INSURANCE

DEPARTMENT OF BANKING AND INSURANCE

OFFICE OF SOLVENCY REGULATION

Credit for Reinsurance

Adopted New Rules: N.J.A.C. 11:2-28.7A through 28.7D, 28.14, and 11:2-28 Appendix Exhibits A through E

Adopted Amendments: N.J.A.C. 11:2-28.4, 28.6, 28.8, 28.9, 28.10, and 28.12

Adopted Repeal and New Rule: N.J.A.C. 11:2-28.13

Proposed: February 21, 2012 at 44 N.J.R. 360(a).

Adopted: August 6, 2012 by Kenneth E. Kobylowski, Acting Commissioner, Department of Banking and Insurance.

Filed: August 7, 2012 as R.2012 d.154, **with a substantial change** not requiring additional public notice and comment (see N.J.A.C. 1:30-6.3).

Authority: N.J.S.A. 17:1-8.1, 17:1-15.e, and 17:51B-1 et seq.

Effective Date: September 4, 2012.

Expiration Date: January 6, 2018.

Summary of Public Comments and Agency Responses:

The Department of Banking and Insurance (Department) timely received written comments from:

1. Lloyd's of London;
2. The Reinsurance Association of America;
3. The ACE Group;
4. Wolters Kluwer Financial Services;

5. The Insurance Council of New Jersey; and

6. Prudential Financial, Inc.

COMMENT: Several commenters supported the proposed new rules and amendments, and their being based on recent changes adopted by the National Association of Insurance Commissioners (NAIC) to its Model Credit for Reinsurance Regulation. The commenters urged the Department not to accept any revisions that would cause New Jersey's credit for reinsurance rules to deviate from the revised Model, which was subject to extensive review and consideration by regulators and interested parties at the NAIC. The commenters also noted that the revised Model represents a compromise negotiated by all interested parties and regulators, cedents, and their respective trade associations in an effort to resolve issues and help allay some of the concerns on developing a viable uniform regulatory approach capable of operating effectively in an international regulatory framework.

RESPONSE: The Department appreciates the support of its proposal.

COMMENT: One commenter noted that the proposal adds a new N.J.A.C. 11:2-28.13 governing suspension or revocation of accreditation or certification. The commenter also noted that the existing rules contain N.J.A.C. 11:2-28.13, which provides for the effective date of the existing rules and the contracts affected thereby. The commenter stated that existing N.J.A.C. 11:2-28.13 has not been recodified or repealed.

RESPONSE: The Department agrees that this is a technical error. This section should have been repealed as part of the original proposal. The Department has determined existing N.J.A.C. 11:2-28.13, which provides an effective date of the rules when they were originally adopted in 1993, is no longer necessary. Accordingly, the Department is repealing existing N.J.A.C. 11:2-28.13 upon adoption. This change may be made upon adoption as it does not affect the scope of the rules nor add or reduce any requirements. This section relates to the effective date of the rules when they were originally adopted and has no present applicability.

COMMENT: One commenter expressed concern with N.J.A.C. 11:2-28.7A(d), which eliminates the requirement that a certified reinsurer post security for catastrophe recoverables for a one-year period from the date of the first instance of a liability reserve entry by the ceding company. The applicability of the one-year deferral period is contingent upon the certified reinsurer continuing to pay claims in a timely manner. The commenter suggested that additional language be included to clearly state that the ceding insurer shall have full credit for such recoverables during the one-year period. In addition, the commenter believed that the rule is vague because it makes the one-year deferral period contingent on a certified reinsurer paying claims “in a timely manner.” The commenter recommended that this provision be clarified to provide that the deferral is contingent on the certified reinsurer continuing to pay claims “in compliance with its contractual obligations as set forth in the reinsurance agreement under which the claims are ceded.” The commenter believed that this would set out a specific, measurable condition where the catastrophe loss deferral will be negated if a certified reinsurer fails to pay catastrophe claims in accordance with the terms and conditions of its contract with the ceding company.

The commenter also questioned providing a mandatory one-year deferral period in the rule. The commenter recommended that the Commissioner of Banking and Insurance (Commissioner) be provided discretion by changing the word "shall" to the word "may." The commenter stated that the NAIC appears to recognize that the catastrophe one-year deferral period may have a disparate impact on ceding companies and thus provided the Commissioner with discretion to enact the deferral period. The commenter noted that in the recent exposure draft published by the NAIC Reinsurance Task Force, the one-year deferral period is not included as a mandatory provision in order for a state to gain NAIC accreditation. Rather, the NAIC cautions that when a state adopts the deferral, it shall not exceed one year.

