

# FEDERATION OF REGULATORY COUNSEL, INC.

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### FINANCIAL SERVICES MODERNIZATION: WHAT HAS THE NEW ADMINISTRATION SAID? WHAT WILL LIKELY HAPPEN AND WHEN?

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For those of you who missed NOLHGA's Legal Seminar in July in Chicago, the word "Loser" comes to mind. You missed a golden opportunity to get smart on receivership, guaranty association, and industry hot topics and to reap tons of CLE credits besides.

Several of the panels focused - and gave us smart tutorials - on financial services modernization. We're obviously in the midst of a vibrant debate over the shape of the insurance regulatory marketplace and have been for several years since Congress passed and President Clinton signed Gramm Leach Bliley in 1999. The Legal Seminar speakers gave the audience a bird's eye view of the pushes, pulls and prospects for action in this Congress and beyond. Here is a snapshot - but without CLE credits - of where we sit today on the legislative axis between the White House and Capitol Hill along Pennsylvania Avenue.

We have to start - and probably end, at least for this year - with Treasury's proposal for systemic financial regulatory reform announced June 17, [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf). It is expressly intended to "build a new foundation for financial regulation and supervision that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market." Notably, the proposal ventures into new areas that Treasury has not previously addressed, including insurance regulation. While the proposal does not go so far as to push a federal charter for insurance companies, it potentially subjects certain insurers to greater federal regulation and leaves the door open for more. In this summary, we will briefly outline the proposal's five stated objectives and then highlight what all of this could mean for insurers and insurance holding companies. We'll not dwell very much on the more extensive banking elements of the proposal, except to the extent they implicate insurance.

#### REFORM OBJECTIVES

The proposed reforms are on a fast track. Many elements of the plan can be accomplished under current law and, therefore, have mandated deadlines that occur in 2009. Other elements of the proposal require the passage of new legislation, which will be key in understanding the actual breadth and depth of Treasury's proposals, but Treasury has instructed regulators to start planning for such legislation even as the debates rage in Congress.

- **Systemic Supervision**. Treasury seeks to establish strong regulatory oversight of any financial institution that is deemed critical to market functioning. The authority of the Federal Reserve Board ("FRB") would be expanded, making it the single point of accountability for supervision of all companies that pose a threat to financial stability, even those that do not own a bank. That element of the plan is probably the most controversial politically, since many legislators have expressed reservations about ceding more power to the FRB.
  - ◆ Treasury will establish the Office of National Insurance ("ONI") to gather information, develop expertise, negotiate international agreements and coordinate policy in the insurance sector. Treasury will support proposals to modernize and improve the current system of

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insurance regulation. As influential industry commentator Karen Shaw Petrou summed it up, "ONI's responsibilities would generally be advisory and focused on systemic risk, but it would gather data from covered insurers and have express authority to preempt state insurance rules found inconsistent with international prudential agreements and to negotiate in this area on behalf of the United States."

- ◆ A Financial Services Oversight Council, chaired by Treasury and comprised of the heads of certain financial regulatory agencies, will advise the FRB regarding emerging systemic risks and settle jurisdictional disputes among the regulators. As proposed, the Council will not include the ONI (except derivatively through Treasury's seat), the NAIC or any state insurance regulator. (The NAIC is working to obtain a seat on the Council representing state regulators.) The Council would maintain a permanent staff at Treasury.
  - ◆ The FRB will directly supervise and regulate each large, interconnected, highly leveraged firm that it deems (in consultation with the Council) a potential threat to systemic financial stability (called Tier 1 Financial Holding Companies or "Tier 1 FHCs"), regardless of whether the firm owns a bank.
  - ◆ Treasury will lead a working group to assess the supervision of and capital requirements for banks and bank holding companies, as well as firms identified as Tier 1 FHCs.
  - ◆ Treasury proposes the creation of a new federal agency, the National Bank Supervisor ("NBS"), to supervise and regulate all federally chartered depository institutions and all branches and agencies of foreign banks. The federal thrift charter will be eliminated; the NBS will assume the responsibilities of the Office of the Comptroller of the Currency and for the institutions currently supervised by the Office of Thrift Supervision. Alternative charters currently enjoyed by certain banking entities, including industrial loan companies, would be curtailed.
  - ◆ All firms that control a bank will be subject to supervision and regulation by the FRB and will be subject to the nonbanking activity restrictions of the Bank Holding Company Act.
  - ◆ The proposal establishes revised regulatory structures for investment banking firms, hedge funds and other private pools of capital, money market mutual funds and government sponsored enterprises (Fannie Mae and Freddie Mac).
- **Market Regulation.** Treasury proposes to establish comprehensive regulation of securitization markets, OTC derivatives (including credit default swaps) and "systemically important payment, clearing and settlement systems." (The Administration offered legislative language on OTC derivatives on August 11, 2009.)
  - **Consumer Protection.** Treasury proposes the formation of an independent agency (the "Consumer Financial Protection Agency" or "CFPA") to regulate firms that provide credit, savings, payment and "other consumer financial products and services," including banks and "other firms not previously subject to comprehensive federal regulation." Notably, investment products and services already regulated by the SEC or CFTC are excepted out of CFPA oversight, but there was no such exception for insurance products regulated by the states. However, the legislation sent to the Hill on June 30 was clearer on that point, and it looks like virtually all insurance products (except for credit, mortgage and title insurance) would be outside the CFPA's jurisdiction. The rules established by the CFPA would set a federal floor to be enforced by the states, which would also have the ability to adopt stricter laws.
    - ◆ The CFPA will set forth new disclosure standards, requiring such communications to be reasonable, balanced, clear and conspicuous in the identification of risks.
    - ◆ "Plain vanilla" products will be subject to different standards than complex products. Firms will be required to offer a mix of such product types.
    - ◆ The SEC will have expanded authority to protect investors through transparent disclosures, new requirements for broker-dealers and investment advisors and expanded protection for

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whistleblowers.

- **Crisis Management**. Treasury proposes the creation of a resolution regime for the orderly resolution of failing bank holding companies, including Tier 1 FHCs, modeled after the existing Federal Deposit Insurance Act. This resolution authority would be limited to those firms whose failure puts the stability of the financial system at risk; in all other instances, bankruptcy would remain the preferred resolution option. The costs associated with the systemic risk resolution regime would be paid by assessments on bank holding companies.
- **International Standards**. Treasury will seek to strengthen the international capital framework, improve the oversight of global financial markets, enhance supervision of internationally active financial firms and reform crisis prevention and management authorities and procedures.

## IMPACT ON THE INSURANCE INDUSTRY

Except for a few specific references, insurance gets scant express attention in the proposal. In fact, only two out of the 88 pages that set forth the reform proposal are dedicated to the insurance industry. However, much of the language of the proposal is broad enough that insurance could be swept into several of the initiatives. In those instances, we will have to await further development of the proposal before we know the exact impact on the insurance industry; some of the initial House and Senate hearings have already touched insurance.

- **Systemic Supervision**. There are three primary elements of systemic supervision that could impact insurance companies or their holding company systems - the establishment of the ONI, the identification of Tier 1 FHCs, and the closure of perceived loopholes in bank regulation.
  - ◆ **Office of National Insurance**. Treasury seeks to create the ONI in order to monitor all aspects of the insurance industry and be responsible for identifying any trends or gaps that could give rise to a future crisis, but does not ascribe any regulatory authority to the ONI. (In fact, the proposal mirrors Congressman Paul Kanjorski's Insurance Information Act of 2009, H.R. 2609, which earlier called for the establishment of a federal Office of Insurance Information.) Additionally, the ONI would recommend to the FRB any insurance companies or insurance holding company systems that it believes should be deemed to be Tier 1 FHCs. Further, in the international arena, the ONI would be the single regulatory voice of the U.S. insurance industry, wielding the authority to enter into international agreements.

Treasury's proposal does not suggest displacing the current state-based system of regulation in exchange for a federal regulator. Instead, Treasury will support proposals to "modernize and improve" the current system of insurance regulation, consistent with six principles:

- ◇ *Effective systemic risk regulation* - Treasury will consider additional regulation, beyond the scope of the current proposal, if that would help further reduce systemic risk.
- ◇ *Strong capital standards and an appropriate match between capital allocation and liabilities for all insurance companies* - Any new insurance regulatory regime should include strong capital standards and appropriate risk management.
- ◇ *Meaningful and consistent consumer protection for insurance products and practices* - Any new insurance regulatory regime should enhance existing consumer protection and address any gaps or problems under the existing system.
- ◇ *Increased national uniformity through either a federal charter or effective action by the states* - Increased consistency in the regulation of insurance should enhance financial stability, increase economic efficiency and result in real improvements for

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consumers.

- ◇ *Improve and broaden the regulation of insurance companies and affiliates on a consolidated basis, including those affiliates outside of the traditional insurance business* - Any new regulatory regime should address gaps in current insurance holding company regulation that permit non-insurance affiliates to threaten the solvency of the insurance companies.
- ◇ *International coordination* - Improvements to the existing system of insurance regulation should enhance the international competitiveness of the American insurance industry.

