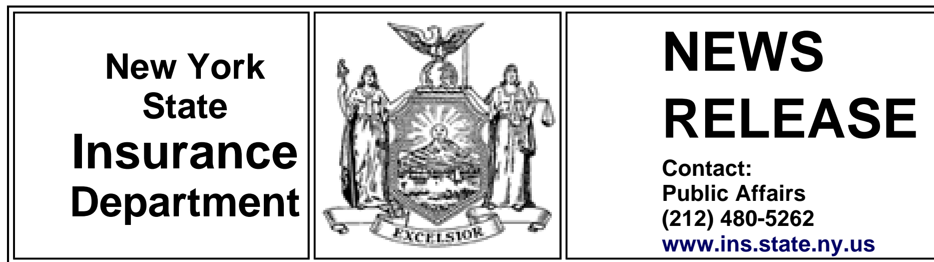

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NEW YORK MODERNIZES REGULATION ON REINSURANCE COLLATERAL

The highest rated U.S. and non-U.S. reinsurance companies not authorized or accredited to do business in New York will be treated the same as New York reinsurance companies as the result of a regulation on collateral requirements proposed today by the New York State Insurance Department, Insurance Superintendent Eric Dinallo announced.

“There is a growing need for reinsurance in the New York to deal with risks from terrorism and from natural catastrophes such as hurricanes. We cannot afford to maintain outdated and unnecessary standards for the international market for reinsurance. This new regulation recognizes the reality of global markets and frees up capital, which will increase capacity in the reinsurance market. It will help attract more capital to the New York reinsurance market, which should help lower costs and benefit consumers and businesses purchasing insurance,” Dinallo said.

“Principles-based regulation recognizes that different reinsurers have differing likelihoods of defaulting on their obligations based more on financial strength than home address,” Dinallo said. “New York’s current regulation requires a strongly capitalized non-New York reinsurer to tie up capital by posting collateral while not imposing a similar burden on a New York reinsurer. This rule was designed to protect consumers on the rare occasions when an insurance company fails. Now, instead of imposing this costly standard in the 99 percent of cases when it is not needed, we will impose it only when it is required to protect consumers.”

Currently, any U.S. or non-U.S. reinsurance company that is not authorized or accredited to operate in New York must post collateral equal to 100 percent of its share of policyholder claims. This is the case even if the non-New York company has a top credit rating and is financially strong. This requirement reduces the amount of reinsurance a reinsurer can offer. It also imposes the cost of posting the collateral. Companies authorized in New York, even if they are financially weaker, have no such requirement.

Under the new regulation, well-capitalized reinsurance companies with the highest credit rating that are not authorized or accredited to do business in New York will be treated the same as authorized companies: They will no longer have to post any collateral. Companies that are not as strong will have to post collateral on a sliding scale from 10 percent to 100 percent. This would apply to both U.S. and non-U.S. reinsurers not authorized or accredited in New York.

Reinsurance is insurance for insurance companies. It is a means of redistributing risk

throughout the global insurance industry. An insurance company covering homeowners on Long Island, for example, will transfer or "cede" part or all of that risk to another party, called the assuming insurer or reinsurer.

The reinsurer then is ultimately responsible for paying its part of those ceded claims. The primary insurer or "cedent" is given credit on its balance sheet for the business ceded to a reinsurer recognized by New York. This allows the cedent to reduce its reserves and increase the number of policies it can write.

However, the ability to take a credit for ceded claims does not currently apply when the reinsurer is not authorized by New York, regardless of its financial strength, unless the reinsurer posts collateral equal to 100 percent of the transferred policyholder claims. Foreign reinsurers had an estimated $120 billion in collateral posted in the U.S. in 2005, the latest year for which we have data, on which they pay about $500 million a year in transaction costs.

Adoption of the New York regulation will reduce this transactional cost and increase reinsurance capacity. It will also bring New York in line with global insurance markets and worldwide accounting standards governing reinsurance contracts. Most jurisdictions do not require collateral from non-domestic reinsurers for their insurers to get credit.

"Principles-based regulation requires aligning regulatory compliance with business goals while protecting consumers," Dinallo said. "The goal here is an effective, efficient reinsurance industry that will maximize the capital available to insurers and help insurers meet consumer needs."

"In these business-to-business transactions, we are moving to let the market decide. We are no longer requiring by regulation that strong reinsurance companies put up collateral. But nothing prevents insurance companies from negotiating their own collateral requirements or from choosing to do business with reinsurers who are willing to put up collateral, if that is what the insurance company prefers," Dinallo said.

In addition, for dealings with domestic reinsurers that now do not have to provide collateral, the regulation imposes principles-based credit risk management on the primary insurers. These ceding companies will now have full responsibility for credit risk management and compliance.

"This risk-focused approach means principles-based regulation is being applied to all reinsurers," Dinallo said. "This levels the playing field and mitigates risk that may exist under the present regulatory structure. It also continues our efforts to keep New York competitive while bringing the U.S. into the 21st Century of financial services regulation."

The Insurance Department is conducting outreach by circulating a working draft of the proposed regulation to the insurance industry and consumers. It will then go through the formal proposal process, which includes publication in the New York State Register and a formal 45-day comment period for written comments. The regulations would take effect July 1, 2008 for all reinsurance contracts made on and after that date.

Key Points in the New Regulation

- Unauthorized or unaccredited reinsurers with a triple A credit rating from two rating companies would have to post no collateral. Those with a double A or

equivalent rating would have to post collateral equal to 10 percent of claims, single A 20 percent, triple B 50 percent. Reinsurers with a rating below triple B would still be required to post 100 percent.

- In addition to the credit rating, to qualify for the no or reduced collateral treatment, the reinsurer must:

  o Meet the standards of solvency, including standards for capital adequacy, established by its domestic regulator.

  o Be authorized in its domiciliary jurisdiction to assume the specific kind of reinsurance it is offering.

  o Maintain a policyholder's surplus or equivalent in excess of $250,000,000.

  o Accept required contract terms, including consent to the jurisdiction of U.S. courts for disputes.

  o Have a primary regulator that has a memorandum of understanding with the New York Insurance Department that addresses information sharing and considers such matters as regulatory equivalency and enforceability of judgments.

  o Be domiciled in a country that allows U.S. reinsurers access to its market on similar terms.

- All unauthorized and unaccredited reinsurers will be required to post 100 percent collateral upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurance company.
- Collateral requirements will not change for authorized reinsurers; they will still not be required to post any collateral. However, new safeguards will be put in place to help ensure the ability of these reinsurers to cover claims and thus protect consumers.
- Insurance companies ceding risk to reinsurers have responsibility for vetting those reinsurers and developing risk management plans for their reinsurance placements.
- The Superintendent of Insurance will retain final authority over any particular transaction.

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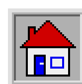

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