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**BILL ANALYSIS**

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Senate Bill 638 (as introduced 10-31-17)  
Sponsor: Senator Margaret E. O'Brien  
Committee: Insurance

Date Completed: 11-29-17

### **CONTENT**

**The bill would amend Chapter 11 (Reinsurance) of the Insurance Code to do the following:**

- **Revise requirements for a ceding insurer to receive credit for reinsurance as either an asset or a reduction from liability.**
- **Specify that a ceding insurer could receive credit for reinsurance if the reinsurance were ceded to an assuming insurer domiciled in a state that employed reinsurance credit standards similar to Michigan's, or to an assuming insurer that had been certified by the Director of the Department of Insurance and Financial Services (DIFS), and met further requirements.**
- **Allow the Director to suspend or revoke the reinsurer's accreditation or certification if an accredited or certified reinsurer ceased to meet the requirements for accreditation or certification, and establish the suspension or revocation procedure.**
- **Require a ceding insurer to take steps to manage its reinsurance recoverable assets proportionate to its own book of business, and to diversify its reinsurance program.**
- **Require a domestic ceding insurer to notify the Director within 30 days after reinsurance recoverable assets from any assuming insurer exceeded 50% of the domestic ceding insurer's last reported surplus to policyholders.**
- **Require a domestic ceding insurer to notify the Director within 30 days after ceding to any assuming insurer more than 20% of the ceding insurer's gross written premium in the prior calendar year.**
- **Allow the Director to promulgate rules with regard to specific reinsurance agreements.**
- **Specify that any asset or reduction from liability for reinsurance ceded would be allowed only to the extent that it was consistent with any rules promulgated by the Director.**

The bill would take effect 90 days after it was enacted.

### **Reinsurance Credit Eligibility**

**Compliance with Rules.** Under the Code, a ceding insurer is allowed credit for reinsurance as either an asset or a reduction from liability on account of reinsurance ceded only if the reinsurance is ceded to an assuming insurer that is authorized to transact insurance or reinsurance in the State or that meets certain requirements described below. The bill would add that credit for reinsurance would be allowed only to the extent that it was consistent with

any rules promulgated by the Director of DIFS regarding the valuation of reserve credits or assets, the amount and forms of security supporting reinsurance agreements, or the circumstances under which credit would be reduced or eliminated.

Ceding Insurance to Accredited Reinsurer in State. Under the Code, a ceding insurer is allowed credit for reinsurance ceded as either an asset or a reduction from liability on account of reinsurance ceded if the reinsurance is ceded to an assuming insurer that is accredited as a reinsurer in the State.

Credit for reinsurance ceded is not allowed if the assuming insurer's accreditation has been revoked by the Director after notice and hearing. The bill would delete this provision.

Currently, an accredited reinsurer under this credit allowance is a reinsurer that: 1) files with the Director evidence of the reinsurer's submission to the State's jurisdiction; 2) is licensed to transact insurance or reinsurance in at least one state, or for a United States branch of an alien assuming insurer is entered through, and licensed to transact insurance or reinsurance in at least one state; 3) submits to the State's authority to examine its books and records; 4) files annually with the Director a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; 5) meets one of the following:

- Maintains a surplus as regards policyholders of \$20.0 million or more and whose accreditation has not been denied by the Director within 90 days of its submission.
- Maintains a surplus as regards policyholders of less than \$20.0 million and whose accreditation has been approved by the Director.

The bill would amend these provisions to require the accredited reinsurer to bear the cost of the book and record examination, and delete the requirement of maintaining a surplus as regards policyholders.

The bill would require the accredited reinsurer to demonstrate to the satisfaction of the Director that it had adequate financial capacity to meet its reinsurance obligations and was otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer would meet the requirement as of the time of its application if it maintained a surplus as regards policyholders in an amount not less than \$20.0 million and its accreditation had not been denied by the Director within 90 days after submission of its application.

