SENATE COMMITTEE ON INSURANCE
Senator Susan Rubio, Chair
2019 - 2020 Regular

Bill No:	AB 2049	**Hearing Date:**	August 4, 2020
Author:	Cooley		
Version:	March 2, 2020 Amended		
Urgency:	No	**Fiscal:**	Yes
Consultant:	Brian Flemmer		

SUBJECT: Reinsurance credit

DIGEST: Updates California insurance law to conform to recent changes to the Credit for Reinsurance Model Act adopted by the National Association of Insurance Commissioners (NAIC).

Due to the COVID-19 Pandemic and the unprecedented nature of the 2020 Legislative Session, all Senate Policy Committees are working under a compressed timeline. This timeline does not allow this bill to be referred and heard by more than one committee as a typical timeline would allow. In order to fully vet the contents of this measure for the benefit of Senators and the public, this analysis includes information from the Committee on Judiciary.

ANALYSIS:

Existing federal law, the Nonadmitted and Reinsurance Reform Act, part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") provides that even though a reinsurer may sell in many states, only the state where the reinsurer is domiciled (where it is incorporated or entered through, and licensed) may regulate the financial solvency of a reinsurer provided the reinsurer meets financial integrity standards that demonstrate that it can meet its obligations to insurers.

Existing state law:

1) Establishes a comprehensive system of financial regulation for insurers, including allowing the use of reinsurance; "insurance for insurers" that satisfies some portion of the insurer's statutory financial requirements.

2) Limits the amount of insurance an insurer can sell according to its capital and surplus (surplus is the value of the insurer's assets minus its liabilities).

3) Allows a domestic insurer to take credit for reinsurance if the reinsurance is ceded to an insurer domiciled in this state, is domiciled in another U.S. State or territory and "accredited" as reinsurer, or is "certified" as a reinsurer domiciled within or outside of the U.S.

4) Establishes a process and standards for certifying reinsurers domiciled within or outside of the U.S. and provides for a cooperative, multi-jurisdictional, and sometimes international, system of supervising these reinsurers. Qualifications include:

a) The reinsurer is domiciled in a "qualified jurisdiction," i.e. a jurisdiction that has agreed to cooperate in joint supervision and meets minimum regulatory standards.

b) Meets minimum capital and surplus requirements.

c) Meets minimum credit rating requirements.

d) Agrees to submit to the jurisdiction of this state and appoint an agent for service of process.

e) Meet specified filing requirements, as well as other requirements imposed by the Insurance Commissioner (commissioner).

5) Requires the commissioner to create and publish a list of qualified jurisdictions reinsurers that satisfy the applicable standards.

This bill:

1) Establishes a new category of reinsurer, a reinsurer from a "reciprocal jurisdiction," and requires that a domestic insurer be allowed a credit for reinsurance ceded to an assuming insurer from a reciprocal jurisdiction that meets specified standards.

   a) Provides that a reciprocal jurisdiction falls into one of the following categories:

      i. A non-U.S. jurisdiction that is subject to an in-force "covered agreement" with the U.S. and that the covered agreement be made pursuant to the Dodd-Frank Act and meets other standards.

      ii. An NAIC accredited jurisdiction within the U.S.

      iii. A "qualified jurisdiction" that applies similar and reciprocal standards as determined by the commissioner and agrees to share information as provided.

   b) Establishes that qualifying reinsurers meet minimum requirements for capital and surplus, maintain a minimum solvency or capital ratio, provide assurance to the commissioner that it submits to the jurisdiction and specified legal remedies of this state, will provide certain regulatory documents, and will maintain a practice of prompt payment of claims.

2) Requires the commissioner to publish a list of reciprocal jurisdictions and a list of reinsurers with a head office or domicile in, and that are licensed in, a reciprocal jurisdiction.

3) Would require a certified reinsurer to file with the commissioner audited financial statements, regulatory filings, and actuarial opinion as filed with a non-United States jurisdiction, with an English translation, and would authorize the commissioner to consider those documents to evaluate the reinsurer's financial strength.