- ◆ **Identification of Tier 1 FHCs.** Large insurance holding companies will be considered for Tier 1 FHC status. (After all, the AIG meltdown is a primary impetus behind forming a systemic risk regulator.) In order to recommend to the FRB certain firms that should be identified as Tier 1 FHCs, the new Financial Services Oversight Council will have authority to require periodic reports from any U.S. financial firm that meets minimum size thresholds yet to be established, including insurers and insurance holding companies. The proposal invites legislation that would set forth specific factors that the FRB must consider in identifying Tier 1 FHCs. A firm deemed to be a Tier 1 FHC will be subject to heightened regulation by the FRB with respect to capital, liquidity and risk management, among other things. The FRB would also have authority to require reports from, conduct examinations of and address systemic risk concerns with respect to all subsidiaries of a Tier 1 FHC, including those that have another primary functional regulator (such as insurance companies).
- ◆ **Closure of Bank Regulation Loopholes.** Currently, under the Bank Holding Company Act ("BHCA"), any company that owns a bank must register as a bank holding company and is subject to supervision and regulation by the FRB. However, certain firms, including insurance holding company systems (such as AIG), have taken advantage of perceived loopholes in the BHCA by which certain depository institutions are not deemed to be "banks;" they have, therefore, avoided certain restrictions and regulation under the BHCA. The Treasury proposal seeks to close such loopholes and would bring firms that own a depository institution under greater regulation by the FRB and would give them five years to come into compliance with the nonbanking activity restrictions of the BHCA.

- **Consumer Protection.** Treasury's proposal suggests that the jurisdiction of the CFPA will extend to firms that provide "other consumer financial products and services," without explanation of how broadly this language will be applied. Treasury officials initially indicated that no decision had been made whether insurance products would be subject to the authority of the CFPA. When asked if the CFPA's authority would extend to the sale of annuities and homeowner's insurance, Treasury Secretary Geithner explained that the Administration is "redrawing the boundaries of authority" for consumer protections and that "not all products respect these boundaries neatly." The legislation sent to the Hill on June 30, however, specifically excluded from its scope the "business of insurance ... other than with respect to credit insurance, mortgage insurance or title insurance."
- **Crisis Management.** Treasury's proposal contemplates a resolution regime that would allow for the orderly resolution of firms whose failure threatens the stability of the financial system. This resolution authority could be invoked only after consultation with the President and upon written recommendation by two-thirds of the members of the FRB and of the FDIC Board (or the SEC, if the bank holding company or an affiliate is a registered broker or dealer). If a failing firm includes an insurance company, the ONI would consult with the FRB and FDIC Board on insurance specific matters. Treasury would generally appoint the FDIC as receiver of the holding company, but the proposal specifically preserves state law consumer protections provided to insurance policyholders. (Treasury's proposed legislation makes clear that the FDIC's resolution authority would not extend to insurance companies.)

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## WHAT'S HAPPENED SO FAR

Three pieces of specific legislation touching insurance have been sent to the Hill by Treasury pursuant to the Administration's plan - the consumer protection proposal embodied in the Consumer Financial Protection Agency Act of 2009, the systemic supervision proposal which includes the new Office of National Insurance within Treasury, and the proposal for regulating over-the-counter derivatives. Hearings on all this have started, even though the Congress has been preoccupied by cap and trade and then health insurance/care reform.

In both chambers, Members have expressed fulsome disagreement over giving the FRB more power, over layering a new consumer protection bureaucracy on top of existing regimes, and over the extent to which "reg reform" is needed at all as the economy starts to pull out of the depths of the 2008 meltdown.

## WHERE FROM HERE?

How much reform/change are we in for? Where are the battles forming in the Congress and around what?

The continuing economic problems, deepening in the first quarter and fueled by the AIG bonus and other controversies, certainly put Congress in the mood to do something, and the House has been pushing for that "something" more than the Senate. The economic improvement the past three months has eased the drum beat for action a little, but we continue to hear from the leading edge of people urging Congress to respond in some way to the economic crisis, particularly if things get worse. The Administration's plan will frame the debate, although the press of so many other compelling issues means it is not a certainty that House Financial Services Committee Chairman Barney Frank's prediction that the President will have regulatory reform legislation by the end of the year will happen. Chairman Frank cannot control what happens in the more leisurely Senate this fall where the Senate Banking Committee under Senator Chris Dodd is in the lead.

Insurance companies - and the solid consumer protections that apply when they go broke - will likely be in that debate, if not this year, then in the future. And the proponents of optional federal chartering will be offering their proposals, including the Bean/Royce bill introduced in April (the National Insurance Consumer Protection Act, H.R. 1880). What happens if the stress in the variable market continues for the foreseeable future? What happens if one, two or more top 25 life companies actually fail? Can the current guaranty system handle that? We know so, but we have to state it, explain it and defend it as several speakers did so eloquently at the NOLHGA Legal Seminar in July in Chicago.

The guaranty association story was not until recently, and probably in a few quarters still is not, completely understood in Congress. The system has done its job of protecting consumers for 40 years, and the capacity of that system is robust. Plus, what happens in an insurance insolvency - replacing insurance policy promises from a failed carrier going out decades with better promises from solvent carriers - is so much different than what is done when a bank fails - replacing cash with cash over a week-end - that it hardly seems logical even to consider an FDIC- type safety set - but that is the comparison.

Does anyone think that we don't need to be able to respond clearly and competently to guaranty capacity inquiries in the context of questions about potential top-25 insurance company failures? Does anyone think that given the speed with which the federal regulators have acted in this crisis, generally, and as to AIG, specifically, that the insurance insolvency and guaranty systems are not going to be in for constant timing comparisons from here on out? And, finally, with taxpayer dollars at risk in AIG, and with TARP funds now going to at least two insurance companies, does anyone seriously doubt that the federal government will be ever more interested in the industry and all of its aspects, including the insolvency safety net? And with FDIC limits going up to \$250,000, does anyone doubt that there will be pressure to increase GA limits and continuing comparisons with the FDIC limits and operations?

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In short, we were always going to see the current guaranty system put under a microscope if there were major insurance failures or strains while the financial services reform and OFC debates pend - or, after a new federal insurance office gets going in Treasury. We can't ignore the changed atmosphere and cling to the hope that Congress or the Administration won't at least look at us hard.

Congress has the power to sweep state receiverships and state guaranty associations out of the way, at least for federally regulated insurance entities if such there ever is, and the federal regulator we get in today's environment may look a whole lot different - and less "optional" - than the one we might have gotten from the last Congress and Administration. That's why we need to keep pointing out that the guaranty system's 40-year track record, coupled with the research, stress testing and analysis we've done, show clearly that ditching the rock solid and time- tested guaranty system safety net would be the worst thing for insurance companies and their policyholders, however regulated, not to mention U.S. taxpayers.

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## NEW NAIC STANDARDS FOR AUDIT COMMITTEE INDEPENDENCE

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A majority of states have adopted the Model Audit Rule either by statute or rule. <sup>1</sup> Although some provisions of the Rule are already in effect in certain states, the independence requirements for insurance company audit committees generally take effect on January 1, 2010.<sup>2</sup>

**BACKGROUND: THE INDEPENDENCE REQUIREMENTS OF SOX.** The Sarbanes-Oxley Act ("SOX") adopted in 2002 expanded the responsibilities of audit committees of publicly-traded companies, including publicly-traded insurance companies and insurance holding companies. In brief, SOX:

- Makes audit committees directly responsible for the appointment, compensation, and oversight of the work by that company (including resolution of disagreements between management and the auditor regarding financial reporting);
- Requires each audit committee to establish procedures for handling complaints, including anonymous submissions by employees, regarding accounting, internal accounting controls, or auditing matters;
- Authorizes each audit committee to engage independent counsel and other advisers, as it determines necessary to carry out its duties;
- Requires appropriate funding of the audit committee to perform its functions, including funding to retain auditors, the audit committee's independent counsel, and other advisers; and
- Requires each member of the audit committee to be "independent."

As discussed below, the SEC has provided further guidance regarding the "independence" standard.

**THE NAIC MODEL AUDIT RULE.** In June 2006, after many months of debate, the NAIC gave final approval to the current version of the Model Audit Rule. The Rule extends a modified version of the audit

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committee independence requirement of SOX to almost all insurers.

Exemptions. The Model Audit Rule's requirements for audit committees do *not* apply to:

- An insurer that is a SOX Compliant Entity (whether required to be compliant with, or voluntarily compliant with, identified provisions of SOX)<sup>3</sup>;
- A direct or indirect wholly-owned subsidiary of a SOX Compliant Entity; or
- A foreign or alien insurer.

But insurers that are subject to the audit committee provisions should be familiar with requirements related to the duties, and in particular, the composition of the audit committee.

## Audit Committee Basics.

*Appointment of the Committee.* The audit committee must be appointed by the board of directors for the purpose of overseeing the accounting and financial reporting processes, and the audit of financial statements, of an insurer or group of insurers within the same insurance holding company.<sup>4</sup> If an audit committee is not designated by the insurer, the insurer's entire board of directors is deemed to be the audit committee.

*Board Members Only.* Every member of an insurer's audit committee must be a member of the board of directors.

*Special Rule for Insurers in a Holding Company System.* The Model Audit Rule allows companies within an insurance holding company structure to streamline compliance with the audit committee requirements by electing to designate the audit committee of a company that controls a group of insurers as the audit committee for the controlled insurers. If such an election is made, then members of the audit committee may be members of the board of the controlling entity. Please note that a company making this election must notify its regulators.

The Independence Requirement. As previously noted, SOX requires that the audit committee of all Listed Companies be "independent." The Model Audit Rule for the first time formally extends an independence requirement to all but the smallest insurance companies.<sup>5</sup>

*Size Matters.* In applying the independence requirement to insurers, the NAIC recognizes that 100% independence, required by SOX, could be difficult for many smaller insurers to achieve. As a result, the percentage of the audit committee that must be independent depends on the size of the insurer.

