Regulatory Impact Statement for the Tenth Amendment to 11 NYCRR 125 (Regulations No. 17, 20, and 20-A)

1. Statutory authority: Sections 110, 201, 301, 307(a), 308, 332, 1301(a)(9), 1301(c), and 1308 of the Insurance Law.

The above-cited Insurance Law sections establish the Superintendent's authority to promulgate regulations governing when an authorized ceding insurer (i.e., an insurer authorized or licensed to do business in New York) may take credit on its balance sheet for a reinsurance recoverable from an assuming insurer not authorized in this state.

Section 110 of the Insurance Law authorizes the Superintendent to share documents, materials and other information with other state, federal and international regulatory agencies and the National Association of Insurance Commissioners (NAIC).

Sections 201 and 301 authorize the Superintendent to effectuate any power accorded to him by the Insurance Law, and prescribe regulations interpreting the Insurance Law.

Section 307(a) requires an insurer doing business in the state to file an annual statement, in a form and containing such matters as shall be prescribed by the Superintendent, in the office of the Superintendent.

Section 308 vests the Superintendent with the authority to require an authorized insurer to file reports relating to the insurer's transactions, financial condition or any matter connected therewith.

Sections 1301(a)(9) and (c) and 1308 authorize the Superintendent to prescribe, by regulation, the conditions under which an authorized ceding insurer may be allowed credit, as an asset or a deduction from loss and unearned premium reserves, for a reinsurance recoverable from an assuming insurer not authorized to do an insurance business in this state.

2. Legislative objectives: Article 13 of the Insurance Law establishes minimum standards for the assets of insurers, including when an authorized ceding insurer may take credit on its balance sheet for reinsurance recoverable from an assuming insurer not authorized to do an insurance business in this state.

3. Needs and benefits: Reinsurance is insurance for an insurer. It is a means of redistributing risk throughout the global insurance industry. Often, an insurer will transfer (or "cede") part or all of its risk to another party (the "assuming insurer"). The assuming insurer is ultimately responsible for paying its part of those ceded claims. The ceding insurer is given credit on its balance sheet for the business ceded to an assuming insurer recognized by New York. This allows the ceding insurer to reduce its reserves and increase the number of policies it can write. Under the existing regulation, however, the ability to take a credit for ceded claims applies on a very limited basis when the assuming insurer, irrespective of its financial strength, is not authorized to do business in New York.

Under the current regulation, when a ceding insurer cedes risk to an unauthorized assuming insurer, it generally may take credit on its balance sheet only if the unauthorized assuming insurer posts collateral equal to 100 percent of the transferred policyholder claims. There is a

seldom-utilized section of the regulation that allows a ceding insurer to take credit of up to 85% on its balance sheet for cessions to unauthorized companies, provided the ceding insurer maintains documentation demonstrating that the unauthorized insurer meets financial requirements similar to those of New York authorized insurers.

Alien assuming insurers posted an estimated $120 billion in collateral in the U.S. in 2005, the latest year for which there is available data, on which they pay about $500 million per year in transaction costs. The Insurance Department has seen no negative fiscal impacts on U.S. ceding insurers in instances where the collateral levels have been reduced. It therefore makes sense, with appropriate safeguards in place, to build on this precedent and allow the most highly-rated alien assuming insurers to reduce their collateral postings further.

Adoption of this amended rule will reduce these transactional costs and increase reinsurance capacity. It also will bring New York in line with global insurance markets and worldwide accounting standards governing reinsurance contracts. Most jurisdictions outside the U.S. do not require non-domestic assuming insurers to post collateral in order for authorized ceding insurers to take credit. Under the amendment, the most financially healthy assuming insurers need not post collateral, or at least not 100% collateral. The amendment will level the playing field among assuming insurers by predicating credit for reinsurance principally on financial strength, not geography. Assuming insurers with strong credit ratings will, under the amendment, post less collateral than those with weak ratings.

In addition, this proposed rule imposes principles-based credit risk management on the authorized ceding insurers, by putting the onus on ceding insurers to ensure that the assuming insurers with whom they do business have the financial wherewithal to meet their obligations.

The proposed rule extends the Department's efforts to keep New York competitive while bringing the U.S. into the 21st century of financial services regulation. Insurers ceding risk to assuming insurers will be responsible for vetting their assuming insurers and developing risk management plans for their reinsurance placements. The amendment thus represents a move to let the market decide whether the posting of collateral is appropriate by eliminating the across-the-board regulatory mandate that requires even the strongest reinsurance companies to post collateral. Nevertheless, under the amendment, nothing prevents an authorized ceding insurer from negotiating its own collateral requirements with an assuming insurer or from choosing to do business with an assuming insurer that is willing to post collateral, should the authorized ceding insurer so insist. The rule amends the existing collateral requirements on a prospective basis, which will prevent any disruption to the existing reinsurance market, while giving the Department the opportunity to assess the effectiveness of the rule.

The National Association of Insurance Commissioners ("NAIC") Reinsurance Task Force has been developing a Model Law on Reinsurance Collateral Requirements. The Department has been a participant in the

Task Force. The amendment is consistent with the Model Law, to the extent it is consistent with the needs of the New York insurance market.