Background

According to the author,

> "AB 2049 modifies California's credit for reinsurance law to avoid federal preemption and maintain California's NAIC accreditation.
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> On June 25, 2019, the NAIC adopted revisions to the "Credit for Reinsurance Model Act and Regulations" to implement the "Bilateral Agreement between the United States and the European Union on Prudential Measures regarding Insurance and Reinsurance." This bilateral agreement eliminates reinsurance collateral requirements for certain reinsurers that maintain a minimum amount of funds and a set solvency capital requirement.
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> It also contains provisions that result in federal preemption, if states do not enact legislation aligning their statutes to the agreement's provisions. Additionally, the modifications adopted by the NAIC to implement the agreement are set to become part of the NAIC state accreditation process. Without making these same modifications to California code, the state will lose NAIC accreditation and have portions of its insurance code pre-empted by federal law."

An insurer assumes liability or risk of financial loss from the policyholder. California law limits the aggregate amount of risk that an insurer can take on and caps that amount, in part, according to its net assets. The amount an insurer can sell is referred to as its "capacity"; the more assets it has relative to its liabilities, the more insurance an insurer can sell.

Reinsurance offers an insurer a way to subtract some liability in that formula. Through a reinsurance agreement, an insurer or *ceding insurer* may pass risk of loss or liability to a third person known as the *assuming insurer* or "*reinsurer*." (Ins. Code § 620.) By passing along that risk, the ceding insurer receives a credit against its liabilities; this credit allows the ceding insurer to accept more risk and sell more insurance. (Legal liability to the policyholder for the original risk remains with the insurer.)

Reinsurance plays a critical role in the insurance market. It can serve as a failsafe when things go really bad (like a catastrophic wildfire), it can provide a form of security that allows an insurer to take on more risk than it would otherwise (like home with a replacement value over $1 million), it can provide the additional capacity that allows smaller insurers to grow more quickly, and it helps to spread risks across multiple balance sheets (including domestic and international companies) so that no one actor is "left holding the bag." In fact, reinsurance is so important that federal law, which generally leaves insurance regulation to the state, intercedes and has established a uniform framework for crediting reinsurance contracts against their liabilities when calculating an insurer's statutory capacity.

But oversight remains necessary to make sure that the reinsurer can make good on in its commitments. Reinsurance agreements are only as good as the reinsurer's financial condition and willingness to pay claims. Although each state has its own insurance regulator, the NAIC (in conformity with Dodd-Frank) has worked out a system to establish uniformity and cooperation among the jurisdictions.

How a reinsurer qualifies to offer creditable reinsurance depends on the reinsurer's jurisdiction of domicile. Foreign insurers come from states or U.S. jurisdictions outside of California. Non-U.S. domiciled insurers, sometimes referred to as *alien insurers* are domiciled outside the U.S. and its territories.

NAIC's Uniform Approach to Oversight of Multijurisdictional Reinsurance Transactions. Federal law leaves the primary responsibility for setting insurance policy with the States. In order to regulate such a large, sophisticated industry, the States generally work together through the NAIC to coordinate policy. NAIC is the U.S. standard-setting and regulatory support organization composed of the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. The NAIC provides policy and support to the insurance regulators in each state, and provides model law proposals on a wide range of insurance issues. There are a core set of insurance model laws states must conform to in order to obtain and maintain "accreditation." Accreditation allows for coordination in financial regulation of insurers whose operations typically span multiple states and nations. Through the NAIC, State Insurance Commissioners operate in large part under a delegation of authority from the legislative branches of individual states, to among other things, develop model legislation. This bill implements recent revisions to the NAIC Model Law governing reinsurance transactions.

State insurance regulators receive accreditation by meeting certain legal, financial, and organizational standards established by the NAIC. Accreditation allows for inter-state regulatory cooperation and decreases regulatory costs. For instance, state insurance commissioners can accept the examination report prepared by another accredited state insurance department in lieu of performing its own financial examination, allowing insurers to operate efficiently in multiple states.