Ceding Insurance to Insurer from State with Similar Standards. The bill specifies that a ceding insurer would be allowed credit for reinsurance as either an asset or a reduction from liability on account of reinsurance ceded if the reinsurance were ceded to an assuming insurer that was domiciled in, or for a United States branch of an alien assuming insurer was entered through, a state that employed standards regarding credit for reinsurance substantially similar to those applicable under the Chapter 11 and the assuming insurer or United States branch of an alien assuming insurer met both of the following:

- Except for reinsurance ceded and assumed under pooling arrangements among insurers in the same holding company system, maintained a surplus as regards policyholders in an amount not less than \$20.0 million.
- Submitted to the State's authority to examine its books and records, and bore the cost of the examination.

Ceding Insurance to Insurer that Maintains Trust Fund. Under the Code, a ceding insurer is allowed credit for reinsurance ceded as either an asset or a reduction from liability on account of reinsurance ceded if the reinsurance is ceded to an assuming insurer that maintains a trust

fund in a qualified United States financial institution for the payment of the valid claims of its United States ceding insurers, their assigns, and successors in interest, the trust agreement complies with other requirements, and the assuming insurer submits to the Director's authority to examine its books and records and bears the cost of the examination.

For a single assuming insurer, the trust fund must consist of a trustee account representing the assuming insurer's liabilities attributable to reinsurance ceded by United States ceding insurers, and, the assuming insurer must maintain a trustee surplus of an amount sufficient in the opinion of the Director to maintain compliance with the Code as respects reinsurance ceded by United States ceding insurers but not less than \$20.0 million.

Under the bill, in addition to the above requirement for a single assuming insurer, after the assuming insurer had permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust could authorize a reduction in the required trustee surplus. The commissioner could not authorize a reduction unless he or she determined, based on an assessment of the risk, that the new required surplus level was adequate for the protection of United States ceding insurers, policyholders, and claimants in light of reasonably foreseeable adverse loss development. The risk assessment could involve an actuarial review, including an independent analysis of reserves and cash flows, and would have to consider all material risk factors, including, when applicable, the lines of business involved, the stability of the incurred loss estimates, and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trustee surplus could not be reduced to an amount less than 30% of the assuming insurer's liabilities attributable to reinsurance ceded by the United States ceding insurers covered by the trust.

Under the Code, for a group including incorporated and individual unincorporated underwriters, the following apply:

- For reinsurance ceded under reinsurance agreements with an inception date, amendment, or renewal date on or after August 1, 1995, the trust must consist of a trustee account in an amount not less than the group's several liabilities attributable to business ceded by the United States domiciled ceding insurers to any underwriter of the group.
- For reinsurance ceded under reinsurance agreements with an inception date on or before July 31, 1995, and not amended or renewed after that date, the trust must consist of a trustee account in an amount not less than the group's several insurance and reinsurance liabilities attributable to business written in the United States.

The bill would change the date in the first provision above to January 1, 1993, and would change the date in the second provision to December 31, 1992.

Under the bill, for a group of incorporated underwriters under common administration, all of the following would apply:

- The group would have to have continuously transacted an insurance business outside the United States for at least three years immediately before applying for accreditation.
- The group would have to maintain an aggregate policyholders' surplus of at least \$10.0 billion.
- The group would have to maintain a trust fund in an amount not less than the group's several liabilities attributable to business ceded by United States domiciled ceding insurers to any member of the group under reinsurance contracts issued in the name of the group.
- The group would have to maintain a joint trustee surplus of which \$100.0 million was held jointly for the benefit of the United States domiciled ceding insurers of any member of the group as additional security for those liabilities.

In addition, within 90 days after its financial statements were due to be filed with the group's domiciliary regulator, the group would have to provide to the Director an annual certification of each underwriter member's solvency by the member's domiciliary regulator and financial statements of each underwriter member of the group prepared by its independent public accountant.

Ceding Insurance to Reinsurer Certified by the Director. Under the bill, a ceding insurer would be allowed credit for reinsurance ceded as either an asset or a reduction from liability on account of reinsurance if the reinsurance were ceded to an assuming insurer that had been certified by the Director as a certified reinsurer in the State and that secured its obligations as required by the bill.