Insurers with more than \$500 million in direct written and assumed premiums must have an audit committee comprised of at least 75% independent directors. Insurers with direct written and assumed premiums between \$300 million and \$500 million must have 50% or more of the members of the audit committee be independent. There are no independence requirements for companies with less than \$300 million in premium. The NAIC's "Implementation Guide" for the Model Audit Rule provides additional detail about when and how to measure premium volume and how to address situations when a company moves from one "category" to another.<sup>6</sup>

*Who is "Independent"?* Many insurers, including those who are not subject to SOX and companies of all sizes, have already moved to name to the audit committee directors whom they believe to be "independent." But as the requirements of the Model Audit Rule take effect, it is important for companies to be familiar with the criteria established in the Model Audit Rule.

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In order to be considered independent for purposes of service on the audit committee, the Model Audit Rule provides that the person:

- May not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the entity; or
- Be an affiliated person of the entity or of any subsidiary of the entity.<sup>7</sup>

These parameters establish who will not be considered independent for purposes of satisfying the requirements of the Rule and are consistent with corresponding provisions of SOX and the additional guidance regarding determining "independence" adopted by the SEC. *See* SEC Rule 10A-3, *Standards Relating to Listed Company Audit Committees*, adopted by SEC Release No. 33-8820 on April 9, 2003.

Specifically, both the Model Audit Rule and SEC Rule 10A-3 exclude from being considered as independent persons who have either of the following two relationships:

- **Affiliated Persons:** any person who directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the insurer; and
- **Compensated Persons:** any person who, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee of the insurer, accepts any consulting, advisory or other compensatory fee from the insurer or any parent or subsidiary of the insurer.

The Model Audit Rule stops there. It does not provide additional guidance, explanation or examples regarding determining independence. However, a drafting note in the Model Audit Rule states that in determining "independence," the commissioner will consider the guidance provided by the SEC to companies listed on one of the stock exchanges.<sup>8</sup>

## SEC GUIDANCE

### "Affiliated Persons"

SEC Rule 10A-3 provides additional guidance as to who is an Affiliated Person, and accordingly, is not independent for purposes of audit committee membership. Under SEC Rule 10A-3 each of the following are Affiliated Persons:

- Any person who is an executive officer of the insurer;
- Any person who is the beneficial owner, directly or indirectly, of more than 10% of any class of voting equity securities of the insurer, if a stock company; however, being the owner of one or more insurance policies issued by the insurer, whether a mutual or a stock company, is not a prohibited affiliation;
- Any person who is an executive officer of a subsidiary or parent of the insurer;
- Any person who is a director of a subsidiary or parent of the insurer and who also is an employee of the subsidiary or parent of the insurer; and
- Any general partner or managing member of a parent or subsidiary of the insurer.

### "Compensated Persons"

SEC Rule 10A-3 also provides additional guidance as to who is a Compensated Person, and accordingly, is not to be considered independent for purposes of audit committee membership. Under SEC Rule 10A-3, the following rules determine whether an individual is a Compensated Person:

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- Direct Acceptance Rule: Any person who accepts any fee that is compensatory for providing any service or property to the insurer or any subsidiary thereof;
- Family Member Rule: Any director who has a spouse, a minor child or stepchild or a child or stepchild sharing a home with the director who accepts a fee that is compensatory for providing any service or property to the insurer or any subsidiary thereof; and
- Entity Rule: Any director who is a partner, member, an officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position in an entity that accepts any fee that is compensatory for providing accounting, consulting, legal, investment banking or financial advisory services to the insurer or any subsidiary thereof.

There is no *de minimis* exception to any of the above rules. Acceptance of "any" compensatory fee -- regardless of amount -- apparently results in a person being a Compensated Person, and accordingly not independent.

*Exceptions from Being Compensated Persons.* SEC Rule 10A-3 provides exceptions for certain compensation that will *not* result in a person being considered a Compensated Person. These exceptions include:

- Acceptance of fixed amounts of compensation under a retirement plan, including deferred compensation, for prior service;
- Being compensated by an entity that does not provide accounting, consulting, legal, investment banking or financial advisory services (the "Prohibited Services") to the insurer or a parent or subsidiary; and
- Being a limited partner, non-managing member or occupying similar positions who, in each case, have no active role in providing to the entity any of the Prohibited Services.

We emphasize the second exception listed above: a person is a Compensated Person under the Entity Rule only if the entity performs specific services -- accounting, consulting, legal, investment banking or financial advisory -- that the SEC believes are problematic. Persons are not considered Compensated Persons under the Entity Rule if the entity is performing, for example, "other commercial relationships."

The Buck Stops with the Board. Notwithstanding this guidance from the SEC and the basic rules established by the Model Audit Rule, insurers and their boards should heed the SEC caution that independence must be ultimately determined based on a consideration of all relevant facts and circumstances that there is no relationship which, in the opinion of the board, would interfere with the exercise of independent judgement. SEC Rule 10A-3 specifically includes this cautionary note. Before appointing individuals to the Audit Committee, the board should consider all relevant facts and circumstances and determine that there is no relationship which, in the opinion of the board, would interfere with the exercise of independent judgement in carrying out the responsibilities as a member of the audit committee.

Insurers may also want to confer with their domiciliary regulator regarding the independence standard. As discussed above, the reference to SEC Rule 10A-3 is included in a drafting note. Some states may not incorporate this reference to SEC Rule 10A-3 into their version of the Model Audit Rule. Similarly, some regulators may have other standards that they may consider or impose on insurers domiciled in their states.

## CONCLUSION

SEC Rule 10A-3 also cautions about the importance of audit committees in corporate America in providing consumers, such as purchasers of insurance, and regulators, such as insurance departments, with accurate and reliable financial information to make informed decisions. As seen from recent events, confidence in the reliability of corporate financial information is fundamental to the liquidity and vibrancy of our economy and markets. In this era of increased scrutiny and the potential for more oversight by regulators, boards should

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exercise caution in making any factual determinations required to determine "independence" for purpose of audit committee members.

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## Endnotes

1. The new version of the Rule also contains other important changes, including requirements related to auditor independence and internal control over financial reporting; these changes are noted briefly below, but not analyzed here.
2. General resources about Model Audit Rule, including the results of a May 2009 survey of state adoption, are available on the NAIC website at [www.naic.org/committees\\_e\\_naic\\_aicpa\\_wg.htm](http://www.naic.org/committees_e_naic_aicpa_wg.htm).
3. To be a "SOX Compliant Entity" for purposes of the Model Audit Rule, an entity must comply with the preapproval requirements of Section 201; the audit committee independence requirements of Section 301; and the internal control over financial reporting requirements of Section 404. *See* Section 3.M of the Model Audit Rule.
4. *See* Model Audit Rule, Section 3.C.
5. Some state insurance regulators have required, or "strongly encouraged," insurers to have independent directors on their audit committees.
6. The Implementation Guide was adopted by the NAIC in 2009 and is an "informational appendix" - Appendix G - to the NAIC Accounting Practices & Procedures Manual.
7. An exception is made where the law requires board participation by otherwise non-independent members. And there is a "transition period" for members of the audit committee who cease to be independent during their service on the audit committee. Model Audit Rule, Sections 14.C and 14.D.
8. *See* Drafting Note to Section 14.D of the Model Audit Rule.

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## TEXAS ENACTS WINDSTORM INSURANCE FUNDING REFORMS

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During the recently completed 81<sup>st</sup> Legislative Session, the Texas legislature adopted the most significant reforms to the Texas Windstorm Insurance Association ("TWIA") since 1997 with the passage of House Bill 4409 ("HB 4409"). This legislative reform was forced upon legislators due to \$2.5 billion in losses from Hurricane Dolly and Hurricane Ike in 2008. These losses were paid from \$1.5 billion in reinsurance proceeds, the totality of TWIA reserves in its catastrophe reserve trust fund ("CRTF"), and \$530 million in assessments

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to TWIA insurer members. Of the total assessed to insurers, \$230 million will be repaid to insurers in premium tax credits over a five-year period. Without legislative reform, TWIA would have begun the 2009 storm season without reserves, reinsurance, or the ability to pay any additional losses except through the use of additional assessments to insurers.

## History of TWIA

TWIA was created by the Texas legislature in 1971 after Hurricane Celia struck the Corpus Christi area in 1970 and many insurers stopped writing insurance on the Texas coast. To provide adequate windstorm coverage and protect consumers, the Texas Catastrophe Property Insurance Association, renamed TWIA in 1993, was created to provide windstorm and hail coverage in the fourteen coastal counties or Tier One counties along the Texas coast. Each insurer authorized to engage in the business of property insurance in Texas is required to participate in TWIA membership and assessments. TWIA coverage is available to residential and commercial entities in the Tier One counties, and a small area of Harris County was added to TWIA's catastrophe area designation in the mid 1980s. Since its creation, TWIA has had to assess insurers only three times: Hurricane Alicia (1983); Hurricane Rita (2005); and Hurricanes Dolly and Ike (2008).

## 2009 Legislative Reforms

Governor Rick Perry announced on February 3, 2009 that legislation to reform TWIA and legislation to fund the CRTF would be emergency items for the 2009 legislative session. Two early legislative proposals, House Bill 911 ("HB 911") and Senate Bill 14 ("SB 14") were considered by coastal legislators to be punitive and financially burdensome to their constituents. Most disturbing to coastal legislators were several provisions in HB 911 that would have capped insurance residential coverage for TWIA policies at \$250,000, required a 60-day waiting period, and resulted in higher rates to TWIA policyholders.