The proposed rule also reflects the purpose of the Dodd-Frank Wall Street Reform and Consumer Protection Act [Public Law 111-203; 7/21/10] (hereinafter, the Dodd-Frank Act)

which preempts certain state laws relating to reinsurance ceded by authorized non-domestic insurers.

4. Costs: The proposed rule requires an initial application fee of $10,000 for assuming insurers applying for a rating from the Superintendent that will allow ceding insurers to take credit for reinsurance without the assuming reinsurer having to post 100% collateral. Assuming insurers are required to pay a renewal fee every year, in the amount of $5,000.

In developing the rating application and renewal fees for assuming insurers, it was considered that Insurance Law, Section 332 provides that the expenses of the Department for any fiscal year, including all direct and indirect costs, shall be assessed by the Superintendent pro rata upon all domestic insurers and licensed United States branches of alien insurers domiciled in New York. Alien assuming insurers are not subject to this assessment. As a result, these expenses will be borne by insurers through the Section 332 assessments, since fees collected by the Superintendent are turned over to the State's general fund, and do not directly reimburse the expenses of the Department. Nonetheless, the Superintendent believes that it is appropriate for the initial and renewal fees charged to assuming insurers to reflect, if not approximate, the costs and expenses incurred by the Department in implementing this regulation. Renewal fees are considerably less than the initial fees. This reflects that expenses incurred on renewal applications are generally lower than on initial application.

The rule does not impose additional costs to the Insurance Department or other state government agencies or local governments. Nor is it expected that either the Insurance Department or regulated entities will directly incur additional costs. Nevertheless, with the adoption of the amendment, authorized ceding insurers must vet the financial wherewithal of their assuming insurers and develop appropriate risk management plans for reinsurance placements. However, even under the current regulation, authorized ceding insurers should be performing these functions as a matter of prudent risk management.

5. Local government mandates: This rule does not impose any program, service, duty or responsibility upon a city, town or village, or school or fire district.

6. Paperwork: As set forth in Section 125.3(b), an authorized ceding insurer shall notify the Superintendent within 30 days after a reinsurance recoverable from any single assuming insurer, or group of affiliated assuming insurers, exceeds 50% of the authorized ceding insurer's last reported surplus to policyholders, or after it is determined that a reinsurance recoverable from any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the authorized ceding insurer. In addition, an authorized ceding insurer shall notify the Superintendent within 30 days after ceding to any single assuming insurer, or group of affiliated assuming insurers, more than 20% of the ceding insurer's gross written premium in the prior calendar year, or after it has determined that the reinsurance ceded to any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the authorized ceding insurer. In addition, if a ceding insurer wishes to take credit for reinsurance ceded to an unauthorized assuming insurer, it must include certain provisions within the reinsurance contract.

Assuming insurers applying for a rating from the Superintendent that will allow ceding

insurers to take credit for reinsurance without the assuming reinsurer having to post 100% collateral must file certain documents annually with the Superintendent. However, these documents should be readily available, since they serve purposes relating to regulation of the unauthorized assuming insurers by other entities.

7. Duplication: This amendment will not duplicate any existing state or federal rule. The NAIC Reinsurance Task Force has been developing a Model Law on Reinsurance Collateral Requirements. The Department has been a participant in the task force. It is the Department's intent to make the rule consistent with the Model Law, to the extent it is consistent with the needs of the New York insurance market.

8. Alternatives: The Department conducted extensive outreach to entities representing authorized ceding insurers, and to assuming insurers both authorized and unauthorized to do business in New York. The Department received comments from seventeen entities. A complete discussion of the comments submitted can be found at the Department's website (http://www.ins.state.ny.us).

9. Federal standards: There are no minimum standards of the federal government for the same or similar subject areas. The regulation is amended, however, to include language from the Dodd-Frank Act inasmuch as that legislation preempts the state from denying credit for reinsurance of a ceding insurer whose state of domicile 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. See Pub. Law 111-203, § 532.

10. Compliance schedule: Once the amended regulation is adopted, regulated parties will be able to comply immediately. This proposal will apply to new or renewed reinsurance contracts effective on or after July 1, 2011.

Statement Setting Forth the Basis for the Finding that the Tenth Amendment to 11 NYCRR 125 (Regulations No. 17, 20, and 20-A) Will Not Impose Adverse Economic Impact or Compliance Requirements On Small Businesses or Local Governments

The Insurance Department finds that this rule would not impose reporting, recordkeeping or other requirements on small businesses. This rule applies to ceding insurers and assuming insurers authorized to do business in New York State, as well as unauthorized assuming insurers. The rule establishes certain requirements for ceding insurers domiciled in New York and for foreign authorized ceding insurers that are domiciled in a state that is neither NAIC-accredited nor has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and does not recognize credit for reinsurance for the insurer’s ceded risk. The rule also establishes standards for assuming insurers, in order to enable ceding insurers to take credit on their balance sheets for risks ceded to assuming insurers.

