LLOYD'S

MARKET BULLETIN

From	Director, Worldwide Markets (extn 6677)
Date	3 November 2006
Reference	Y3900
Subject	**California: Credit for Reinsurance Regulations**
Subject areas	New California Credit for Reinsurance Regulations
Attachments	
Action points	**Managing agents to note requirements and ensure compliance**
Deadlines	

Purpose of bulletin

To notify the market of a change to the California Credit for Reinsurance law as the final California "Reinsurance Accounting, Agreements and Oversight" regulations (the "Regulations") were approved on 24 October, 2006, and are to become effective 1 January, 2007.

The Regulations

The California Department of Insurance ("CDI") has adopted a modified version of its long pending general revision of the rules governing reinsurance in California[1]. These Regulations, which are generally referred to as the "Reinsurance Oversight Regulations", reflect a wholesale rewrite of California's reinsurance rules on accounting for reinsurance on financial statements, including credit for reinsurance, general requirements for reinsurance agreements and the oversight of those matters by CDI.

Similar to credit for reinsurance laws in other United States jurisdictions, the California Reinsurance Oversight Regulations set forth standards that assuming reinsurers – including

[1] The new rules appear at California Regulations Title 10, Chapter 5, Subchapter 3, Article 3,§§2302 through 2303.25 and are entitled: "Reinsurance Accounting, Agreements and Oversight".

reinsurers that maintain multiple beneficiary trust fund structures as is the case with Lloyd's - must meet in order for their ceding insurers to be allowed balance sheet credit for the reinsurance. CDI continues to reserve the right to apply its credit for reinsurance rules to all California licensed ceding insurers, not just California domestics. Further, the rules impose much the same special oversight upon "commercially domiciled[2]" ceding insurers as is imposed upon California domestic insurers.

Summary of key amendments included in the Reinsurance Oversight Regulations

The full text of the Regulations can be viewed here, and can be found at the following address - http://www20.insurance.ca.gov/epubacc/REG/89540.htm. The regulations are both quite detailed and voluminous.

Market participants who are actively involved in providing reinsurance for US ceding insurers that might be subject to the regulations are urged to seek further information

In addition to imposing standards on reinsurers, the new Regulations also impose rules regarding such issues as insurance risk transfer requirements (which for property casualty reinsurance follows the requirements of SSAP 62) and mandated provisions for reinsurance agreements. The key amendments which Underwriters should be alert to include the following:

- treaty reinsurance agreements must contain an "entire agreement" provision;
- limits are placed on early termination provisions in reinsurance agreements;
- specific provisions are required to be included in the agreement if an intermediary is to handle premium or claims payments between the parties;
- except for affiliated reinsurance, California domestic ceding insurers and commercially domiciled insurers are generally called upon to retain at least 10% of the reinsured risk, although CDI can allow a smaller retention;
- syndicate managers who rely heavily upon letters of credit in their US credit for reinsurance trust funds may wish to note in particular that the new regulations impose limits upon how much of the trusts may be comprised of letters of credit.
- There are a significant number of other requirements as well, including as you will note below, requirements which potentially impact certain Lloyd's-specific trust fund issues.

These Regulations have been in the process of development for more than a year. Underwriters may recall that earlier versions of the proposed regulations contained provisions that would have been highly problematic for the industry had they been adopted. For example, earlier versions of the proposed regulation would have given the CDI even broader powers to regulate reinsurance contract terms, required reinsurers to place

[2] A commercially domiciled ceding insurer is an insurer that is domiciled under the laws of a United States jurisdiction but has an emphasis on California business as defined in the regulation and related statute.

disputed reinsurance proceeds into an escrow account pending the outcome of arbitration or litigation in some circumstances, limited reinsurers' right of offset and would have exposed reinsurers to a charge of acting in bad faith for failing to make payment to the ceding insurer in accordance with the cedent's settlement report if the reinsurer's response to the settlement report was found not to have established a "reasonable basis" for its decision. Subsequent versions of the proposal were much improved as a result of extended negotiations between CDI and industry representatives, including Lloyd's representatives, and each of the above described problematic proposals was ultimately dropped.

Lloyd's America, Inc. and outside US regulatory counsel, LeBoeuf, Lamb, Greene & MacRae, L.L.P, have been in extensive dialogue with CDI on these regulations, both generally but also particularly with respect to Lloyd's specific issues. These discussions have been productive and have led to CDI's agreement to a number of changes requested by Lloyd's. Some of Lloyd's requested changes are reflected in the published final version of the regulation and CDI has indicated to Lloyd's that many of our remaining comments and requested changes will be addressed in a "clean-up" amendment to these Regulations to be published in the near future.

Further information

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This market bulletin has been sent to active underwriters and to the compliance officers of managing agents and Lloyd's brokers.

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