Another commenter strongly supported the language in N.J.A.C. 11:2-28.7A(d) as proposed. The commenter stated that this subsection, which reflects the language contained in the NAIC Model, represents a concession made by non-admitted reinsurers, who preferred the two-year deferral period originally contained in the Model. This commenter also did not believe that the rule eliminates the Commissioner's discretion in this area, as the enabling statute vests the Commissioner with complete discretion with regard to all decisions as to whether to reduce or eliminate collateral requirements for qualified reinsurers.

RESPONSE: Upon review, the Department has determined not to change this provision. The Department notes that, with respect to all of the concerns expressed regarding the new rules, the proposed new rules implement changes to the statute governing credit for reinsurance at N.J.S.A. 17:51B-2.f. This statute provides an additional means by which ceding companies may receive credit for business ceded to reinsurers that do not otherwise meet the requirements set forth in the statute or rules, without the reinsurer being required in all cases to post 100 percent collateral for

the amount ceded. The standards in the proposed amendments and new rules reflect the national standard as adopted by the NAIC. As some of the commenters noted, the standards adopted by the NAIC were extensively debated and reviewed. Numerous comments from both regulators and interested parties, including ceding insurers, were reviewed and considered before the changes were ultimately adopted by the member commissioners of the NAIC. In addition, it should be noted that the new rules do not require a ceding insurer to cede business to a certified reinsurer. Ceding insurers are free to contract with any reinsurer they choose and receive credit for reinsurance ceded in accordance with the standards set forth in applicable statutes and rules.

With respect to the suggestion that additional language be added to provide that the insurer shall have full credit for such recoverables during the one-year period, the Department does not believe that such a provision is needed. The rule, by its terms, provides for this, so long as the reinsurer pays claims in a timely manner during the one-year deferral period.

With respect to the specific concern regarding the one-year deferral period for posting security for a catastrophic occurrence, provided that the certified reinsurer is continuing to pay claims in a timely manner, the Department notes that this provision applies to those reinsurers already certified. Moreover, the Department does not believe that the rule is vague. This reflects the national standard as adopted by the NAIC Model. In addition, the language suggested by the commenter that the reinsurer must continue to pay claims "in compliance with its contractual obligations as set forth in the reinsurance agreement under which the claims were ceded" would be redundant. Failure to pay claims in accordance with the terms or conditions of its contract with the ceding company would constitute failure to pay claims in a timely manner. However, the language in the rules goes further than the commenter requested by giving the Commissioner the authority to evaluate the totality of the circumstances to ensure that the certified reinsurer is

paying claims in a timely manner and, consequently, the one-year deferral of the requirement that it post security for catastrophic occurrences should continue.

The Department also does not agree that the rule should be changed to provide that the Commissioner "may" provide the one-year deferral. The commenter suggested no standards on which the Commissioner would base such a determination on whether to grant the deferral. In addition, as noted previously, the rule as drafted reflects the national standard adopted by the NAIC. The fact that various exposure drafts by the NAIC may have provided different language is not dispositive of the issue. The Department is utilizing the language as ultimately adopted by the NAIC. The Department also notes that, with respect to the comment that the enabling statute vests the Commissioner with complete discretion with regard to all decisions as to whether to reduce or eliminate collateral requirements for qualified reinsurers, this discretion is exercised in accordance with the standards set forth in the new rules.

COMMENT: One commenter expressed the following concerns with respect to N.J.A.C. 11:2-28.7A(d): (1) the appropriateness of deferrals for Level 5 and vulnerable Level 6 Reinsurers; (2) the term "catastrophic occurrence" is not defined in the proposed amendments; and (3) no process is identified for the Commissioner to follow in order to "recognize" a catastrophic occurrence. The commenter stated that this subsection creates an exception to the general security loss provisions and requires that the Commissioner give certified reinsurers a one-year deferral from posting any security for catastrophe losses that are owed to a ceding insurer. The commenter believed that, as currently worded, weakly capitalized reinsurers will be required to receive deferrals. The commenter stated that this is because the security deferral will apply to all certified reinsurers, even to those with a financial strength rating of "Secure-5" or "Vulnerable-

6" from rating agencies and so designated by the Commissioner. The commenter questioned how granting a catastrophe security loss deferral to certified reinsurers holding those ratings is in the public interest. The commenter suggested as an alternative that the catastrophe security loss deferral provision be modified so that the Commissioner may only permit the deferral for certified reinsurers to which the Commissioner has "assigned a rating of Secure-1, Secure-2, Secure-3 or Secure-4." In addition, the commenter believed that it would be helpful if the term "catastrophic occurrence" were further defined and for the process that the Commissioner will use to make such a determination to be identified in the rules.

