



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS



Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 638 (as enacted)
Sponsor: Senator Margaret E. O'Brien
Senate Committee: Insurance
House Committee: Insurance

PUBLIC ACT 91 of 2018

Date Completed: 4-10-18

CONTENT

The bill amends 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 may receive credit for reinsurance if the reinsurance is ceded to an assuming insurer domiciled in a state that employs reinsurance credit standards similar to Michigan's, or to an assuming insurer that has been certified by the Director of the Department of Insurance and Financial Services (DIFS), and meets further requirements.
- Allow the Director to suspend or revoke the reinsurer's accreditation or certification if an accredited or certified reinsurer ceases 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 exceed 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 is allowed only to the extent that it is consistent with any rules promulgated by the Director.

The bill will take effect on June 24, 2018.

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 adds that credit for reinsurance is allowed only to the extent that it is 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 will 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 deletes 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; and 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 deletes this requirement to maintain a surplus as regards policyholders. Instead, the bill requires the accredited reinsurer to demonstrate to the satisfaction of the Director that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer will meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than \$20.0 million and its accreditation has not been denied by the Director within 90 days after submission of its application.

The bill also requires the accredited reinsurer to bear the cost of the book and record examination.

Ceding Insurance to Insurer from State with Similar Standards. The bill specifies that a ceding insurer is allowed credit for reinsurance 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 domiciled in, or for a United States branch of an alien assuming insurer is entered through, a state that employs 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 meets both of the following:

- Except for reinsurance ceded and assumed under pooling arrangements among insurers in the same holding company system, maintains a surplus as regards policyholders in an amount not less than \$20.0 million.
- Submits to the State's authority to examine its books and records, and bears 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 with respect to 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 has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trustee surplus. The commissioner may not authorize a reduction unless he or she determines, based on an assessment of the risk, that the new required surplus level is adequate for the protection of United States ceding insurers, policyholders, and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and must 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 must 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 changes the date in the first provision above to January 1, 1993, and changes 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 apply:

- The group must have continuously transacted an insurance business outside the United States for at least three years immediately before applying for accreditation.
- The group must maintain an aggregate policyholders' surplus of at least \$10.0 billion.
- The group must 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 must maintain a joint trustee surplus of which \$100.0 million is 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 are due to be filed with the group's domiciliary regulator, the group must 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 is allowed credit for reinsurance ceded as either an asset or a reduction from liability on account of reinsurance if the reinsurance is ceded to an assuming insurer that has been certified by the Director as a certified reinsurer in the State and that secures its obligations as required by the bill.

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

- It is domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the Director.
- It maintains minimum capital and surplus, or its equivalent, in an amount determined by the Director under rule.
- It maintains financial strength ratings from two or more rating agencies considered acceptable by the Director under rule.
- It agrees to submit to the State's jurisdiction.
- It agrees to appoint the Director as its agent for service of process in the State.
- It agrees to provide security for 100% of its liabilities attributable to reinsurance ceded by United States ceding insurers if it resists enforcement of a final United States judgment.
- It agrees 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 satisfies any other requirements for certification that the Director considers relevant.

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

- It meets the requirements for an assuming insurer listed above.
- It satisfies its minimum capital and surplus requirements through the capital and surplus equivalents, net of liabilities, of the association and its members, that include a joint central fund that may 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 are not engaged in any business other than underwriting as a member of the association, and are 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 are due to be filed with the association's domiciliary regulator, the association provides to the Director an annual certification by the regulator of the solvency of each underwriter member, or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.

The Director must create and publish a list of qualified jurisdictions under which an assuming insurer licensed and domiciled in a qualified jurisdiction is 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 is eligible to be recognized as a qualified jurisdiction, the Director must 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 must agree to share information and cooperate with the Director with respect to all certified reinsurers domiciled within that jurisdiction. The Director may not recognize a jurisdiction as a qualified jurisdiction if the Director determines that it does not adequately and promptly enforce final United States judgments and arbitration awards. The Director may consider

additional factors to determine if the domiciliary is eligible to be recognized as a qualified jurisdiction.