The Director could not certify an assuming insurer as a certified reinsurer unless the assuming insurer met all of the following:

- It was domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the Director.
- It maintained minimum capital and surplus, or its equivalent, in an amount determined by the Director under rule.
- It maintained financial strength ratings from two or more rating agencies considered acceptable by the Director under rule.
- It agreed to submit to the State's jurisdiction.
- It agreed to appoint the Director as its agent for service of process in the State.
- It agreed to provide security for 100% of its liabilities attributable to reinsurance ceded by United States ceding insurers if it resisted enforcement of a final United States judgment.
- It agreed to meet applicable information filing requirements as determined by the Director, both with respect to an initial application for certification and on an ongoing basis.
- It satisfied any other requirements for certification that the Director considered relevant.

The Director could certify an association including incorporated and individual unincorporated underwriters as a certified reinsurer if the association met all of the following:

- It met the requirements for an assuming insurer listed above.
- It satisfied its minimum capital and surplus requirements through the capital and surplus equivalents, net of liabilities, of the association and its members, that included a joint central fund that could be applied to an unsatisfied obligation of the association or any of its members, in an amount determined by the Director to provide adequate protection.
- The incorporated members of the association were not engaged in any business other than underwriting as a member of the association, and would be subject to the same level of regulatory and solvency control by the association's domiciliary regulator as the unincorporated members.
- Within 90 days after its financial statements were due to be filed with the association's domiciliary regulator, the association provided to the Director an annual certification by the association's domiciliary regulator of the solvency of each underwriter member, or if a certification were unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.

The Director would have to create and publish a list of qualified jurisdictions under which an assuming insurer licensed and domiciled in a qualified jurisdiction would be eligible to be considered for certification by the Director as a certified reinsurer. To determine if the domiciliary jurisdiction of a non-United States assuming insurer were eligible to be recognized as a qualified jurisdiction, the Director would have to evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on

an ongoing basis, and consider the rights, benefits, and extent of reciprocal recognition afforded by the non-United States jurisdiction to reinsurers licensed and domiciled in the United States. A qualified jurisdiction would have to agree to share information and cooperate with the Director with respect to all certified reinsurers domiciled within that jurisdiction. The Director could not recognize a jurisdiction as a qualified jurisdiction if the Director determined that it did not adequately and promptly enforce final United States judgments and arbitration awards. The Director could consider additional factors to determine if the domiciliary was eligible to be recognized as a qualified jurisdiction.

In determining whether a jurisdiction was a qualified jurisdiction, the Director would have to consider a list of qualified jurisdictions published by the National Association of Insurance Commissioners (NAIC) committee process. If the Director approved as qualified a jurisdiction that did not appear on the list, the Director would have to provide thoroughly documented justification to the NAIC in accordance with criteria required by rule. The Director would have to recognize a United States jurisdiction that met the requirement for accreditation under the NAIC financial standards and accreditation program as a qualified jurisdiction. If a certified reinsurer's domiciliary jurisdiction ceased to be a qualified jurisdiction, the Director could suspend the reinsurer's certification indefinitely, instead of revoking it.

The Director would have to assign a rating to each certified reinsurer, giving consideration to the financial strength ratings that had been assigned by rating agencies considered acceptable to the Director by rule. The Director would have to publish a list of all certified reinsurers and their ratings.

A certified reinsurer would have to secure obligations assumed from the United States ceding insurers at a level consistent with its rating, as specified in rules promulgated by the Director. Except as otherwise provided, a domestic ceding insurer would not qualify for full financial statement credit for reinsurance ceded to a certified reinsurer unless the certified reinsurer maintained security in a form acceptable to the Director and consistent with the Code, or in a multibeneficiary trust. If a certified reinsurer maintained a trust to fully secure its obligations, and chose to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer would have to maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security provided under these provisions or comparable laws of other United States jurisdictions and for its obligations. The Director could not certify a reinsurer unless the reinsurer bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each trust account, to fund, on termination of a trust account, out of the remaining surplus of the trust any deficiency of any other trust account.

