DODD-FRANK ACT – NRRA EFFECTIVE TODAY, JULY 21, 2011 – IMPACT ON U.S. CEDING INSURERS

July 21, 2011

To Our Clients and Friends:

Today is July 21, 2011, the effective date for important preemption provisions affecting reinsurance ceded by U.S. ceding insurers contained in the Nonadmitted Insurance and Reinsurance Reform Act of 2010 (the "NRRA"), part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The purpose of this client update is to review these preemption provisions and their impact and actions taken by states to date acknowledging their impact.

NRRA § 531

There are two important preemption provisions in the NRRA that relate to ceded reinsurance – NRRA § 531(a) relating to nondomestic state reinsurance credit rules and NRRA § 531(b)(4) relating to application of state laws to reinsurance agreements of a nondomestic ceding insurer.

Reinsurance Credit

NRRA § 531(a) (15 U.S.C. § 8221(a)) provides that if a ceding insurer's domestic state (i) is NAIC-accredited (or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation), and (ii) recognizes credit for reinsurance for the ceding insurer's ceded risk, then no nondomestic state may deny such reinsurance credit. While this preemption is effective July 21, 2011, it applies without reference to any time period. Therefore, it applies to all reinsurance agreements entered into by a U.S. ceding insurer, whether entered into or effective before, on or after July 21, 2011. However, this preemption merely preempts nondomestic state reinsurance credit rules – it does not change the substantive terms of any existing or new reinsurance agreement which may impose requirements greater than those required under state law (as preempted by NRRA § 531(a)).

Other State Laws

NRRA § 531(b)(4) (15 U.S.C. § 8221(b)(4)) provides that all laws, regulations, provisions, or other actions of a ceding insurer's nondomestic state (except those with respect to taxes and assessments on insurers or insurance income) are preempted to the extent that they otherwise apply the laws of the state to reinsurance agreements of nondomestic ceding insurers. In our view, this provision preempts nondomestic states' laws that require filing

and/or approval of reinsurance agreements by U.S. ceding insurers in nondomestic states. Therefore, if a U.S. ceding insurer enters into a reinsurance agreement on or after July 21, 2011 that is subject to filing and/or approval in a nondomestic state, then NRRA § 531(b)(4) preempts that nondomestic state filing and/or approval requirement. As such, the only applicable filing and/or approval requirements that will apply to a reinsurance agreement entered into by a U.S. ceding insurer on or after July 21, 2011 will be those of the ceding insurer's domestic state.

STATE ACTIONS ACKNOWLEDGING THE IMPACT OF NRRA § 531

So far, two states, California and New York, have taken actions that acknowledge the impact of NRRA § 531 on their state insurance laws and regulations.

California

The California Department of Insurance issued Bulletin No. 2011-2 dated April 11, 2011 in which the Department informed licensed insurers of its initial response to NRRA § 531. This initial response includes the following pronouncements:

Reinsurance Credit Rules. The California Department will not deny credit for reinsurance ceded by a nondomestic ceding insurer that has been recognized by the ceding insurer's domestic state insurance regulator. This includes compliance with California's reinsurance collateral requirements, risk transfer rules and required contract requirements (CIC § 922.6 and 10 CCR §§ 2303.10, 2303.11, 2303.12 and 2303.13).

Reinsurance Filing and/or Approval Requirements. The following California reinsurance agreement filing and/or approval requirements will not apply to a nondomestic insurer:

- Reinsurance agreements under which the ceding insurer cedes 75% or more of its total premium or total liabilities – so-called "1011(c)" filings (CIC § 1011(c) and 10 CCR § 2303.15(c)-(f)). However, Bulletin No. 2011-2 states that CIC § 1011(c) will continue to apply to mergers, consolidations and "sale" transactions entered into by a nondomestic insurer. We understand a "sale" transaction to have the meaning in 10 CCR 2303.15(c)(3), namely assumption reinsurance. Therefore, the California Department seems to be taking

the position that the NRRA § 533(4) definition of "reinsurance"[1] does not include assumption reinsurance and the preemptive effect of NRRA § 531(b)(4) will not extend to assumption reinsurance entered into by a nondomestic insurer.

