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MEMORANDUM

To: House Committee on Insurance
From: Jason Thompson, Senior Assistant Revisor of Statutes
Date: February 16, 2017
Subject: Bill Brief for SB 19

SB 19 enacts the credit for reinsurance model law. The bill amends K.S.A. 40-221a, which addresses reinsurance of risks of and by Kansas companies, and replaces the 4 subsections of current law with more comprehensive provisions, based largely on the NAIC Credit for Reinsurance Model Law.

Current law

Subsection (a) broadly grants a domestic insurance company the authority to cede and accept risk. Specifically, it grants a domestic insurance company the authority to cede all its risks to another insurance company licensed to do business in the state. It also authorizes a domestic insurance company to accept all or part of another insurance company's risks, all or part of an individual risk or class of risks it is authorized to insure, and cede all or any part of an individual risk or class of risks to another solvent insurer empowered to accept such reinsurance.

Subsection (b) allows a domestic insurance company to take credit for ceded risks as an asset or as a deduction from loss and unearned premium reserves to the extent that the ceded risk was reinsured by an insurer authorized to transact business in the state. The subsection limits the credit for ceded risks reinsured by an insurer not authorized to transact business in the state. This limit is equal to an amount specified by: (1) the amount of deposits by and funds withheld from the assuming insurer pursuant to the reinsurance contract; (2) the amount of a clean and irrevocable letter of credit issued for an initial term of one year; or (3) the amount of loss and unearned premium reserves on the ceded risks, held in a trust maintained by a qualified U.S. financial institution.

Subsection (c) provides that no credit for reinsurance shall be allowed as an admitted asset or deduction from liability, to any domestic ceding insurer, unless the reinsurance contract provides that in the event of the insolvency of the ceding insurer, the reinsurance shall be payable on the basis of the liability of the ceding company under contract or contracts reinsured, without diminution because of the ceding company's insolvency.

Subsection (d) provides that in the event of insolvency, the liquidator shall give notice within a reasonable time to the assuming insurer that a claim exists against the ceding insurer, after the claim has been filed.

New provisions

Under the model law provisions, beginning on page 4, a domestic insurer may only take credit for reinsurance under very specific criteria set forth in paragraphs 1 through 6 of subsection (a), pages 5 through 11.

Paragraph (1), on page 5, states that credit shall be allowed when the reinsurance is ceded to an assuming insurer that is licensed to transact insurance or reinsurance in the state.

Paragraph (2) states that credit shall be allowed when the reinsurance is ceded to an assuming insurer that is accredited by the commissioner as a reinsurer. Subparagraphs (A) through (E) state the criteria that an insurer must meet to become accredited.

Paragraph (3) states that credit shall be allowed when the reinsurance is ceded to an assuming insurer that is domiciled in a state that employs standards regarding reinsurance that are substantially similar to those applicable to the home state. In the case of a US branch of an alien assuming insurer, the branch must be located in a state that employs such similar standards. Clauses (i) and (ii) at the bottom of the page list requirements that a foreign or alien assuming insurer must meet for the ceding insurer to take credit for reinsurance. Those requirements, however, do not apply to pooled insurers in the same holding company system.

Paragraph (4), at the top of page 6, states that credit for reinsurance shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified United States financial institution. The assuming insurer must file annual reports with the commissioner in order to verify the adequacy of the trust fund amount. The paragraph states further that credit for reinsurance shall not be given unless the form of the trust and any amendments to the trust have been approved by: (1) the commissioner of the state in which the trust is domiciled; or (2) the commissioner of another state who has accepted regulatory

oversight of the trust. Subparagraph (C) lists requirements that apply to specific categories of assuming insurers, ending on page 8.

Paragraph (5), on page 8, states that credit for reinsurance shall be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the commissioner as a reinsurer and the reinsurer secures its financial obligations in accordance with the requirements in subparagraph (A). Subparagraph (B) states that an association including incorporated and individual unincorporated underwriters may be a certified reinsurer and provides additional requirements that must be satisfied. Subparagraph (C) states that the commissioner shall create and publish a list of qualified jurisdictions under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be considered for certification by the commissioner. Subparagraph (D), on page 10, requires the commissioner to assign a rating to each certified reinsurer and publish a list of certified reinsurers and their ratings. Subparagraph (E) requires certified reinsurers to secure their financial obligations at a level consistent with its rating, and as specified by the commissioner. Clauses (i) through (v), on pages 10 and 11, list financial requirements that a certified reinsurer must meet in order for a ceding insurer to receive full financial statement credit for reinsurance. Subparagraph (F) authorizes the commissioner to defer to another jurisdiction's certification and rating of an assuming insurer applying for certification as a reinsurer in this state that has been certified as a reinsurer in another jurisdiction accredited by the national association of insurance commissioners. Subparagraph (G) allows a certified reinsurer that ceases to assume new business in this to maintain certification in inactive status.

Paragraph (6), at the bottom of page 11, states that credit for reinsurance shall be allowed when reinsurance is ceded to an assuming insurer that does not meet the requirements of paragraphs (1) through (5), but only as to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

Paragraph (7), at the top of page 12, lists requirements that an assuming insurer that is not licensed, accredited or certified to transact insurance or reinsurance in the state must meet for a domestic ceding insurer to take the credit permitted by paragraphs (3) and (4).

Paragraph (8) states that if an assuming insurer does not meet the requirements of paragraph (1), (2) or (3), then the credit permitted for reinsurance allowed in paragraphs (4) or (5) shall not be allowed unless said assuming insurer agrees in a trust agreement to fulfill the conditions set forth in subparagraphs (A) through (D).

Paragraph (9), on page 13, provides that if an accredited or certified reinsurer ceases to meet the requirements of this section, the commissioner may suspend or revoke the reinsurer's accreditation or certification, after notice and opportunity for a hearing.

Paragraph (10) provides in subparagraph (A) that a domestic ceding insurer shall take steps to manage its reinsurance recoverables proportionate to its own book of business. A domestic ceding insurer shall notify the commissioner within 30 days after reinsurance recoverables from any single assuming insurer or group of affiliated insurers exceeds 50% of the domestic ceding insurer's last reported surplus to policyholders, or after it is determined that reinsurance recoverables from any single assuming insurer or group of affiliated insurers is likely to exceed the limit. Subparagraph (B) provides that a domestic ceding insurer shall take steps to diversify its reinsurance program. A domestic ceding insurer shall notify the commissioner 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 the domestic ceding insurer has determined that the reinsurance ceded to any single assuming insurer or group of affiliated assuming insurers is likely to exceed this limit.

Subsection (b), on page 14, states that when a domestic insurer cedes reinsurance to an assuming insurer that does not meet the requirements of subsection (a), an asset or reduction from liability shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of the funds held by or on behalf of the ceding insurer under a reinsurance contract with the assuming insurer as security for the payment of obligations under the contract. Paragraphs (1) through (4) list the acceptable forms of security.

Subsection (c)(1) gives the definition of a qualified United States financial institution for the purposes of subsection (b)(3), pertaining to letters of credit issued or confirmed by a qualified United States financial institution. Subsection (c)(2) gives the definition of a qualified US financial institution for the purposes of the provisions of the section specifying those institutions that are eligible to act as a fiduciary of a trust.

Subsection (d) grants the commissioner the authority to adopt any rules and regulations necessary to enact the provisions of this law.

Finally, subsection (e) states that the new provisions shall apply to all cessions under reinsurance contracts that occur on or after January 1, 2018.