However, SB 14 also did not satisfy coastal legislators and the needs of their constituents. Senate Bill 14, as filed, could have resulted in surcharges to coastal policyholders of over 60% when taking into consideration rate increases, automatic surcharges to fund the CRTF, and surcharges to non-compliant structures and second homes. As SB 14 was passed by the Senate, all of the surcharge issues were removed from the legislation, but one provision still caused concern for coastal House members. Section 37 of SB 14 would have required that TWIA rates migrate to actuarially sound rates by August 31, 2012. It was estimated that the migration would have resulted in rate increases of almost 35% over three years without any consideration of additional rate increases due to catastrophe and non-catastrophe losses of TWIA. Coastal House members successfully blocked consideration of both HB 911 and SB 14 in the House Insurance Committee because a majority of committee members did not support either bill.

It was not until May 20, 2009 that significant steps were made to move TWIA legislation. On that day, Governor Perry threatened to call a special session to address TWIA if legislators failed to pass a bill by the end of the session, June 1, 2009. Significant discussions occurred to amend SB 14, which resulted in the legislation being passed by the House Insurance Committee and set on the House calendar.

However, due to delays caused by other legislation, SB 14 was not able to pass the House before a May 26 deadline. Legislators were already considering how to address TWIA issues in a special session when an unrelated bill relating to disaster preparation and management, HB 4409, was amended in the Senate to include the version of SB 14 as it had passed the Senate. The amendment of HB 4409 created a legislative vehicle to address TWIA issues. With Senate amendments added to a House bill, the House moved not to concur in the amendments thus moving discussions on TWIA reform into a conference committee of Senate and House legislators. A flurry of activity between House and Senate members negotiating a solution occurred on May 29 and May 30, which ultimately resulted in a compromise on the funding of TWIA losses and passage of the HB 4409 into law. Governor Perry signed HB 4409 into law on June 19, 2009.

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## Summary of House Bill 4409

The funding structure in House Bill 4409 provides funding for losses up to \$2.5 billion. Any surplus revenue in TWIA from premiums not used to pay losses will be deposited in the CRTF. If no catastrophic events occur, the CRTF could increase annually up to \$240 million as TWIA places its profits from premiums not used to pay losses or expenses into the CRTF. However, in the event of a catastrophe, excess losses will be paid in the following sequence:

- Level 1 - Any available TWIA premium and other revenue;
- Level 2 - Any available funds in the CRTF;
- Level 3 - Public securities (Class 1 Public Securities) not to exceed \$1 billion with repayment not to exceed 10 years by payment from TWIA available revenues;
- Level 4 - Public securities (Class 2 Public Securities) not to exceed \$1 billion with repayment not to exceed 10 years. Thirty percent or \$300 million of the public securities will be repaid by insurers' assessments and seventy percent or \$700 million will be repaid by surcharges on coastal property and casualty policies. The surcharges on the coastal property and casualty policyholders will not exceed 2.8 percent a year for ten years unless multiple storms occur over multiple years. In other words, if a hurricane's landfall results in TWIA losses up to \$2 billion, then coastal property and casualty policyholders will see up to a 2.8 percent increase in annual premiums for a ten year period. That is equivalent to \$28 for every \$1,000 in premiums, which is under \$2.50 a month; and
- Level 5 - Public securities (Class 3 Public Securities) not to exceed \$500 million with repayment not to exceed 10 years paid by assessments on insurers or via the purchase of reinsurance by insurers to cover the assessment. Insurers will no longer be able to claim a premium tax credit for the payment of assessments under the new legislation.

Reinsurance may be purchased by TWIA to operate in addition to or in concert with the CRTF, public securities, financial instruments, and assessments. TWIA in the very near future could purchase reinsurance of \$700 million or more to ensure that TWIA policyholders will never see a surcharge to repay any losses resulting from a catastrophe paid by Class 2 Public Securities. In fact, TWIA will, most likely, move towards the purchase of reinsurance in excess of \$1 billion to protect TWIA policyholders and insurers from the burden imposed on multiple bond issuances to avoid similar problems faced by Florida policyholders last year which was caused by several bond issuances and a weak bond market.

For the setting and adoption of rates, rating territories may be adopted, but rates within a county may only vary 5 percent in 2009 and increase 1 percent annually until 2012 for an 8 percent variance of rates within a county. However, there is no limitation on the variance of rates between rating territories outside a particular county.

For the first time, catastrophe models may be used in determining rates. The legislation allows for a file and use of 5 percent that must be approved by the Insurance Commissioner. TWIA will need rates approved that exceed 5 percent. Rate increases of less than 5 percent go into effect after 30 days and do not need approval. However, a 10 percent rate cap increase per year was retained in HB 4409 unless the new rate is the result of catastrophic losses which have occurred to TWIA policyholders from a tropical system(s) to justify the higher rate and the proposed rate is approved by the Commissioner of Insurance.

New structures along the Texas coast will need to be built to the windstorm building code to ensure they will be eligible for coverage during and after construction. All construction, alteration, remodeling, enlargement, and repair of, or addition to, any structure located in the catastrophe area that is begun on or after the effective date of the act must be performed in compliance with the applicable building code standards to qualify for TWIA coverage. Even though purchasers may be able to obtain insurance coverage in the private market on their newly constructed property, if that person ever loses that private insurance, TWIA cannot provide future

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coverage to that property unless it was built to the windstorm building code. Today, some TWIA policyholders have coverage only because they were able to obtain coverage through an approval process that was implemented in 2006 after large numbers of policies were not renewed by private carriers in reaction to losses of Hurricanes Katrina, Rita, and Wilma in 2005. These private carriers wanted to limit their coastal exposures, and large numbers of policies were shifted to TWIA to provide windstorm coverage. The new law retains the approval process for existing structures. It is possible, even though these reforms have been passed, that some private insurers may still withdraw from areas in coastal Texas that will require the approval process to be utilized on these existing structures to obtain TWIA coverage.

Further, if a structure is built on or after September 1, 2009, and the structure is located in Zone V or another similar zone with an additional hazard associated with storm waves, as defined by the National Flood Insurance Program, and if flood insurance under the federal program is available, TWIA may not issue an insurance policy unless there is evidence the property is covered by a flood insurance policy. In addition, another new change requires new TWIA applicants and TWIA renewals to provide a declination from a private insurer before obtaining TWIA coverage.

The current TWIA board of directors will continue through the current storm year until the end of 2009. A new 9-member board of directors will be established before January 1, 2010, and all members will be appointed by the Commissioner of Insurance. The board's composition will be 4 insurer representatives, 4 coastal residents with, at least one being an agent, and 1 non-coastal member.

## **Impact of the Legislation on Consumers and Insurers**

TWIA policyholders and coastal legislators have claimed victory based on the passage of HB 4409. On its face and with a little luck, TWIA policyholders will most likely see only a five percent rate increase this year and future years despite the fact that TWIA began the 2009 storm season with no reserves and the payment of \$2.5 billion in losses, unless there is a large catastrophe loss or several non-catastrophe losses to TWIA. House Bill 4409 was passed because coastal legislators could support it without any adverse rate impact to their constituents.

In addition, consumers and public members will now represent the majority of the TWIA board of directors. The existing board had a majority of five insurers, two independent agents, and two public members, and insurers typically prevailed on contested issues by a 5-4 majority. It will be interesting to see how TWIA operates under the new board and whether the loss of insurance expertise results in decisions that could adversely impact TWIA's operations. In addition, the board retains its four coastal representatives of the nine members. It is very likely that future board decisions may become more consumer oriented and coastal-friendly.

With the change to allow rating territories, it is possible that the solidarity of the coast will become divided in the future through higher rates between territories. It could certainly be argued by some that rates should increase in the Galveston area because of Hurricane Ike losses and the fact that approximately 50 percent of TWIA's exposure is situated there. Because of losses from Hurricane Dolly in South Texas and Hurricanes Rita and Ike in Southeast Texas, TWIA rates for those areas might also increase. However, the Corpus Christi area has not experienced a hurricane since 1980. Based on that fact, Corpus Christi might see sizable decreases while rates go up for other TWIA policyholders who supported HB 4409.

It is certain that insurers can claim some success from the passage of HB 4409. Despite losing the majority governance of the board, the reforms removed a key concern to insurers, unlimited assessments to insurers to pay losses in excess of available revenues, reserves, and reinsurance. In addition, there are no barriers to entry for new insurers coming into the Texas marketplace as they will not be subject to paying any TWIA assessments until two years after they enter the marketplace. Under the funding structure in HB 4409,

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insurers will be subject to \$300 billion in losses for Class 2 public securities and \$500 million in losses for Class 3 public securities from the \$2.5 billion in total coverage limits per year for TWIA losses.

### The Future of TWIA

Although HB 4409 will insure TWIA losses up to \$2.5 billion per year, it does not address losses in excess of that amount. TWIA has not experienced losses in excess of \$2.5 billion in its history, but it may be a matter of time. A probable maximum loss to TWIA in the Galveston area could total \$8-\$10 billion while a probable maximum loss to TWIA in the Corpus Christi area could total \$4 billion. TWIA has yet to be tested by even a Category 4 storm since it began its existence in 1971.

What was the legislative intent to cover losses in excess of \$2.5 billion? Have the Governor call a special session. It is widely believed that if a hurricane were to strike the Texas coast and losses exceeded the \$2.5 billion amount, a special session would be needed to address all the related issues to state government resulting from a storm of such magnitude, not to mention the possible impact to the private insurance market.

