

REVISE REINSURANCE LAWS

Senate Bill 1219 as passed by the Senate First Analysis (5-23-00)

Sponsor: Sen. Bill Bullard, Jr.
**House Committee: Insurance and Financial
Services**
Senate Committee: Financial Services

THE APPARENT PROBLEM:

Barron's Dictionary of Insurance Terms describes reinsurance as follows:

“[a] form of insurance that insurance companies buy for their own protection, a ‘sharing of insurance’. An insurer (the reinsured) reduces its possible maximum loss on either an individual risk or on a larger number of risks by giving (ceding) a portion of its liability to another insurance company (the reinsurer). Reinsurance enables an insurance company (1) to expand its capacity; (2) stabilize its underwriting results; (3) finance its expanding volume; (4) secure catastrophic protection against shock losses; (5) withdraw from a class or line of business, or a geographical area, within a relatively short time; and (6) share large risks with other companies.”

When an insurance company cedes insurance, it can take a reinsurance credit on its books, which will allow it to take on business beyond what would otherwise be its statutory limit, according to industry specialists. Because insurers cede insurance to companies located all over the world, state laws only allow ceding insurers to take reinsurance credits when the reinsurer meets certain standards. Michigan's law regarding reinsurers is said to be based on the 1991 model drafted by the National Association of Insurance Commissioners. The NAIC adopted a new model in 1996, according to a spokesperson from the Reinsurance Association of America, and legislation has been introduced so that Michigan law would adopt the updated provisions.

THE CONTENT OF THE BILL:

The bill would amend the Insurance Code to make changes in provisions dealing with reinsurance transactions.

The code specifies when a ceding insurer (a company acquiring reinsurance from an assuming insurer) can be allowed a credit as either an asset or a reduction from

liability. The credit is only allowed when the assuming reinsurer meets certain specified conditions. The bill would provide the following.

- When an assuming insurer was licensed to transact insurance or reinsurance in the state or met other state requirements, credit would only be allowed the ceding insurer for cessions of those kinds or classes of business that the assuming insurer was licensed to or otherwise permitted to write or assume in its state of domicile or, for a United States branch of an alien insurer (that is, one from another country), in the state through which it was entered and licensed to transact insurance or reinsurance.
- A ceding insurer would be allowed credit for reinsurance if the assuming insurer was accredited as a reinsurer in the state, and would not be allowed credit if the reinsurer's accreditation had been revoked by the commissioner of OFIS after notice and a hearing. An accredited insurer would be one that met all of the following requirements: filed with the commissioner evidence of the reinsurer's submission to the state's jurisdiction; submitted to the state's authority to examine its books and records; was licensed to transact insurance and reinsurance in at least one state or, for an alien insurer, was entered through and licensed to transact insurance or reinsurance in at least one state; filed annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited statement; and either maintained a surplus as regards policyholders of \$20 million or more and whose accreditation has not been denied by the commissioner within 90 days of its submission or maintained a surplus of less than \$20 million and whose accreditation had been approved by the commissioner.
- Ceding insurers are allowed credit if the reinsurer maintains a trust fund in a qualified U.S. financial

institution for the payment of its valid claims. The bill would require that the trust fund meet certain new requirements. For reinsurance ceded under agreements with an inception date, amendment, or renewal date on or after August 1, 1995, to a group of insurers, the trust would have to consist of a trustee account in an amount not less than the group's several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any one group. All trusts and amendments to trusts would have to be in a form approved by the commissioner of the state where the trust was domiciled or another commissioner who had accepted principal regulatory oversight of the trust.