The minimum trusteed surplus requirements would not apply with respect to a multibeneficiary trust maintained by a certified reinsurer for the purpose of securing obligations incurred under these provisions, except that the trust would have to maintain a minimum trusteed surplus of \$10.0 million.

With respect to obligations incurred by a certified reinsurer, if the security were insufficient, the Director would have to reduce the allowable credit by an amount proportionate to the deficiency, and could impose further reductions in allowable credit on finding that there was a material risk that the certified reinsurer's obligations would not be paid in full when due.

For purposes of these provisions, a certified reinsurer whose certification had been terminated for any reason would be considered a certified reinsurer required to secure 100% of its obligations. If the Director continued to assign a higher rating, the requirement would not apply to a certified reinsurer in inactive status or to a reinsurer whose certification had been

suspended. "Terminated" in these provisions would mean revoked, suspended, voluntarily surrendered, or placed in inactive status.

If an applicant for certification had been certified as a reinsurer in an NAIC-accredited jurisdiction, the Director could defer to that jurisdiction's certification, and could defer to the rating assigned by that jurisdiction, and the applicant would be considered a certified reinsurer in Michigan.

A certified reinsurer that ceased to assume new business in the State could request to maintain its certification in inactive status to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer would have to continue to comply with all applicable requirements, and the Director would have to assign a rating that took into account, if relevant, the reasons why the reinsurer was not assuming new business.

Unlicensed or Unaccredited Insurer. Under the Code, if the assuming insurer is not licensed or accredited to transact insurance or reinsurance in Michigan, the credit pertaining to reinsurance ceded to an assuming insurer that maintains a trust fund in a qualified United States financial institution is not allowed unless the assuming insurer agrees in the reinsurance agreements to certain conditions. Under the bill, these provisions also would apply to an insurer that was not certified to transact insurance or reinsurance in Michigan.

Trust Agreement. Under the Code, the credit pertaining to reinsurance ceded to an assuming insurer that maintains a trust fund in a qualified United States financial institution is not allowed unless the assuming insurer agrees in the trust agreement that if the trust fund is inadequate because it contains an amount less than the amount required, or if the trust grantor has been declared or placed into receivership, rehabilitation, liquidation, or similar proceedings under the laws of its state or country of domicile, the trustee will 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 Director all of the assets of the trust fund, among other things.

Under the bill, this provision also would apply to the proposed credit for reinsurance ceded to an assuming insurer that had been certified by the Director as a certified reinsurer in the State and secured its obligations as required by the bill.

#### Suspension or Revocation of Accreditation or Certification

Under the bill, if an accredited or certified reinsurer ceased to meet the requirements for accreditation or certification, the Director could suspend or revoke the reinsurer's accreditation or certification. The Director would have to give the reinsurer notice and opportunity for a hearing. The suspension or revocation could not take effect until after the Director's order on hearing, unless one of the following occurred:

- The reinsurer waived its right to hearing.
- The Director's order was based on regulatory action by the reinsurer's domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer's eligibility to transact insurance or reinsurance business in its domiciliary jurisdiction or in the primary certifying state of the reinsurer.
- The Director found that an emergency required immediate action and a court of competent jurisdiction had not stayed the Director's action.

While a reinsurer's accreditation or certification was suspended, a reinsurance contract issued or renewed after the effective date of the suspension would not qualify for credit except to the extent that the reinsurer's obligations under the contract were secured. If a reinsurer's

accreditation or certification were revoked, credit for reinsurance could not be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract were secured.

#### Additional Required Ceding Insurer Actions

A ceding insurer would have to take steps to manage its reinsurance recoverable assets proportionate to its own book of business. A domestic ceding insurer would have to notify the Director within 30 days after reinsurance recoverable assets from any single assuming insurer, or group of affiliated assuming insurers, exceeded 50% of the domestic ceding insurer's last reported surplus to policyholders, or after it had determined that reinsurance recoverable assets from any single assuming insurer, or group of affiliated assuming insurers, were likely to exceed the limit.

