



INSURANCE AND FINANCIAL SERVICES UPDATE

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Proposed Amendment to New York Insurance Regulation

On July 22, 2010, the New York State Insurance Department (the “Department”) issued for public comment a proposed amendment to its regulations governing credit for reinsurance. The Department has proposed similar amendments over the last few years but has not promulgated a final regulation, partly because of its involvement in a similar multi-state measure through the National Association of Insurance Commissioners (“NAIC”). However, implementation of the NAIC measure has not yet occurred, in part because such measure requires passage of a federal bill, and a bill has yet to be introduced in Congress.

The proposed amendment, published as the Proposed Tenth Amendment to Regulations No. 17, 20 and 20-A (11 NYCRR 125), modifies 11 NYCRR 125 (“Regulation 20”) by: (1) introducing an alternative standard for determining credit for reinsurance provided by unauthorized reinsurers that meet certain ratings, financial, solvency and other related criteria established by the New York State Superintendent of Insurance (the “Superintendent”); (2) excluding foreign ceding insurers domiciled in NAIC-accredited states from the application of Regulation 20; (3) obligating ceding insurers to demonstrate prudent reinsurance credit risk management in a number of specified ways; and (4) providing the Superintendent with flexibility to reduce the amount required to be held in a New York State trust fund by non-U.S. reinsurers that have discontinued underwriting new business secured by the trust for at least three full years. Set forth below is additional information on the more significant of these changes.

I. Alternative Credit for Reinsurance Rule for Unauthorized Reinsurers

Section 125.3(h) of amended Regulation 20 introduces a proposed alternative method of determining the amount of collateral required to be posted by unauthorized assuming reinsurers in order for ceding insurers to receive full reserve credit for cessions to unauthorized reinsurers under property/casualty and life/annuity reinsurance agreements¹ entered into, renewed or having an anniversary on or after

¹ Section 125.3(h) applies to life, annuity and accident and health risks pursuant to the terms of Section 125.4(a).

January 1, 2011. The amount of collateral required shall be determined based on a rating (“Rating”) determined in accordance with the following chart:

<u>Rating</u>	<u>Collateral Required</u>
Secure-1	0%
Secure-2	10%
Secure-3	20%
Secure-4	75%
Vulnerable-5	100%

The unauthorized reinsurer’s collateral posting obligation will be consistent with such reinsurer’s Rating. Accordingly, a ceding insurer will receive full credit for reinsurance under reinsurance agreements with the highest-rated (Secure-1) reinsurers, without any corresponding collateral. Collateral posting obligations for assuming reinsurers increase as the Ratings for such reinsurers decrease. The determination by the Superintendent of a reinsurer’s Rating is based in part on the reinsurer’s interactive financial strength ratings, on a stand-alone basis, separate from its parent or any affiliated entities, from at least two of (1) S&P, (2) Moody’s, (3) Fitch, (4) A.M. Best and (5) any other rating agency approved by the Superintendent, as follows:

<u>Rating</u> ²	<u>A.M. Best</u>	<u>S&P</u>	<u>Moody’s</u>	<u>Fitch</u>
Secure-1	A++	AAA	Aaa	AAA
Secure-2	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure-3	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
Secure-4	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB
Vulnerable-5	B, B-, C++, C+, C, C-, D, E, F	BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R, NR	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, DD

The Superintendent may lower a reinsurer’s Rating below what the preceding chart may otherwise indicate, based on an evaluation of the following additional criteria: (1) the reinsurer’s compliance with the contractual terms and obligations of its reinsurance contracts; (2) the reinsurer’s business practices in dealing with its ceding insurers; (3) for national reinsurers, a review of the most applicable NAIC Filing Blank, either Schedule F or Schedule S; (4) the reinsurer’s reputation for prompt payment of claims under

² The Rating may not be greater than the reinsurer’s lowest rating indicated in the chart (e.g., if an assuming insurer has an A+ A.M. Best rating and AAA/Aaa/AAA from the other three agencies, such assuming insurer would receive no higher than a “Secure-2” rating).

reinsurance agreements; (5) regulatory actions against the reinsurer; (6) an independent audit opinion of the reinsurer; (7) audited financial statements, regulatory filings and actuarial opinions; (8) the liquidation preference of obligations to a ceding insurer in the reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding; (9) a reinsurer's participation in any solvent scheme of arrangement or similar procedure that involves U.S. ceding insurers (entrance into such an arrangement will result in an automatic assignment of a Vulnerable-5 rating); and (10) any other information deemed relevant by the Superintendent.