- Credits would only allowed if the assuming insurer (the reinsurer) agreed to certain requirements in the trust agreement. The trust agreement would have to provide that if the trust fund was inadequate or if the trust grantor was declared or placed into receivership, rehabilitation, liquidation, or similar proceedings, the trustee would comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund. The agreement would have to provide that the assets be distributed by and claims filed with and valued by the commissioner with regulatory oversight in accordance with the applicable laws in which the trust was domiciled. The assuming insurer would also have to agree that if the commissioner with regulatory oversight determined that the trust fund assets or any part of the trust fund assets were not necessary to satisfy the claims of the U.S. ceding insurers of the trust grantor, the assets would be returned by the commissioner to the trustee for distribution in accordance with the trust agreement. And the trust agreement would have to provide that the trust grantor waived any right otherwise available under U.S. laws inconsistent with the abovementioned provisions.

- For credit to be granted to a ceding insurer the reinsurance contract would have to provide, in substance, that if the ceding insurer became insolvent, the reinsurance would be payable under the terms of the contract by the assuming insurer on the basis of reported claims allowed by the liquidation court (with one exception) without diminution because of the insolvency of the ceding insurer. The payments would have to be made directly to the ceding insurer or its domiciliary liquidator unless the contract required or an endorsement signed by the reinsurer required the reinsurer to make payment to the payees under the reinsured policies if the ceding insurer became insolvent. The reinsurance agreement could provide

that the domiciliary liquidator of an insolvent ceding insurer would have to give written notice to the assuming insurer of the pendency of a claim against the ceding insurer on the contract reinsured within a reasonable time after the claim was filed in the liquidation proceeding. The exception referred to above would involve cases when a life and health guaranty association (or its successor) had assumed policy obligations of the insolvent ceding insurer and had succeeded to the rights of the insolvent insurer under the reinsurance contract. In that case, the reinsurer's liability would continue under the reinsurance contract and would be payable at the direction of the guaranty association. As a condition to succeeding to the insolvent insurer's rights under the contract, the guaranty association would be responsible for premiums payable under the reinsurance contract for periods after the date of the liquidation. Similar provisions would be added in a section addressing amounts recoverable from reinsurers by liquidators.

- The bill would eliminate a provision that permits the commissioner to allow credit for reinsurance that did not otherwise meet the requirements of the code if certain specified conditions are met.

MCL 500.1101 et al.

FISCAL IMPLICATIONS:

The Senate Fiscal Agency reports that the bill would have no fiscal impact on state or local government. (SFA floor analysis dated 5-8-00)

ARGUMENTS:

For:

The bills would add highly technical provisions to the Insurance Code to address issues related to reinsurance transactions. The changes are based on updates made to the model law on the subject drafted by the National Association of Insurance Commissioners. Industry spokespersons say they would make significant contributions to stronger solvency regulation and establish appropriate oversight and regulation of ceding insurers and reinsurance companies. Language has also been adopted to clarify the responsibility of reinsurers should there be an insurance company insolvency. A dozen states are said to have adopted these standardized provisions. A spokesperson for the Reinsurance Association of American argued that the provisions would strengthen solvency regulation by: reinforcing state actions to compel security from non-U.S. reinsurers and enforce state requirements that the claims against insolvent non-U.S. insurers be valued

and paid in accordance with state law; ensuring Michigan's ability to assert its rights to control alien company collateral so that it cannot be repatriated under federal bankruptcy law; creating uniform language for various classes of trusts and make the regulatory authority over the trusts consistent; amending trust fund requirements to conform state law governing Lloyd's reinsurance trust funds to the actual operation of the funds, as restructured by the New York Insurance Department and Lloyd's in 1995; and clarifying the state law to ensure that cut through endorsements are recognized so that reinsurers do not have to pay the same claims twice. (Cut-through endorsements are clauses that specify that the amount of loss that an insurance company would have recovered from a reinsurer can be paid instead directly to policyholders if the ceding insurance company becomes insolvent.)

POSITIONS:

The Office of Financial and Insurance Services (OFIS) has indicated support for the bill. (5-17-00)

A representative of the Reinsurance Association of America testified in support of the bill. (5-17-00)

The Michigan Insurance Federation has indicated support for the bill. (5-17-00)

The Life Insurance Association of Michigan has indicated support for the bill. (5-17-00)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.