Another commenter expressly stated that there is no reason why the deferral provisions of N.J.A.C. 11:2-28.7A(d) should not apply to reinsurers qualified at Secure Levels 5 and 6. The commenter stated that the key to the deferral is whether or not the reinsurer is paying claims in a timely fashion at the time the obligation accrues. The commenter believed that the level at which the reinsurer has been qualified is irrelevant. The commenter also noted that this was an issue that was debated at the NAIC, which adopted the current approach. The commenter also stated that the rule as proposed vests the Commissioner with the discretion to determine what constitutes a catastrophic occurrence as well as the process to follow in order to recognize a catastrophic occurrence, and should be adopted as drafted.

RESPONSE: Upon review, the Department has determined not to change this provision. The Department notes that the provision reflects the National Standard as adopted by the NAIC. As noted previously, ceding companies are under no obligation to utilize certified reinsurers in general, or any particular certified reinsurer. In addition, ceding companies may request additional contractual guarantees or security be posted by a certified reinsurer as they deem

appropriate. The Department believes that adopting uniform national standards by which alien insurers may be certified as reinsurers, with specific collateral requirements based on the reinsurer's financial strength rating and the regulatory structure in its domiciliary jurisdiction, is in the public interest. The rules will provide an expanded reinsurance market that permits additional well-capitalized companies to provide reinsurance to New Jersey-domiciled ceding insurers. For these reasons, the Department does not agree that the deferral should be limited as one commenter suggested.

With respect to the comment that the term "catastrophic occurrence" should be defined, the Department notes that this term is usually undefined and that it would be very difficult to prospectively provide a definition that would apply in all cases. For example, an automobile could be destroyed in a hurricane. Whether that loss would be considered a catastrophic loss because it was due to the hurricane or just a standard automobile physical damage loss would depend on the totality of the circumstances. Similarly, the process to be utilized to determine a "catastrophic occurrence" would be an evaluation of all relevant facts regarding the specific event, including, but not limited to, any pronouncements by government agencies and insurance industry organizations such as the Insurance Services Organization Property-Claims Service and the Insurance Information Institute.

COMMENT: One commenter expressed concern with N.J.A.C. 11:2-28.7A(e), which provides that credit for reinsurance shall apply to reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer, and other modifying language, centered around the effective date of the certification of the assuming insurer. The commenter stated that the enabling statute, N.J.S.A. 17:51B-2.f, specifies that its provisions "shall apply

only to reinsurance contracts entered into or renewed on or after the effective date of P.L.2011, c. 39, except that the provisions applicable to life reinsurance contracts shall not become effective until the earlier of 24 months from the effective date of [the statute], or the implementation of principles-based standards for life insurance reserving by the National Association of Insurance Commissioners." The commenter believed that the language in the rule should mirror the language in the statute. By referring to amendments to reinsurance contracts which predate the effective date of the statute, the commenter questioned whether the Department has unintentionally exceeded its authority by potentially subjecting those reinsurance contracts to the reduced collateral requirements. The commenter stated that while the intent of the language may have been to clarify the prospective impact of the statute, it may have the opposite effect. The commenter cited the following example: a ceding company has a claim free reinsurance contract which incepts in 1972 and terminates in 1973. The reinsurance contract is then amended for any reason in 2013 (for example, an amendment to recognize new contact and address information for loss notices or intermediary name), after the reinsurer becomes certified, and the ceding company then incurs a latent tort loss in 2015 under the reinsurance contract. The commenter stated that under the proposed rule, the latent tort loss would be subject to the reduced collateral provisions since the "loss was incurred and reserves were reported after the effective date of the amendment" of the reinsurance contract. The ceding company is without the collateral negotiated and paid for when it placed the contract in 1972.