In summary, the future of TWIA's stability is based on denial -- a denial that a storm will impact the coast, thus allowing TWIA to rebuild its CRTF. This denial could lead to monstrous reliance on bonding to provide funding of storm losses that could adversely impact TWIA policyholders and non-TWIA policyholders along the Texas coast who will be subject to surcharges to repay these bonds. We, along with all Texans, hope for good weather this and every hurricane season on the Gulf Coast.

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## FLORIDA'S FIRST DCA UPHOLDS BROAD STATUTORY AUTHORITY FOR DEPARTMENT OF FINANCIAL SERVICES TO INVESTIGATE CAUSE OF INSURER'S INSOLVENCY

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On April 24, 2009 the First District Court of Appeal in Florida issued an opinion in the matter of *Everest Re Group, LTD. v. Department of Financial Services*, as receiver for Southern Family Insurance Company, Atlantic Preferred Insurance Company, and Florida Preferred Insurance Company ("Poe Companies").<sup>1</sup> The opinion upheld the broad authority delegated to the Department of Financial Services ("DFS") by section 631.156, *Florida Statutes* (2008), with regard to insurer liquidation proceedings. Everest Re Group, LTD. ("Everest"), a Bermuda holding company, had petitioned the appellate court for a writ of certiorari to review a trial court order compelling disclosure of documents and information in this liquidation proceeding.

The Poe Companies were ordered into liquidation in 2008 as a result of their collective inability to pay claims which related to the 2004 and 2005 Florida hurricane seasons. These proceedings were filed in Leon County, Florida by the DFS and are currently pending. As the receiver, the DFS is in the process of collecting assets and administering the estates of the insolvent insurers. It also has filed an action against the various owners, management, and affiliates of the Poe Companies to recover funds disbursed, despite the losses incurred during the 2004 and 2005 hurricane seasons. The DFS alleged that the named parties had taken certain actions

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that ultimately contributed to the insolvency of the insurance companies.

As part of its investigation, the DFS served an investigative demand on Everest to obtain information it believed relevant to the insolvency of the insurance companies. Everest refused to comply with the demand, and after motions by both parties, the trial court ordered Everest to comply with the demand.

In its petition for certiorari, Everest argued that it is not subject to regulation under Florida's liquidation laws, since it is not authorized to do business in Florida. However, the court held that Florida law confers broad investigatory power upon the DFS and does not contain an exemption for foreign corporations. Section 631.156, *Florida Statutes*, provides:

The department may take statements under oath and examine and review the books, records, and documents of the insurer or any affiliate, controlling person, officer, director, manager, trustee, agent, adjuster, employee, or independent contractor of any insurer or affiliate and any other person possessing any executive authority over, or exercising or having exercised any control over any segment of the affairs of the insurer or affiliate.

The court held that the possession of assets or records of an insolvent insurance company qualifies as exercising control over a particular aspect of its business. Since the DFS had alleged (and Everest had not denied) that Everest possessed assets or records relating to the Poe Companies, it was subject to the investigative powers established by Florida law.

Additionally, the court rejected Everest's argument that the statute does not provide a basis for the exercise of long-arm jurisdiction, which is the legal concept under which a court may exercise in certain circumstances jurisdiction over a foreign or alien person or entity in connection with pending litigation. The court pointed out that since Everest is merely a witness, and not a party to a lawsuit, jurisdictional issues are not applicable under section 631.156. The court did not discuss the constitutional principles that form the basis and circumscribe the application of long-arm jurisdiction and the exercise of other extra-territorial authority over a foreign or alien person or entity.

A Motion for Rehearing was filed by Everest with the First District Court of Appeal on May 11, 2009. The motion was denied on June 11, 2009.

In essence, this case interprets Florida law to authorize the broad investigative power of DFS in insurance company liquidation proceedings. This authority even extends to foreign and alien entities that do not do business in Florida, but who have exercised control over any segment of the affairs of the insurer or an affiliate. This extends to a Bermuda holding company, which apparently did business with the insolvent insurer(s).

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## Endnotes

1. 10 So. 3d 1120 (Fla. 1st DCA 2009).
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**FEDERATION OF REGULATORY COUNSEL, INC.**  
**COMPENDIUM OF STATE SURPLUS LINES ELIGIBILITY  
REQUIREMENTS**

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Although the majority of insurance departments maintain eligibility lists, distribution methods will vary. Historically, the two most common distribution methods were: (1) publication on a regular basis (i.e., annually, semiannually or quarterly) and (2) distribution to surplus lines associations, stamping offices, and broker associations. Many states now make their lists available on their websites. There are also states that do not formally publish an eligibility list, yet will make this information available upon public inquiry. With respect to distribution, individual insurance departments should be contacted for state specific procedures. 1

**ALABAMA**

The Alabama Insurance Commissioner does not maintain a list of eligible surplus lines insurers. The insurance commissioner is authorized to maintain a list of ineligible surplus lines insurers. ALA CODE § 27-10- 26(b)(5). However, the insurance commissioner does not presently maintain a list of ineligible surplus lines insurers.

**ALASKA**

The Alaska insurance director is required to maintain a list of eligible surplus lines insurers. ALASKA STAT. § 21.34.050(a). However, the insurance director is not required to place or maintain the name of a nonadmitted insurer on the list of eligible surplus lines insurers. ALASKA STAT. § 21.34.050(b). Even so, the statute does not require the insurance director to maintain a list of ineligible surplus lines insurers.

Alaska's list of eligible surplus lines insurers can be found at:  
<http://www.commerce.state.ak.us/insurance/bulletins/B09-011.pdf>

**ARIZONA**

The Arizona insurance director maintains a list of unauthorized insurers that are approved to write surplus lines insurance. ARIZ. REV. STAT. ANN. § 20-413(G). The insurance director is not required to maintain a list of ineligible surplus lines insurers.

Arizona's list of eligible surplus lines insurers can be found at:  
[http://www.id.state.az.us/publications/WHITELISTnameonly09to10\\_ver.5\\_.pdf](http://www.id.state.az.us/publications/WHITELISTnameonly09to10_ver.5_.pdf)

**ARKANSAS**

The Arkansas insurance commissioner may maintain a list of approved surplus lines insurers ARK. CODE ANN. § 23-65-310(a). The insurance commissioner is not required to maintain a list of ineligible surplus lines insurers.

Arkansas's list of eligible surplus lines insurers can be found at:  
[http://www.insurance.arkansas.gov/Finance/surpluslinespage\\_files/surpluslineslist.pdf](http://www.insurance.arkansas.gov/Finance/surpluslinespage_files/surpluslineslist.pdf)

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## CALIFORNIA

The California insurance commissioner maintains a list of eligible surplus lines insurers that have met the requirements of § 1765.1(a)-(e). CAL. INS. CODE § 1765.1(f). The insurance commissioner refers to the list maintained by the National Association of Insurance Commissioners (NAIC) in its review of nonadmitted insurers. CAL. INS. CODE § 1765.1(d)(1).

California's list of eligible surplus lines insurers can be found at:

<http://www.insurance.ca.gov/0250-insurers/0300-insurers/0200-bulletins/eligible-surplus-line/index.cfm>

## COLORADO

The Colorado insurance commissioner maintains a list of nonadmitted insurers approved to accept surplus lines risks; however, the statute does not require the insurance commissioner to maintain a list of ineligible surplus lines insurers. COLO. REV. STAT. § 10-5-108(1).

Colorado's list of eligible surplus lines insurers is accessible through:

<http://cdlookup.asisvcs.com/CompanySearch.aspx>

## CONNECTICUT

The Connecticut insurance commissioner maintains a list of eligible surplus lines insurers. CONN. GEN. STAT. § 38a-741. The insurance commissioner is not required to maintain a list of ineligible surplus lines insurers.

Connecticut's list of eligible surplus lines insurers can be found at: <http://www.ct.gov/cid/lib/cid/licencom.pdf>; look for companies coded "K."

## DELAWARE

The Delaware insurance commissioner maintains a list of all eligible surplus lines insurers. 18 DEL. CODE ANN. § 1907(b). The insurance commissioner is not required to maintain a list of ineligible surplus lines insurers.

Delaware's list of eligible surplus lines insurers can be found at:

[http://delawareinsurance.gov/departments/documents/bulletins/SurplusBull5/EligibleList\\_02-13-09.xls](http://delawareinsurance.gov/departments/documents/bulletins/SurplusBull5/EligibleList_02-13-09.xls)

## DISTRICT OF COLUMBIA

The District of Columbia insurance commissioner does not maintain a list of eligible or ineligible surplus lines insurers.

## FLORIDA

The Florida insurance commissioner maintains a list of eligible surplus lines insurers. FLA. STAT. ANN. § 626.918(3). The insurance commissioner is not required to maintain a list of ineligible surplus lines insurers.

Florida's list of eligible surplus lines insurers is accessible through: <http://www.floir.com/CompanySearch/>

## GEORGIA

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The Georgia insurance commissioner does maintain a list of eligible alien surplus lines insurers; however, the statute does not require the insurance commissioner to maintain a list of ineligible surplus lines insurers. GA. CODE ANN. § 33-5-25(b)(1)(C).

Georgia's list of eligible alien surplus lines insurers is accessible through:

<http://www.inscomm.state.ga.us/Insurers/Home.aspx>

## HAWAII

The Hawaii insurance commissioner does not maintain a list of eligible or ineligible surplus lines insurers.

## IDAHO

The Idaho insurance director maintains a list of eligible surplus lines insurers. IDAHO CODE § 41-1217(2). The insurance director is not required to maintain a list of ineligible surplus lines insurers.