An assuming reinsurer must also meet solvency standards in its domiciliary jurisdiction, be authorized to assume the kinds of insurance ceded by the ceding insurer and maintain policyholders' surplus or equivalent capitalization of \$250 million based on U.S. GAAP or statutory accounting principles. The party making the application must file with the Superintendent certain information with respect to the reinsurer's financial condition, including audited financial statements, a certification as to the reinsurer's good standing with its domiciliary regulator and a list of any disputed or overdue reinsurance recoverables.

Further, before an unauthorized non-U.S. reinsurer may take advantage of Section 125.3(h) of amended Regulation 20, (1) the Superintendent and the domiciliary regulator(s) must have executed a memorandum of understanding pursuant to Section 125.3(h) that addresses matters that the Superintendent deems relevant and (2) access to the market in the unauthorized reinsurer's place of domicile must be provided to U.S. reinsurers on terms and conditions that are at least as favorable as those provided by New York State law to non-U.S. reinsurers.

Finally, the subject reinsurance agreements must include certain provisions with respect to notification of any changes to the licensing or rating status of the reinsurer, a New York compliant insolvency clause and specified language with respect to service of process, jurisdiction, venue and choice of law.

In the event of entry of a receivership order against the ceding insurer, the reinsurer shall be obligated, within 30 days of entry of the order, to fund the entire amount for which the ceding insurer has taken credit from the reinsurer. Failure of a reinsurer to comply on a timely basis with this funding requirement will prevent such reinsurer and any member of its holding company system from being able to provide credit under any reinsurance agreements entered into or renewed by the reinsurer with other cedents on or after the first day of such failure to comply, unless the Superintendent determines that it is in the public interest to allow the credit in whole or in part.³

II. Non New York-Domiciled Insurers

Under Section 125.1, proposed amended Regulation 20 would no longer apply to foreign ceding insurers domiciled in an NAIC-accredited state or in a state that has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation and which state recognizes credit for reinsurance for the ceded risk.⁴ As a consequence, amended Regulation 20 would at this time only apply to New York domiciled ceding insurers, because all fifty states and the District of Columbia are currently accredited by the NAIC.⁵

3 It is unclear how the obligation to "fund" is intended to be satisfied.

4 This provision appears to respond to a provision under Title V, Subsection B of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which prohibits any state from denying credit for reinsurance to a ceding insurer whose domiciliary state recognizes such credit for reinsurance and is NAIC-accredited or has financial solvency requirements substantially similar to the requirements necessary for NAIC-accreditation.

5 Ceding insurers domiciled in Guam, Puerto Rico and other U.S. territories may also be subject to the amended Regulation 20, as such U.S. territories are not currently NAIC-accredited.

III. Ceding Insurer's Obligation to Exercise Prudent Reinsurance Credit Risk Management

Section 125.2 of proposed amended Regulation 20 would obligate the ceding insurer to demonstrate that it exercises prudent reinsurance credit risk management when considering and accounting for risks associated with each reinsurance agreement into which it enters. The ceding insurer would be required to consider and account for (1) compliance with all applicable legal and regulatory requirements, (2) the net risk to be retained, (3) concentration of risk on a net and gross basis, (4) projections as to reasonable future availability and affordability of reinsurance support for the ceding insurer's ongoing operations, (5) the degree to which future reinsurance proceeds for existing and future ceded reserves are likely to be recoverable based upon best current available information, (6) the way an assuming reinsurer will be selected, including how to assess its security, (7) how the reinsurance program will be monitored (i.e., the reporting and internal control systems) and (8) that the terms of the agreements with any affiliated reinsurer are fair and equitable. Section 125.2 also requires a ceding insurer to manage its reinsurance recoverable proportionate to its book of business and diversify its reinsurance program. As a result, a ceding insurer must notify the Superintendent within 30 days after either (x) the ceding insurer's reinsurance recoverable from any single reinsurer, or affiliated groups of reinsurers, exceeds, or is likely to exceed, 50% of the ceding insurer's last reported surplus to policyholders or (y) the ceding insurer cedes to any single reinsurer, or affiliated groups of reinsurers, more than, or what will likely be more than, 20% of the ceding insurer's gross written premium in a prior calendar year and explain how the exposure is being safely managed by the ceding insurer. The proposed amendment does not explicitly provide consequences if the Superintendent finds that a ceding insurer has failed to demonstrate that it exercises prudent reinsurance credit risk management when considering and accounting for risks associated with its reinsurance agreements.

IV. Public Comment Period

Comments to the Proposed Tenth Amendment to Regulations No. 17, 20 and 20-A may be submitted to the Department by email no later than August 4, 2010. The email address for submission of comments is jfritsch@ins.state.ny.us.

If you have any questions regarding the Proposed Amendment to New York Insurance Regulation, please contact your regular Sidley Austin LLP contact or any member of the Insurance and Financial Insurance Group.

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