Another commenter agreed that the language of the rule should reflect the statute. This commenter recommended that this sentence be eliminated and that the provision be limited to the language contained in the first sentence of that section, which would be consistent with the provisions of the enabling statute. The commenter, however, rejected any suggestion that the

current language of the rule, or any provision of the enabling statute or Model, would impose a collateral reduction on a ceding company by operation of law when the reinsurance contract provides otherwise. The commenter stated that it is a fundamental principle of both the NAIC Model law and regulation, as well as the New Jersey statutes and rules, that parties are free to agree to full collateral regardless of the secure rating of the assuming carrier.

Another commenter recommended that when an assuming insurer's credit worthiness/ratings improve, the new security rules should be applied to already in-force reinsurance agreements.

RESPONSE: Upon review, the Department has determined not to change this provision. The commenters apparently have misconstrued the language dealing with the effective date of the certification of the reinsurer. The language in the statute, as well as the rules, provides that the requirements therein do not apply to reinsurance contracts entered into or renewed prior to the effective date of either the statute or the certification of the reinsurer. The rules actually provide a later effective date than the statute, since to date no reinsurers have been certified. Secondly, the concern that the provision in the rule could be used to modify prior reinsurance contracts is unfounded. The example provided by the commenter would not fall into the exemption provided by the rule. The rule provides that, for a contract that was in effect prior to the date of certification of the reinsurer, and is subsequently amended after the effective date of the certification of the assuming insurer or of a new reinsurance contract which covers a risk for which collateral was previously provided, such a contract shall only be subject to the new requirements with respect to losses incurred and reserves reported from and after the effective date of the amendment or new contract. The Department construes "losses incurred," as used in

this provision, as meaning when the event triggering the loss occurred. In the example provided by the commenter, the latent tort losses would have been incurred in 1972, prior to the effective date of the amendment or new contract. Thus the old contract and old collateral requirements would apply. The Department also reiterates that this provision reflects the national standard adopted by the NAIC. The Department also agrees with one of the commenters that rejected any suggestion that the current language of the new rule or any provision of the enabling statute or model would impose a collateral reduction on a ceding company by operation of law when the reinsurance contract provides otherwise. The Department notes that this provision is intended to apply prospectively, not retroactively. This provision is not intended to require a ceding insurer to accept a reduced collateral amount under amended reinsurance contracts or new contracts covering risks for which 100 percent collateral was previously provided, when losses are incurred and reserves are reported after the effective date of the amendment or new contract. The provision is not intended to permit unilateral revision of contract terms, including collateral requirements, by one party.

For the same reasons, the Department does not agree with the suggestion that the rule be revised to provide that when an assuming insurer's credit worthiness/ratings improve, the new security rules should be applied to already in-force reinsurance agreements. The contract would control, as rule changes cannot alter already in-force contracts.

COMMENT: One commenter expressed concern with N.J.A.C. 11:2-28.7A(h), which requires the Commissioner to comply with reporting and notification requirements that may be established by the NAIC with respect to certified reinsurers and qualified jurisdictions. The commenter stated that a review of the status of the NAIC schedule for issuance of the requisite

guidance reflects a projected 2012 delivery date. Should the NAIC schedule follow New Jersey's adoption of the proposed rules, the commenter questioned whether the Department could clarify the notification provisions that will be followed by the Commissioner. For example, the commenter questioned whether the notification provisions will include a comment period prior to certification of the reinsurer.

RESPONSE: The commenter has apparently misconstrued the operation of this provision. N.J.A.C. 11:2-28.7A(h) imposes no duty on reinsurers. Rather, the subsection provides that the Commissioner shall comply with all notification requirements established by the NAIC. Thus, its text is sufficiently general to allow for future revisions by the NAIC to its reporting requirements. There will be no additional comment period provided by this Department. However, interested parties are afforded the ability to review and comment on NAIC activities. The Department suggests that interested parties continue to monitor the NAIC for further information and developments.

COMMENT: One commenter expressed concern with N.J.A.C. 11:2-28.7B(f), which sets forth the information that must be filed by a certified reinsurer to meet initial requirements for certification and on an ongoing basis. The commenter noted that with the exception of the 10-day notification of any regulatory action, the rule only requires that information be filed "annually," which could be any time during the year unless timing is specified. The commenter stated that it had expressed a concern, presumably during deliberations on the NAIC Model, that the current language provides for leeway in timing submittals which may be to the benefit of a struggling reinsurer who is better served by delaying the filing. The commenter questioned

whether the Department intends to keep submittals on a rolling annual calendar schedule, or establish a date certain by which submittals must be completed and filed. The commenter requested that the Department set forth a structure and definitive timing for these filings.