On June 25, 2019, the NAIC unanimously adopted revisions to the Credit for Reinsurance Model Act and Regulations in order to implement the Bilateral Agreement between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance. The agreement eliminates reinsurance collateral requirements for certain reinsurers that maintain a minimum amount of funds and a solvency capital requirement. It also requires states to enact the provisions of the revised model act with respect to the reinsurance collateral requirements or the state's laws regarding credit for reinsurance will face potential federal preemption. The provisions will also become part of the NAIC state accreditation process.

Specifically, this bill expands the methods that a reinsurer can be deemed worthy of issuing agreements that will be credited against a ceding insurer's liabilities. This new process recognizes that the reinsurers are already overseen in a similar fashion when it is domiciled or has its headquarters in a qualifying" reciprocal" jurisdiction and meets other standards designed to ensure financial stability.

National Conference of Insurance Legislators. NCOIL is an organization comprised principally of legislators serving on state insurance and financial committees around the country. NCOIL and NAIC have long disagreed over what lawmaking power may be constitutionally delegated to nonpublic entities. The practice, incorporation by reference

(IBR), allows noncontroversial, technical, and procedural changes to become law without debate or scrutiny. Many states' insurance statutes, including California's, allow an update by the NAIC to change the law in that state. In recent years, NCOIL members, insurance trade associations, and members of this committee have expressed concern regarding NAIC's use of IBR to introduce substantive changes into state codes that conflict with constitutional restraints on the delegation of legislative authority.

AB 2049 does not appear to cause the same concern. Despite having opposed some of the underlying reinsurance collateral provisions, NCOIL advocates for adoption on its website, writing, "Therefore, in order to guard against federal preemption of the state-based system of insurance regulation – a system that has effectively protected consumers and helped create the largest, most competitive and innovative insurance market in the world – NCOIL urges all states to adopt the amended Reinsurance Models as quickly as possible."[1]

Information provided by the Senate Judiciary Committee:

This bill touches upon issues within the jurisdiction of the Senate Judiciary Committee, including federal preemption. The U.S. Supreme Court has held that federal law can preempt state law expressly, when a federal statute or regulation expressly state it preempts state laws, or impliedly, when the intent of Congress is implicit in the relevant federal law. Under the implied preemption doctrine two sub-areas have emerged where the courts have found state laws are preempted by federal law, conflict preemption and field preemption. Field preemption exists when federal law is so pervasive in an area that it implicitly precludes state regulation or where states attempt to legislate in a field that is clearly a federal interest. Conflict preemption occurs when compliance with both federal law and state law is impossible or state law poses obstacles to accomplishing the goals of federal law. This bill is attempting to avoid having California's insurance laws be preempted by federal law by conforming California's laws to the NAIC adopted revisions to the Credit for Reinsurance Model Act and Regulations to implement the Bilateral Agreement between the United States and the European Union on Prudential Measures regarding Insurance and Reinsurance.

Related/Prior Legislation

AB 938 (Cooley, 2017) Chapter 202, Statutes of 2017, authorized the commissioner to adopt regulations applicable to aspects of reinsurance arrangements for certain life and universal life insurance policies, long-term care policies, variable annuities, and other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance.

SB 1216 (Lowenthal) Chapter 277, Statutes of 2012, incorporated changes to the NAIC model act adopted in response to Dodd-Frank.

ARGUMENTS IN SUPPORT: The American Property Casualty Insurance Association writes, "The bill tracks the newly revised National Association of Insurance Commissioners (NAIC) Credit for Reinsurance Model Law and provides for collateral relief for reinsurers in the European Union and the U.K. The U.S. has entered into

[1] http://ncoil.org/state-adoption-of-amended-naic-reinsurance-models/

agreements with both countries that ensure that only financially stable and well-regulated EU reinsurers qualify for collateral relief. The bill also grants similar relief to reinsurers in certain countries outside of the E.U. who have been found by U.S. regulators to be similarly financially strong and well-regulated."

SUPPORT:

California Department of Insurance (Sponsor)
American Property Casualty Insurance Association
Reinsurance Association of America

OPPOSITION:

None on file.

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