurisdiction must maintain minimum capital and surplus in the amount of \$250 million, or a greater amount as specified by FSC rule, and certain minimum solvency or capital ratios. A non-U.S. jurisdiction subject to an in-force covered agreement must maintain a minimum solvency or capital ratio specified in the covered agreement. A U.S. jurisdiction must maintain a risk-based capital ratio of 300 percent of the authorized control

³⁶ The bill defines a “covered agreement” to mean an agreement entered into pursuant 31 U.S.C. ss. 313 and 314 (The Dodd-Frank Wall Street Reform and Consumer Protection Act) which is effective or in a period of provisional application and addresses the elimination, under specified conditions, of collateral requirements as a condition for entering into any reinsurance agreement with a ceding insurer domiciled in this state or for allowing the ceding insurer to recognize credit for reinsurance.

³⁷ The United States entered into such an agreement on September 22, 2017, the Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance.

³⁸ The Financial Services Commission is comprised of the Governor, Attorney General, Chief Financial Officer and the Commissioner of Agriculture.

level,³⁹ calculated pursuant to s. 624.4085, F.S. A qualified jurisdiction subject to this section must maintain a minimum solvency or capital ratio determined by OIR to be an effective measure of solvency.

The reinsurer's supervisory authority must annually confirm to OIR whether the reinsurer complies with these minimum requirements. In the event the reinsurer falls below these minimum requirements, or if regulatory action is taken against it for serious noncompliance with applicable law, the reinsurer must provide written notice to OIR.

The reinsurer must consent to the jurisdiction of Florida state courts and the designation of the CFO for purposes of lawful service of process in any action, suit, or proceeding brought by the insurer against the reinsurer. The reinsurer must consent to pay all final judgements declared enforceable in the jurisdiction where the judgment was obtained, and the reinsurance contract must contain a provision requiring the reinsurer to provide security equal to 100 percent of reinsurance liabilities in the event the reinsurer resists enforcement of a final judgment or a properly enforceable arbitration award.

The reinsurer must agree to provide security equal to 100 percent of reinsurance liabilities and notify the insurer if the reinsurer enters into receivership for conservation, rehabilitation, or liquidation purposes.

Upon request by OIR, the reinsurer must provide the following additional documentation:

- Annual audited financial statements, for the 2-year period before entering into the reinsurance agreement and on an annual basis thereafter, in accordance with the applicable law of the jurisdiction of its head office or domiciliary jurisdiction, as applicable, including the external audit report.
- The solvency and financial condition report or actuarial opinion, if filed with the assuming insurer's supervisor, for the 2-year period before entering into the reinsurance agreement.
- Before entering into the reinsurance agreement and not more than semiannually thereafter, an updated list of all disputed and overdue reinsurance claims outstanding for 90 days or more regarding reinsurance assumed from ceding insurers domiciled in the U.S.
- Before entering into the reinsurance agreement and not more than semiannually thereafter, information regarding the assuming insurer's assumed reinsurance by ceding insurer, ceded reinsurance by the assuming insurer, and reinsurance recoverable on paid and unpaid losses by the reinsurer.
- Additional information as reasonably required by OIR.

The reinsurer must pay claims promptly pursuant to FSC rule.

OIR may revoke the reinsurer's eligibility for recognition if the reinsurer fails to meet one or more of the requirements of the subsection. In the event OIR revokes the reinsurer's eligibility,

³⁹ Risk-based capital is a capital adequacy standard that represents the amount of required capital an insurer must maintain, based on the inherent risks in the insurer's operations. It is determined by a formula that considers certain material risks depending on the type of insurer, and generates the regulatory minimum amount of capital that a company is required to maintain to avoid regulatory action. The risk-based capital standards raises a safety net for insurers, is uniform among states, and operates as a tripwire system to give state insurance regulators authority for timely corrective action.

the insurer does not qualify for credit for reinsurance except to the extent the reinsurer has provided collateral to secure the reinsurance liabilities.

Many reinsurers domiciled in what the bill defines as “reciprocal jurisdictions” are currently required under Florida law to hold surplus in excess of \$250 million and have a secure financial strength rating from at least two statistical rating agencies.⁴⁰ The bill will allow reinsurers in reciprocal jurisdictions to instead meet the requirements created by this bill. This will allow insurers in this state to receive credit for reinsurance obtained from reinsurers having a surplus of less than \$250 million if the reinsurer is domiciled in a reciprocal jurisdiction and otherwise meets the requirements established by the bill.

Section 2 provides an effective date of July 1, 2021.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Allowing insurers to receive credit for reinsurance and eliminating additional collateral requirements for reinsurers if the reinsurer is domiciled in a “reciprocal jurisdiction” provides U.S. domestic insurers with greater access to global reinsurance and improves diversification of risk.

⁴⁰ See s. 624.610(3)(e), F.S.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends section 624.610, Florida Statutes.

IX. Additional Information:

A. Committee Substitute – Statement of Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.