Another commenter expressly opposed any provision that would set a date certain for reinsurers to apply for qualified status. The NAIC Model specifically recognizes that different reinsurers will be a position to apply for certification at different times, depending on a variety of factors, such as the status of necessary financial information or discussions with rating agencies. The commenter also stated that this issue was raised and considered during negotiations at the NAIC.

RESPONSE: Upon review, the Department has determined not to change this provision. The Department believes that it is reasonable to permit applicants for initial certification to apply for such certification at any time. This is consistent with the current system by which reinsurers may be accredited, as well as licensed to transact business in this State. With respect to the timeframe when information must be filed for annual review, the Department anticipates utilizing a similar procedure to that provided for accredited reinsurers by which certified reinsurers would renew their certification annually to be effective October 1. The Department will propose any further amendments as may be necessary to reflect these further clarifications.

COMMENT: One commenter requested clarification of N.J.A.C. 11:2-28.7B(f) regarding the public/non-public status of certain information required to be filed as part of the certified reinsurer application and on an ongoing basis. Specifically, the commenter stated that it is unclear whether forms CR-S and CR-F, which provide information regarding a foreign

reinsurer's retrocession, will be made public. Information regarding a foreign reinsurer's retrocessional programs and specific credit risk aggregations stemming from those programs currently is not publicly available. The commenter stated that publicly traded reinsurance companies may be hesitant to disclose this information since it was not previously disclosed to stockholders. Given the significant changes to collateral provisions in the rules, the commenter requested the authority to provide New Jersey cedents with the ability to review prospective reinsurers' retrocessional balances as well as annual CR-S/CR-F filings for currently certified reinsurers to better evaluate their financial position.

RESPONSE: The information cited by the commenter would be considered confidential under these rules, as well as under the Open Public Records Act, N.J.S.A. 47:1A-1 et seq., as this information is proprietary, trade secret information that could provide an advantage to competitors. The Department notes that this would not preclude a ceding insurer from requesting the reinsurer to provide such information to the ceding insurer directly.

COMMENT: One commenter requested that, in light of the amendments being proposed, the Department confirm that it will continue its practice of maintaining and updating its online list of accredited reinsurers by the fourth quarter, so that it may be relied upon by carriers as they prepare their annual statements.

RESPONSE: The Department confirms that it will continue to do so. In addition, as noted previously, the Department intends to post information regarding certified reinsurers and their requisite collateral requirements as well.

COMMENT: One commenter noted that N.J.A.C. 11:2-28.14 sets forth limits on concentration of risk of a ceding insurer. The commenter recommended that all reinsurance with affiliates be excluded from this limitation. The commenter stated that when a ceding insurer reinsures risk with one or more of its affiliates, the concentration of risk provisions should recognize that the cession of risk to affiliated companies results in the same risk amount remaining with the issuing organization even if allocated to different entities.

RESPONSE: Upon review, the Department has determined not to change this provision. The Department notes that the rule reflects the national standard as adopted by the NAIC. The fact that the risk remains within one organization does not necessarily mean that the impact to the group as a whole is identical, depending on which affiliate has the concentration of risk based on each individual affiliate's financial position.

Federal Standards Statement

There is Federal law applicable to reinsurance. P.L. 111-203, enacted in 2010, provides for single state regulation of credit for reinsurance. If the domiciliary state of the ceding insurer is accredited by the NAIC, or has financial solvency requirements similar to the requirements necessary for NAIC accreditation, no other state may deny credit for reinsurance. Also, if the domiciliary state of a reinsurer is accredited by the NAIC, or has financial solvency requirements similar to the requirements necessary for NAIC accreditation, such states shall be solely

responsible for regulating the financial solvency of the insurer. The adopted new rules, repeal, and amendments do not exceed these Federal requirements or standards.

Full text of the adoption follows (deletion from proposal indicated in brackets with asterisks *[thus]*):

*[11:2-28.13 Contracts affected

All new and renewal reinsurance transactions entered into after February 5, 1994 shall meet the standards set forth in this chapter if credit is to be given to the ceding insurer for such reinsurance.]*