- Reinsurance agreements under which the ceding insurer cedes 50% or more of its total premium or total liabilities (CIC § 730 and 10 CCR § 2303.15(g)). Interestingly, the California Department also announced that no domestic insurer would be required to make a filing of this kind of reinsurance agreement.
- Certain material affiliate reinsurance agreements entered into by a nondomestic insurer that is a "commercially domiciled insurer" in California (CIC § 1215.5(b)(3)).

10% Retention Requirement. The California rule that a domestic insurer and a nondomestic "volume insurer" retain at least 10% of direct premiums written per line of business will no longer be applied to a nondomestic insurer (CIC § 717(d) and 10 CCR § 2303.15(b)). A similar California rule that the California Commissioner's consent to a cession of 100% of direct written premium on prospective business to an inter-company pool will be conditioned on the reinsurance agreement providing a retrocession to the ceding insurer of an amount not less than 10% of its direct written premium will no longer be applied to a non-domestic insurer (CIC § 1011(c) and 10 CCR § 2303.15(f)).

Effective Date. These revised California rules became effective July 1, 2011. Therefore, reinsurance transactions executed prior to July 1, 2011 remained subject to all pre-July 1, 2011 California standards and prior approval requirements. Financial statement credit for ceded reinsurance taken on a financial statement with an "as of" date on or before June 30, 2011 was also subject to pre-July 1, 2011 California law.

New York

On November 22, 2010, the New York Insurance Department promulgated the 10th Amendment to its Regulation 20 (Credit for Reinsurance) effective January 1, 2011. In addition to introducing risk-based collateral in New York, new 11 N.Y.C.R.R. § 125.1 makes the application of Regulation 20 consistent with NRRA § 531(a) as follows:

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[1] *NRRA § 533(4) (15 U.S.C. § 8223(4)) defines "reinsurance" to mean "the assumption by an insurer of all or part of a risk undertaken originally by another insurer."*

> This Part [Regulation 20] shall apply to insurers authorized to do business in this State, provided that where the state of domicile of a foreign ceding insurer is an NAIC-accredited state, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then the foreign ceding insurer may take credit for the reinsurance.

As a result of this change, New York has already acknowledged the preemption effect of NRRA § 531(a) on the credit for reinsurance rules set out in Regulation 20 effective January 1, 2011. Since Regulation 20 incorporates by reference the conditions to permissible reinsurance letters of credit (Regulation 133) and assets deposited in a single beneficiary reinsurance trust (Regulation 114) in 11 N.Y.C.R.R. § 125.6(b)(2) and (b)(3), we believe that, effective January 1, 2011, those standards do not apply to a nondomestic insurer that is domiciled in an NAIC-accredited state which recognizes credit for reinsurance for the insurer's ceded risk. However, New York Department has not formally amended its Regulation 102 relating to risk transfer and other conditions to life reinsurance credit to acknowledge the preemptive effect of NRRA § 531(a). Nevertheless, the Regulation 102 reinsurance credit rules are similarly subject to preemption under NRRA § 531(a) effective July 21, 2011 subject to the conditions in NRRA § 531(a).

The New York Department has to date taken no action to publicly acknowledge the effect of NRRA § 531(b)(4) on any reinsurance filing and/or approval requirements applicable to nondomestic insurers. These requirements include (i) New York Insurance Law § 1308(f)(1)(B) (100% cession of a New York life, health or annuity risks by a nondomestic insurer), (ii) New York Insurance Law § 1505(d)(2) (any affiliate reinsurance if the nondomestic life insurer is a "commercially-domiciled" insurer in New York), and (iii) Regulation 102 (11 N.Y.C.R.R. § 127.2(c)) (cession of in-force life, health and annuity risks by a nondomestic insurer).

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If you would like more information on these or other topics of interest, please contact the undersigned or any insurance industry lawyer at Debevoise & Plimpton LLP.

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