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

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

A certified reinsurer must 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 will not qualify for full financial statement credit for reinsurance ceded to a certified reinsurer unless the certified reinsurer maintains security in a form acceptable to the Director and consistent with the Code, or in a multibeneficiary trust. If a certified reinsurer maintains a trust to fully secure its obligations, and chooses to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer must 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 may not certify a reinsurer unless the reinsurer binds 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 trustee surplus requirements do 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 must maintain a minimum trustee surplus of \$10.0 million.

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

For purposes of these provisions, a certified reinsurer whose certification has been terminated for any reason will be considered a certified reinsurer required to secure 100% of its obligations. If the Director continues to assign a higher rating, the requirement will not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended. "Terminated" in these provisions means revoked, suspended, voluntarily surrendered, or placed in inactive status.

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

A certified reinsurer that ceases to assume new business in the State may 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 must continue to comply with all applicable requirements, and the Director must assign a rating that takes into account, if relevant, the reasons why the reinsurer is 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 apply to an insurer that is 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 applies to the credit for reinsurance ceded to an assuming insurer that has been certified by the Director as a certified reinsurer in the State and secures its obligations as required by the bill.

Suspension or Revocation of Accreditation or Certification

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

- The reinsurer waives its right to hearing.
- The Director's order is 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 finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the Director's action.

While a reinsurer's accreditation or certification is suspended, a reinsurance contract issued or renewed after the effective date of the suspension will not qualify for credit except to the extent that the reinsurer's obligations under the contract are secured. If a reinsurer's accreditation or certification is revoked, credit for reinsurance may not be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured.

Additional Required Ceding Insurer Actions

The bill requires a ceding insurer to take steps to manage its reinsurance recoverable assets proportionate to its own book of business. A domestic ceding insurer must notify the Director within 30 days after reinsurance recoverable assets from any single assuming insurer, or group of affiliated assuming insurers, exceeds 50% of the domestic ceding insurer's last

reported surplus to policyholders, or after it has determined that reinsurance recoverable assets from any single assuming insurer, or group of affiliated assuming insurers, are likely to exceed the limit.

A ceding insurer also must take steps to diversify its reinsurance program. A domestic ceding insurer must 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 has determined that the reinsurance ceded to any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed the limit.

Both of the notifications described above must demonstrate that the exposure is safely managed by the domestic ceding insurer.

A ceding insurer that is a member of the Catastrophic Claims Association created under the Code is exempt from these requirements for purposes of cessions to the Association.

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 is allowed only to the extent that it is consistent with any rules promulgated by the Director regarding valuation of reserve credits or assets, the amount and forms of security supporting reinsurance agreements, or the circumstances under which credit will 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 may 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 allows 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 contains either 1) policies issued after December 31, 2014; or 2) policies issued before January 1, 2015, if the risk pertaining to the policies is 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 contains 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 considers necessary for the administration of Sections 1103 and 1105.

A rule promulgated concerning life insurance policies may 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 will not apply to cessions to an assuming insurer that either 1) is certified as a reinsurer in the State or 2) maintains 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) is licensed to transact insurance or reinsurance in at least 26 states, or b) is licensed to transact insurance or reinsurance in at least 10 states and is 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 will have a negative fiscal impact on the Department of Insurance and Financial Services due to an increase in duties assigned to the Director. The new duties include the creation of a list of qualified jurisdictions under which an assuming insurer is eligible to be considered for certification, ongoing evaluation of a reinsurance supervisory system of a jurisdiction, provision of qualifying documentation for a jurisdiction that is not approved by the National Association of Insurance Commissioners, assignment of a rating system for certified reinsurers, credit adjustment when the Director finds that the security of a reinsurer is insufficient, and provision of notice and an opportunity for a hearing for a reinsurer before the suspension of that reinsurer's certification. It is likely that the increased costs associated with the increased duties will be absorbed by the Department.

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

Fiscal Analyst: Michael Siracuse

SAS\S1718\s638es

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.