A ceding insurer would have to take steps to diversify its reinsurance program. A domestic ceding insurer would have to notify the Director within 30 days after ceding to any single assuming insurer, or group of affiliated assuming insurers, more than 20% of the ceding insurer's gross written premium in the prior calendar year, or after it had determined that the reinsurance ceded to any single assuming insurer, or group of affiliated assuming insurers, was likely to exceed the limit.

Both of the notifications described above would have to demonstrate that the exposure was safely managed by the domestic ceding insurer.

#### Reduction from Liability

Under Section 1105 of the Code, an asset or reduction from liability for the reinsurance ceded by a ceding insurer to an assuming insurer that does not meet the requirements in Section 1103 (which contains all of the provisions described above) is allowed in an amount not to exceed the liabilities carried by the ceding insurer. The bill specifies that, in addition, any asset or reduction from liability for reinsurance ceded would be allowed only to the extent that it was consistent with any rules promulgated by the Director under the bill regarding valuation of reserve credits or assets, the amount and forms of security supporting reinsurance agreements, or the circumstances under which credit would be reduced or eliminated.

The Code requires the reduction to 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 under the reinsurance contract, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer and, for a trust, held in a qualified United States financial institution. The security may be in the form of any of the following:

- Cash.
- Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified United States financial institution by December 31 of the year for which filing is being made, and in the possession of the ceding insurer on or before the filing date of its annual statement.
- Securities that may be valued by the Director under the Code and are approved for investment by insurers under Chapter 9 (Investments).
- Any other form of security acceptable to the Director.

Under the bill, the securities would include those considered exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office of the NAIC.

## Promulgation of Rules

The bill would allow the Director to promulgate rules with regard to reinsurance agreements concerning any of the following:

- Life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits, if the reinsurance treaty contained either 1) policies issued after December 31, 2014; or 2) policies issued before January 1, 2015, if the risk pertaining to the policies were ceded, in whole or in part, in connection with the treaty, after December 31, 2014.
- Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period, if the reinsurance treaty contained policies meeting the criteria described above.
- Variable annuities with guaranteed death or living benefits.
- Long-term care insurance policies.
- Other life and health insurance and annuity products as the Director considered necessary for the administration of Sections 1103 and 1105.

A rule promulgated concerning life insurance policies could require a ceding insurer to use the valuation manual adopted by the NAIC under the NAIC Standard Valuation Law when calculating amounts or forms of security required to be held under law.

A rule concerning life insurance policies would not apply to cessions to an assuming insurer that either 1) was certified as a reinsurer in the State or 2) maintained at least \$250.0 million in capital and surplus when determined in accordance with the NAIC Accounting and Practices and Procedures Manual and either a) was licensed to transact insurance or reinsurance in at least 26 states, or b) was licensed to transact insurance or reinsurance in at least 10 states and was licensed to transact insurance or reinsurance or accredited as a reinsurer in a total of at least 35 states.

MCL 500.1103 et al.

Legislative Analyst: Drew Krogulecki

## **FISCAL IMPACT**

The bill would have a negative fiscal impact on the Department of Insurance and Financial Services due to an increase of duties assigned to the Director under the bill. Those new duties would include the creation of a list of qualified jurisdictions under which an assuming insurer was eligible to be considered for departmental certification, ongoing evaluation of the appropriateness and effectiveness of a reinsurance supervisory system of a jurisdiction, provision of qualifying documentation for a jurisdiction that was not approved by the National Association of Insurance Commissioners, assignment of a rating system for certified reinsurers, credit adjustment when the Director finds the security of a reinsurer is insufficient, provision of notice and an opportunity for a hearing for a reinsurer before the suspension of that reinsurer's certification, and the promulgation of rules regarding reinsurance agreements. Despite these increased duties, it is likely that the increased costs associated with them would be absorbed by the Department.

The bill would have no fiscal impact on local units of government.

Fiscal Analyst: Michael Siracuse

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