The Insurance Department has reviewed the filed Reports on Examination and Annual Statements of authorized insurers and the trusteed surplus of alien insurers subject to this amendment, and believes that none of them comes within the definition of "small business" set forth in section 102(8) of the State Administrative Procedure Act, because there are none which are both independently owned and have under 100 employees.

This rule also is not expected to have any adverse economic impact on local governments, and does not impose reporting, recordkeeping or other compliance requirements on local governments. The basis for this finding is that this rule is directed at ceding insurers and assuming insurers, none of which is a local government.

Rural Area Flexibility Analysis for the Tenth Amendment to 11 NYCRR 125 (Regulations No. 17, 20, and 20-A)

1. Types and estimated numbers of rural areas: This amendment applies to insurers authorized to do business in New York State and addresses whether a ceding insurer may take credit on its balance sheet, as an asset or deduction from reserves, for reinsurance recoverable from an unauthorized reinsurer. The amendment establishes certain requirements for ceding insurers and reinsurers, and puts the onus on ceding insurers to prudently manage their risk. The ceding insurers and reinsurers do business in every county in this state, including rural areas as defined under State Administrative Procedure Act, Section 102(13).

2. Reporting, recordkeeping and other compliance requirements, and professional services: Section 125.3(b) of the regulation requires a ceding insurer to notify the Superintendent within 30 days after a reinsurance recoverable from any single reinsurer, or group of affiliated reinsurers, exceeds 50% of the ceding insurer's last reported surplus to policyholders, or after it is determined that a reinsurance recoverable from any single reinsurer, or group of affiliated reinsurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the domestic ceding insurer. In addition, a domestic ceding insurer shall notify the Superintendent within 30 days after ceding to any single reinsurer, or group of affiliated reinsurers, more than 20% of the ceding insurer's gross written premium in the prior calendar year, or after it has determined that the reinsurance ceded to any single reinsurer, or group of affiliated reinsurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the ceding insurer.

In addition, if a ceding insurer wishes to take credit for reinsurance ceded to an unauthorized assuming insurer, it must include certain provisions within the reinsurance contract.

Assuming insurers applying for a rating from the Superintendent that will allow ceding insurers to take credit for reinsurance without the assuming reinsurer having to post 100% collateral must file certain documents annually with the Superintendent. However, these documents should be readily available, since they serve purposes relating to regulation of the unauthorized assuming insurers by other entities.

There are no other additional paperwork requirements specific to ceding insurers and reinsurers that are based in rural areas.

3. Costs: This rule imposes no additional costs for ceding insurers, including those based in rural areas. Of course, the rule requires ceding insurers to vet the financial wherewithal of the reinsurers with whom they do business, but even under the current regulation, ceding insurers should be performing this function as a matter of prudent risk management.

The rule requires an initial application fee of $10,000 for assuming insurers applying for a rating from the Superintendent that will allow ceding insurers to take credit for reinsurance

without the assuming reinsurer having to post 100% collateral. Assuming insurers are required to pay a renewal fee every year, in the amount of $5,000.

4. Minimizing adverse impact: The current regulation requires a strongly capitalized non-New York (unauthorized) reinsurer to tie up capital by posting collateral while not imposing a similar burden on a New York (authorized) reinsurer. The proposed rule requires ceding insurers to assume full responsibility for credit risk management and compliance in entering into reinsurance arrangements.

This rule applies uniformly to regulated parties that do business in both rural and nonrural areas of New York State. This rule levels the playing field for all reinsurers, mitigates the risk that may exist under the present regulatory structure, and continues the Department's efforts to keep New York competitive while bringing the state into the 21st century of financial services regulation.

5. Rural area participation: In developing this rule, the Department conducted extensive outreach by contacting insurers, reinsurers, trade groups, other regulators, and other interested parties, including those located or domiciled in rural areas.

Job Impact Exemption for the Tenth Amendment to 11 NYCRR 125 (Regulations No. 17, 20, and 20-A)

The proposed amendment should have no negative impact on jobs or economic opportunities in New York State. The amendment applies to reinsurance contracts, and establishes a framework by which a ceding insurer may take credit on its balance sheet, as an asset or deduction from reserves, for a reinsurance recoverable from any unauthorized assuming insurer that maintains, on a stand-alone basis separate from its parent or any affiliated entities, an interactive financial strength rating from at least two rating agencies. In addition, the Superintendent must evaluate the unauthorized assuming insurer and determine the proper amount of collateral to be maintained by the assuming insurer for the ceding insurer to take credit on its balance sheet. The regulation also imposes principles-based credit risk management on the ceding insurers, by putting the onus on cedents to ensure that the assuming insurers with whom they do business have the financial wherewithal to meet their obligations. Moreover, private parties may, as a matter of contract, require an assuming insurer to post collateral.

While ceding insurers may change their choice of assuming insurers to ensure that they receive credit as an asset or deduction from reserves for such reinsurance, the amendment will not change the fact that authorized insurers need to obtain such reinsurance.

The proposal requires unauthorized assuming insurers applying for a rating from the Superintendent that will allow ceding insurers to take credit for reinsurance without the assuming reinsurer having to post 100% collateral to file certain documents annually with the Superintendent.

Thus, there should be no negative impact on jobs or economic opportunities in New York State.