Idaho's list of eligible surplus lines insurers can be found at:

<http://www.doi.idaho.gov/insurance/surpluslineslist.aspx>

## ILLINOIS

There is currently no statutory or regulatory authority for the Illinois insurance director to maintain a list of eligible or ineligible surplus lines insurers. The insurance director is authorized to declare a surplus lines insurer ineligible. 215 ILL. COMP. STAT. ANN. 5/445(9); ILL. ADMIN. CODE tit 50, § 2801.30(e) (stating that when an authorized company is deemed hazardous to policyholders, the director shall order the Surplus Lines Association of Illinois not to countersign the company's insurance contracts and further stating that the Director shall direct all surplus lines producers to cease procuring insurance from said company). Based on this authority, the state insurance department maintains a list of ineligible surplus lines insurers.

## INDIANA

The Indiana insurance commissioner maintains a list of eligible surplus lines insurers. The commissioner is authorized to order the surplus lines producer to cancel a policy if the commissioner is of the opinion that the financial statement or condition of the unauthorized insurer does not warrant continuance of the risk . IND. CODE. ANN. 27-1-15.8-4(c). The insurance commissioner is not required to and does not maintain a list of ineligible surplus lines insurers. Alien surplus lines insurers are automatically eligible for surplus lines in Indiana if they appear on the NAIC Quarterly List of Alien Insurers.

Indiana's list of eligible foreign surplus lines insurers can be found at:

<http://www.in.gov/cgi-bin/idoi/ssDisplay-2.pl?file=SurplusLines&letter=a>

## IOWA

The Iowa insurance commissioner maintains a list of nonadmitted insurers who have provided information required by law that demonstrates the ability of each insurer to satisfy insurance obligations. 191 IOWA ADMIN. CODE 21.5(515) The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Iowa's list of eligible surplus lines insurers can be found at:

<http://www.iid.state.ia.us/iacompanylisting/results.asp?Type=7&Pageno=0&linksback=companymain>.

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## KANSAS

The Kansas insurance commissioner maintains a list of eligible surplus lines insurers. KAN. STAT. ANN. § 40-246(e). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Kansas's list of eligible surplus lines insurers is accessible through:

<http://www.ksinsurance.org/about/downloadlist.php>

## KENTUCKY

The Kentucky insurance commissioner does not maintain a list of eligible or ineligible surplus lines insurers.

## LOUISIANA

The Louisiana insurance commissioner maintains a list of authorized insurers that have been approved for the placement of surplus lines insurance. LA. REV. STAT. ANN. 22:436. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Louisiana's list of eligible surplus lines insurers can be found at:

[http://www.lidi.state.la.us/search\\_forms/white\\_list/white\\_list.aspx](http://www.lidi.state.la.us/search_forms/white_list/white_list.aspx)

## MAINE

The Maine insurance superintendent maintains a list of eligible surplus lines insurers. 24-A ME. REV. STAT. ANN. § 2007. The insurance superintendent does not maintain a list of ineligible surplus lines insurers.

Maine's list of eligible surplus lines insurers can be found at:

<http://www.maine.gov/pfr/insurance/company/slcompanies.htm>

## MARYLAND

The Maryland insurance commissioner is authorized to maintain a list of approved surplus lines insurers. MD. CODE. ANN. INS. § 3-304. The insurance commissioner is not authorized to maintain a list of ineligible surplus lines insurers.

The list of eligible surplus lines insurers is accessible through:

<http://www.mdinsurance.state.md.us/iq/jsp/interactiveQuery/CompanySearch.jsp?mode=true>

## MASSACHUSETTS

The Massachusetts insurance commissioner maintains a list of eligible surplus lines insurers. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Massachusetts's list of eligible surplus lines insurers can be found at:

<http://www.mass.gov/Eoca/docs/doi/Companies/SurplusLines.pdf>

## MICHIGAN

The Michigan insurance commissioner maintains a list of eligible surplus lines insurers. MICH. COMP. LAWS ANN. § 500.1920. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

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Michigan's list of eligible surplus lines insurers can be found at:

[http://www.michigan.gov/documents/quarterly\\_surplus\\_lines\\_list\\_166029\\_7.pdf](http://www.michigan.gov/documents/quarterly_surplus_lines_list_166029_7.pdf)

## MINNESOTA

The Minnesota insurance commissioner maintains a list of eligible surplus lines insurers. MINN. STAT. ANN. § 60A.206. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Minnesota's list of eligible surplus lines insurers is accessible through:

<http://www.commerce.state.mn.us/LicenseLookupMain.html>

## MISSISSIPPI

The Mississippi insurance commissioner maintains a list of nonadmitted insurers deemed eligible for the placement of surplus lines insurance. MISS. CODE ANN. § 83-21-17. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Mississippi's list of eligible surplus lines insurers is accessible through:

[http://www.mid.state.ms.us/licapp/download\\_list.aspx](http://www.mid.state.ms.us/licapp/download_list.aspx)

## MISSOURI

The Missouri insurance director maintains a list of eligible surplus lines insurers. MO. ANN. STAT. § 384.021. The insurance director does not maintain a list of ineligible surplus lines insurers.

Missouri's list of eligible surplus lines insurers can be found at:

<http://www.insurance.mo.gov/industry/EligibleSL.htm>

## MONTANA

The Montana insurance commissioner maintains a list of eligible surplus lines insurers. MONT. CODE ANN. § 33-2-307(3). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Montana's list of eligible surplus lines insurers can be found at:

<http://www.sao.mt.gov/forms/Exams/Lists/biannlst.pdf>

## NEBRASKA

The Nebraska insurance director does not maintain a list of eligible or ineligible surplus lines insurers, but instead relies on the NAIC listing.

## NEVADA

The Nevada insurance commissioner maintains a list of eligible surplus lines insurers. NEV. REV. STAT. ANN. § 685A.070(4). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

## NEW HAMPSHIRE

The New Hampshire insurance commissioner maintains a list of eligible surplus lines insurers. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

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New Hampshire's list of eligible surplus lines insurers can be found at:

<http://www.nh.gov/insurance/companies/premiumtax/documents/surpluslist2008.pdf>

## NEW JERSEY

The New Jersey insurance commissioner maintains a list of eligible surplus lines insurers. N.J. STAT. ANN. § 17:22-6.45. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

New Jersey's list of eligible surplus lines insurers can be found at:

[http://www.state.nj.us/dobi/sleo\\_whitelist.pdf](http://www.state.nj.us/dobi/sleo_whitelist.pdf)

## NEW MEXICO

The New Mexico insurance superintendent maintains a list of eligible surplus lines insurers. N.M. STAT. ANN. § 59A-14-4. The insurance superintendent does not maintain a list of ineligible surplus lines insurers.

## NEW YORK

The New York insurance superintendent maintains a list of eligible surplus lines insurers. Insurers must be approved by the Excess Line Association of New York (ELANY) before insurance may be placed through a broker. ELANY also keeps a record of those companies that have been removed from the list for which they will no longer stamp policies.

New York's lists of eligible surplus lines insurers can be found at: <http://www.elany.org/es-el-f.aspx>, <http://www.elany.org/es-el-a.aspx> and <http://www.elany.org/es-el-ls.aspx>. New York's lists of ineligible surplus lines insurers can be found at: <http://www.elany.org/es-inel-f.aspx>, <http://www.elany.org/es-inel-a.aspx> and <http://www.elany.org/es-inel-ls.aspx>

## NORTH CAROLINA

The North Carolina insurance commissioner maintains a list of eligible surplus lines insurers. N.C. GEN. STAT. § 58-21-20. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

North Carolina's list of eligible surplus lines insurers can be found at:

[http://infoportal.ncdoi.net/viewpdf.jsp?report\\_name=FE\\_reinsurers\\_slr.rpt&CMP\\_TYPE=64&STEXT=Eligible%20Su](http://infoportal.ncdoi.net/viewpdf.jsp?report_name=FE_reinsurers_slr.rpt&CMP_TYPE=64&STEXT=Eligible%20Su)

## NORTH DAKOTA

The North Dakota insurance commissioner maintains a list of eligible surplus lines insurers. N.D. ADMIN. CODE § 45-05-05-08(3). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

North Dakota's list of eligible surplus lines insurers can be found at:

<http://www.nd.gov/ndins/uploads/resources/87/surpluslines.pdf>

## OHIO

The Ohio insurance director maintains a list of eligible surplus lines insurers. The insurance director does not maintain a list of ineligible surplus lines insurers.

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Ohio's list of eligible surplus lines insurers can be found at:

<http://www.ohioinsurance.gov/reports/SLCompanies.pdf>

## OKLAHOMA

The Oklahoma insurance commissioner maintains a list of eligible surplus lines insurers. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Oklahoma's list of eligible surplus lines insurers can be found at:

<http://www.ok.gov/oid/documents/04%20Surplus%20Lines%20Listing%20051407.pdf>

## OREGON

The Oregon Insurance Division does not maintain a public list of eligible or ineligible surplus lines insurers. Oregon surplus lines licensees bear the sole responsibility for determining that an insurer is qualified at the time of placement. For information purposes only, a list of insurers that are unlikely to be disapproved by the Division is maintained on the Oregon Surplus Line Association, available at: <http://www.slaor.org>

## PENNSYLVANIA

The Pennsylvania insurance commissioner maintains a list of eligible surplus lines insurers. PA. STAT. ANN. tit. 40, § 991.1605(b). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Pennsylvania's list of eligible surplus lines insurers can be accessed at:

<http://www.ins.state.pa.us/ins/cwp/view.asp?a=1280&q=527362>

## PUERTO RICO

The Puerto Rico insurance commissioner maintains a list of eligible surplus lines insurers. 26 P.R. LAWS ANN. § 1007a(2). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Puerto Rico's list of eligible surplus lines insurers can be found at:

<http://www.ocs.gobierno.pr/ocspr/Portals/0/SI/Informes/asliex.pdf>

## RHODE ISLAND

The Rhode Island insurance commissioner maintains a list of eligible surplus lines insurers. R.I. GEN. LAWS § 27-3-40. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Rhode Island's list of eligible surplus lines insurers can be found at:

[http://www.dbr.state.ri.us/documents/divisions/insurance/nonlicensed/Approved\\_Surplus\\_Lines\\_Insurers.pdf](http://www.dbr.state.ri.us/documents/divisions/insurance/nonlicensed/Approved_Surplus_Lines_Insurers.pdf)

## SOUTH CAROLINA

The South Carolina insurance director maintains a list of eligible surplus lines insurers. S.C. CODE ANN. § 38-45-90. The insurance director does not maintain a list of ineligible surplus lines insurers.

South Carolina's list of eligible surplus lines insurers can be found at:

<http://doi.sc.gov/NR/rdonlyres/B71EE0AA-AEBB-47EB-807F-AAE4A86274AC/0/listofapprovedeligiblesinsasof112>

## SOUTH DAKOTA

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The South Dakota insurance director does not maintain a list of eligible surplus lines insurers. The insurance director does maintain a list of ineligible surplus lines insurers, but it is not clear whether the list is complete or updated regularly. This list can be found at:

<http://www.state.sd.us/drr2/reg/insurance/companies/surpluslines.htm>

### **TENNESSEE**

The Tennessee insurance commissioner maintains a list of eligible surplus lines insurers. TENN. CODE ANN. § 56-14-108(g). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Tennessee's list of eligible surplus lines insurers can be found at:

[http://tennessee.gov/commerce/insurance/documents/ListofSLinTN\\_000.xls](http://tennessee.gov/commerce/insurance/documents/ListofSLinTN_000.xls)

### **TEXAS**

The Texas Department of Insurance maintains a list of surplus lines insurers that have provided satisfactory evidence of eligibility. 28 TEX. ADMIN. CODE §15.8(j). The Texas Department of Insurance does not maintain a list of ineligible surplus lines insurers.

Texas' list of eligible surplus lines insurers can be found at:

<http://www.slsot.org/SLSOT/CompanyInformation/insurerslist.html>

### **UTAH**

The Utah insurance commissioner maintains a list of unauthorized foreign insurers considered to be reliable and solid, for the placement of surplus lines insurance. UTAH CODE ANN. § 31A-15-103(6)(d). The insurance commissioner is authorized to issue a list of unauthorized foreign insurers whose solidity is doubted or whose practices are considered objectionable. *Id.* However, the insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Utah's list of eligible surplus lines insurers can be found at: <http://www.insurance.utah.gov/docs/SLCOList.pdf>

### **VERMONT**

The Vermont insurance commissioner maintains a list of eligible surplus lines insurers. VT. STAT. ANN. Tit. 8, § 5026(b). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Vermont's list of eligible surplus lines insurers is generally updated monthly, and the latest version can be found at:

[http://www.bishca.state.vt.us/InsurDiv/Forms\\_CompanyLicensing/Insurer\\_Lists/index\\_authorizedinsurers.html](http://www.bishca.state.vt.us/InsurDiv/Forms_CompanyLicensing/Insurer_Lists/index_authorizedinsurers.html)

### **VIRGIN ISLANDS**

The Virgin Islands insurance commissioner maintains a list of eligible surplus lines insurers. Although there is no express statutory authority, the list is maintained based upon the authority to approve eligible surplus lines insurers. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

### **VIRGINIA**

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The Virginia insurance commissioner maintains a list of eligible surplus lines insurers. The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

Virginia's list of eligible surplus lines insurers can be accessed through:

<http://www.scc.virginia.gov/division/boi/external/app/companylookup/companyLookup.asp?comtype=sl>

## WASHINGTON

The Washington insurance commissioner does not maintain a list of eligible or ineligible surplus lines insurers.

## WEST VIRGINIA

The commissioner maintains a list of eligible surplus lines insurers published from time to time but at least annually. The commissioner is not required to place or maintain the name of any nonadmitted insurer on the list of eligible surplus lines. W. VA. CODE § 33-12C-5(c)(5).

West Virginia's list of eligible surplus lines insurers can be found at:

<http://www.wvinsurance.gov/LinkClick.aspx?fileticket=6btPZLtwawg%3d&tabid=122&mid=679>

## WISCONSIN

The Wisconsin insurance commissioner may maintain a list unauthorized nondomestic insurers who are believed to be reliable and solid. WIS. STAT. ANN. § 618.41(6)(d). However, the insurance commissioner is not required to and does not currently maintain such a list. The insurance commissioner is also authorized to maintain a list of insurers whose solidity is believed to be doubtful or whose practices are believed to be objectionable. *Id.* However, the insurance commissioner does not maintain a list of ineligible surplus lines insurers.

## WYOMING

The Wyoming insurance commissioner is authorized to publish a list of eligible surplus lines insurers, but has never done so. WYO. STAT. ANN. § 26-11-107(d). The insurance commissioner does not maintain a list of ineligible surplus lines insurers.

[1] Authors: Robert M. Ferm, Beth A. Dickhaus, with the assistance of Hall & Evans, LLC summer law clerks: Mathew J. Hegarty and Christopher A. Poirier. This compendium will be included in the publication, Annotations to Surplus Lines Statutes by the Excess, Surplus Lines and Reinsurance Committee of the Tort Trial and Insurance Practice Section of the American Bar Association. The research and compilation were closed July 2009.

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### Endnotes

1. Authors: Robert M. Ferm and Beth A. Dickhaus, with the assistance of Hall & Evans, LLC summer law clerks: Mathew J. Hegarty and Christopher A. Poirier; This compendium will be included in the publication, Annotations to Surplus Lines Statutes by the Excess, Surplus Lines and Reinsurance Committee of the Tort Trial and Insurance Practice Section of the American Bar Association; The research and compilation were closed July 2009.

**NEW PERSPECTIVES ON REINSURANCE COLLATERAL  
REQUIREMENTS**

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After years of discussion and different iterations, in December 2008, the National Association of Insurance Commissioners ("NAIC") adopted the Reinsurance Regulatory Modernization Framework (the "Framework"). This Framework would modernize and dramatically alter the current state-based regulation of reinsurance. Since the conceptual framework requires federal legislation to implement its objectives, the Reinsurance Task Force (the "Task Force") of the NAIC issued an exposure draft of proposed federal legislation on March 24, 2009. The Reinsurance Regulatory Modernization Act of 2009 (the "Modernization Act") has since been subject to significant public comment. On July 27, 2009, the Task Force exposed a revised draft of the Modernization Act for further public comment, after incorporating and addressing a number of the comments it received. Additional comments were due by August 17, 2009.

**Background**

Under current United States credit for reinsurance rules, insurers are permitted to take credit on their financial statements for the reinsurance they cede, if the assuming reinsurer is authorized or accredited in the state of the ceding insurer. If the reinsurer is not authorized or accredited, it is unauthorized and is required to post appropriate collateral equal to 100% of its gross actuarially estimated reinsurance liabilities. State authorization or accreditation of a reinsurer requires an application process and subjects the reinsurer to the state's jurisdiction and some of its laws and regulations. Many insurers do not wish to be subject to this process and these requirements for a variety of reasons, including tax consequences applicable to certain alien reinsurers.

Alien reinsurers have particularly denounced these collateral requirements, arguing that they tie up capital, create significant costs for doing business in the United States, and place them at a disadvantage against their United States competitors, who are not necessarily burdened by the same requirements in non-U.S. jurisdictions. Some alien insurers and reinsurers operate through United States subsidiaries in order to avoid these onerous requirements. Critics of the current system also argue that restricting availability of capital from alien reinsurers limits competition. Of course, this could theoretically affect pricing for reinsurance.

Some insurers are in favor of keeping the current credit for reinsurance rules because the required posting of collateral provides security to the ceding insurer. If the reinsurer is not required to post collateral, solvency issues related to the collection of reinsurance recoverables would be implicated and, at the least, it is feared that collection could be compromised by shifting negotiating leverage to the benefit of the reinsurer, especially if the reinsurer is located in a foreign country.

Another issue involves the equities of the requirement to post collateral. Alien reinsurers are not necessarily subject to United States tax laws, which are generally imposed on U.S. domiciled reinsurers. This tax insulation has been used as partial justification that it is fair to impose collateral requirements on alien

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reinsurers. To the extent alien reinsurers are not required to post collateral to engage in reinsurance in the United States, some domestic insurers argue this, along with the continuation of the tax exemption, will provide the alien reinsurers with an unfair competitive advantage.

## Summary of Proposal

The United States, which is the largest reinsurance market in the world, is the only major market that imposes such collateral rules. Some in the insurance industry believe the time is ripe for change. In 2007, the NAIC charged the Task Force with the responsibility of considering alternatives to the current regulatory framework which provides credit for reinsurance. Specifically, the Task Force was asked to develop methods of assessing the strength of reinsurers, regardless of their state or country of domicile. Subsequently, the Task Force studied and considered a ratings-based system that would serve to supplement or replace current collateral requirements for foreign and alien reinsurers. Under a ratings-based system, a regulatory system would be established that would require the reinsurer to post collateral based on the financial strength of a reinsurer, the depth and quality of regulatory oversight of the reinsurer's state or country of domicile, and a variety of other factors.

The following is a brief summary of select provisions of the July 27, 2009 revised draft of the Modernization Act.

The Modernization Act proposed by the NAIC establishes two types of reinsurers in the United States: U.S. domiciled reinsurers, called "National Reinsurers," and non-U.S. reinsurers, called Port of Entry ("POE") Reinsurers ("POE Reinsurers").<sup>1</sup> Each type of reinsurer would be supervised by a single state: either the home state (where the National Reinsurer is licensed and domiciled) or the POE state (where a non-U.S. assuming reinsurer is certified to provide creditable reinsurance to ceding insurers).<sup>2</sup>

The Modernization Act establishes the Reinsurance Supervision Review Board (the "Board"), comprised of ten insurance regulators and five representatives of U.S. agencies as appointed by the President and with the advice and consent of the Senate.<sup>3</sup> The Board would have the authority to evaluate the regulatory systems of the states to determine if they qualify as home states and/or POE state supervisors.<sup>4</sup> The Board also has authority to evaluate reinsurance supervisory systems of non-U.S. jurisdictions to determine if they are eligible as a qualified jurisdiction under NAIC standards.<sup>5</sup> The Board would also have the authority to enter into agreements with state, federal, and non-supervisory and law enforcement agencies for sharing supervisory information on a confidential basis.<sup>6</sup>

The Modernization Act would authorize a certification mechanism allowing states demonstrating requisite resources, expertise, and experience to regulate reinsurers on a cross-border basis to serve as the home state for U.S. domiciled reinsurers or POE state for non-U.S. reinsurers.<sup>7</sup> POE state supervisors would be authorized by the Modernization Act to enter into reciprocal recognition agreements.<sup>8</sup> Additionally, a POE state would be authorized to enter into information sharing agreements with qualified non-U.S. jurisdictions, in accordance with NAIC standards and procedures adopted by the Board.<sup>9</sup> This authorization is intended to eliminate constitutional concerns about possible violations of the Compact Clause of the U.S. Constitution, which prohibits states from entering into "any Agreement or Compact with another State, or with a foreign Power," without the consent of Congress.<sup>10</sup>

Under the Framework and Modernization Act, reinsurers would be required to have at least \$250 million in capital and surplus for eligibility as either a National Reinsurer or POE Reinsurer.<sup>11</sup> This surplus requirement could be satisfied by a group including a number of underwriters having the required capital and surplus and a central fund of at least \$250 million.<sup>12</sup> In order to be certified as a POE Reinsurer, a company would be required to be organized in and licensed by an eligible non-U.S. jurisdiction.<sup>13</sup> The Board would determine eligibility of non-U.S. jurisdictions.

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Credit for reinsurance ceded by a domiciled insurer to a National Reinsurer or a POE Reinsurer would be granted in accordance with the standards set forth in the Framework and Modernization Act.<sup>14</sup> The amount of collateral a reinsurer would be required to post under the Framework would be based on an evaluation by its home state or POE state supervisor, as applicable. These supervisors would utilize standards recommended by the NAIC and adopted by the Board to determine the rating (financial strength) of a reinsurer. Ultimately, the supervisor would assign a reinsurer one of five ratings regarding the financial strength of the reinsurer. These ratings range from various levels of "secure," which would require the posting of no or staggered percentages of collateral, to "vulnerable," which would require the posting of 100% collateral.<sup>15</sup>

A home state or POE state supervisor would utilize Board approved standards which would include, among others, such considerations as:

- Financial strength ratings from at least two qualified rating agencies;
- Compliance with reinsurance contracts;
- The business practice of the reinsurer in dealing with its ceding insurers;
- For National Reinsurers, a review of the most recent NAIC Annual Statement;
- For POE Reinsurers, a review of a report filed annually in the form of the applicable NAIC Annual Statement Blank;
- The reinsurer's reputation for prompt payment of claims;
- Regulatory actions against the reinsurer;
- Report by an independent auditor on the reinsurer's financial statements;
- For POE Reinsurers, audited financial statements, regulatory filings, and actuarial opinions;
- The liquidation priority of obligations to a ceding insurer;
- A reinsurer's participation in any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers; and
- Any other information deemed relevant by the home state or POE state supervisor.<sup>16</sup>

Under the Framework, insurers providing reinsurance who do not choose to become National Reinsurers or POE Reinsurers would have the option of continuing to operate under the current Credit for Reinsurance Model Law, which requires the posting of 100% collateral for the reinsurer's obligations, unless the reinsurer is authorized or accredited in the applicable state.<sup>17</sup>

## Ongoing Comments

The industry and other interested parties submitted a substantial number of comments to the first draft of the Modernization Act. The Modernization Act provides for different standards pertaining to the amount of collateral which must be posted by a reinsurer depending upon whether that reinsurer is a National reinsurer or POE Reinsurer. The higher rated classes of "secure" National reinsurers will not be required to post collateral, whereas those same classes of "secure" POE Reinsurers will be required to post collateral. Some have commented that the Modernization Act would afford preferential treatment to U.S. reinsurers.

Some comments focused upon possible constitutional issues related to the Modernization Act. Some interests expressed concerns with regard to the constitutionality of states entering into agreements with non-U.S. jurisdictions. Furthermore, others expressed concern that the delegation of authority to the Board would constitute an improper delegation of legislative and executive power to a private institution without federal oversight. Another constitutional argument centered upon the assertion that since Congress does not have the authority to command state action, provisions in the Modernization Act requiring state supervisors to take action with regard to capital and surplus, financial statements, and security requirements may be construed as a violation of the Constitution.

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Others expressed a more basic concern that the elimination of collateral with regard to reinsurance obligations could impair the ability of ceding insurers to collect reinsurance proceeds thereby impairing some ceding insurers who often rely on the reinsurance collateral as a security bedrock in their operations. It was pointed out by one industry association that the Oversight and Investigations subcommittee of the U.S. House Energy and Commerce Committee had concluded that the inability of U.S. insurers to collect reinsurance payments from alien reinsurers was a critical factor in the U.S. insurer insolvencies in the 1980s. This association noted that since the subsequent enactment of the credit for reinsurance laws, the failure to collect reinsurance recoverables has not been a critical factor in any U.S. insolvencies.

## Specific State Action

Some states have decided to take action without waiting for a resolution of the issue by the NAIC and the Federal Government. For example, on September 16, 2008, Florida adopted a new regulation that authorizes the Insurance Commissioner to establish lower collateral requirements for unauthorized and unaccredited foreign and alien reinsurers that have financially secure ratings from at least two nationally recognized rating organizations and meet certain eligibility standards, such as maintaining surplus over \$100 million and being authorized in their domiciliary jurisdiction for the types of insurance to be ceded.<sup>18</sup> After eligibility is determined, the amount of collateral the reinsurer is required to post is determined by the Rule, which contains a schedule. The higher a reinsurer's financial strength rating, the less collateral the reinsurer is required to post. Florida's ratings-based collateral rule applies only to reinsurance ceded by Florida domestic property and casualty insurers.

On December 24, 2008, the New York State Insurance Department (the "Department") published its proposed tenth amendment to a regulation relating to the ratings-based reinsurance collateral issue.<sup>19</sup> Although similar to the NAIC proposal, the New York regulation applies only to non- U.S. reinsurers. Like the Florida rule, the New York regulation sets collateral based on reinsurer financial strength ratings from at least two recognized rating agencies; however, it requires the unauthorized assuming reinsurer to maintain a minimum net worth of \$250 million and to be authorized by, and meet solvency and capital standards of, its domiciliary jurisdiction. The highest rated reinsurers would not be required to post any collateral, while lower rated reinsurers would be required to post collateral ranging from 10% to 100% of their reinsurance obligations. Although the New York regulation was originally set to be effective July 1, 2009, the Department has advised that it is in the process of reviewing and evaluating public comments and does not expect the regulation to take effect prior to January 1, 2010.

## Conclusion

The issues raised with regard to the efforts to modernize the collateral requirements obligation under reinsurance contracts and the numerous comments which have been submitted to the NAIC by the industry and the other interested parties evidence the significance of the subject to the industry. It is expected that significant discussion will continue on the Modernization Act and that the Task Force will need to further revise the Modernization Act. At the time this article was prepared, the Task Force had just released its most recently revised exposure draft of the Modernization Act. The Task Force has indicated that it is accepting further comments to the exposure draft and will announce plans for future discussion.

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## Endnotes

1. The Reinsurance Regulatory Modernization Act of 2009 § 2 (The National Association of Insurance Commissioners Tentative Revised Draft July 27, 2009) (hereinafter Modernization Act).

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2. *Id.* §§ 4, 10(10), (18).
  3. *Id.* § 2.
  4. *Id.* § 2(a).
  5. *Id.* § 2(b).
  6. Modernization Act, *supra* note 1, § 2(d).
  7. *Id.* § 4.
  8. *Id.* § 4(h).
  9. *Id.* § 2(c).
  10. U.S. Const. art. 1, § 10, cl. 3.
  11. Modernization Act, *supra* note 1, § 5(a).
  12. *Id.*
  13. *Id.* § 10(17).
  14. *Id.* § 5(b).
  15. *Id.*
  16. Modernization Act, *supra* note 1, § 5(b)(4)(A)-(L).
  17. *See id.* § 6.
  18. Fla. Stat. § 624.610 (2007); Fla. Admin. Code Ann. r. 69O-144.007.
  19. Tenth Amendment to N.Y. Comp. Codes R. & Regs. tit. 11, § 125 (Regulation No. 20).
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