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Do Unto Others—**Reciprocity** Through the Lens Of **Insurance Regulation**

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SHUTTERSTOCK

The uneven effects of laws across boundaries, when applied to persons or activities having nexuses to multiple jurisdictions, can often be neutralized by reciprocity—treating a non-resident in a particular jurisdiction the same way that a resident of that jurisdiction would be treated under identical circumstances by the laws of the non-resident's home jurisdiction. In a regulated industry such as insurance, trends in reciprocity, including among the 50 states but also between the U.S. and other nations, can reflect broader political developments and illuminate consequential public policy debates in a key sector of the economy.

An insurer "domiciled" (incorporated) in one state can be licensed to carry on business not only in that state but in as many as 49 others and will be subject to the laws of each state in which it is so licensed. Many states have adopted insurance laws imposing reciprocal treatment with respect to specified matters on insurers domiciled elsewhere but doing business in the adopting state. Some instructive examples include:

Holding company act regulation. In virtually all states, a licensed insurer controlled by another entity (e.g., a holding company) must register as a controlled insurer and must observe certain ongoing reporting requirements. However, under the model "insurance holding company act" governing these requirements (issued by the National Association of Insurance Commissioners, or NAIC, a standard-setting body), where the insurer's domiciliary state has a substantially equivalent law, registration in that state will suffice and will obviate the need for reporting in the non-domiciliary state. (New York, whose holding company act differs in certain respects from the NAIC model, remains a key exception to this general rule. A controlled insurer licensed in New

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York must register with and report holding company information annually to the New York Superintendent of Financial Services even where the insurer is domiciled in a state with a similar law.)

Investments. State laws regulate the types and amounts of portfolio investments that insurers may make with the assets supporting outstanding policies and surplus. Typically these requirements are imposed only on domestic insurers, as in the NAIC model investment law. However, the laws of some prominent insurance jurisdictions, including New York, Delaware and South Carolina, do subject a "foreign" insurer (that is, an insurer domiciled in another state) to the state's investment laws unless it is subject to "substantially similar" laws in its domiciliary state.

Credit for reinsurance. Reinsurance is essentially a transaction in which an insurer cedes some of the risks it has underwritten to another carrier. In order to recognize the financial effect of reinsurance on its balance sheet—that is, to receive financial statement "credit" for the transfer of the insurance liabilities to the reinsurer—the ceding insurer must observe certain state laws prescribing conditions on such reinsurance. In general, under these rules, where an assuming reinsurer does not meet certain criteria, it must post collateral in favor of the ceding company in order for the ceding company to receive credit. Concepts of reciprocity can be seen in at least two aspects of credit-for-insurance regulation:

- On the one hand, the NAIC model law on credit for reinsurance permits a ceding insurer to claim credit where the assuming insurer is domiciled in a state that "employs standards regarding credit for reinsurance substantially similar to those" applicable in the ceding company's state. (The assuming insurer must meet other technical requirements as well, including submission to examination authority of the ceding company's domiciliary state.)
- On the other hand, reciprocity historically did not always apply in the application of reinsurance rules to foreign insurers. Prior to the Dodd-Frank reforms discussed below, some states applied their reinsurance rules extraterritorially, that is, even to ceding insurers domiciled elsewhere. This was particularly visible in the large and influential states of New York (whose credit for reinsurance regulations, prior to 2011 amendments, did not distinguish between domiciled and non-domiciled insurers) and California (where a provision of the insurance code arguably gives the California regulator authority to approve certain acquisitions involving non-California domiciled insurers).

Developments over the period 2010-2017—bookended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, at one end, and the U.S./EU "Covered Agreement," on the other—illustrate efforts to incorporate additional reciprocity into these areas of insurance regulation. Key developments included the following:

Domiciliary control of credit for reinsurance regulation. In addition to its more visible provisions affecting banks, Dodd-Frank effectively ended the long-arm reach of state reinsurance laws. The statute prohibits any state but the domiciliary state from regulating reinsurance terms and conditions such as collateral requirements. (California and New York both responded to this development in 2011 by limiting the regulator's authority over non-domestic insurers.)

U.S./EU "Covered Agreement." Dodd-Frank also authorized the Executive Branch to negotiate and enter into "Covered Agreements," defined as an agreement with other countries that "achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level achieved under State" regulation. In its final days in January 2017, the Obama Administration announced that it had entered into such a Covered Agreement with the European Union, which, among other things, required each jurisdiction to impose credit-for-reinsurance standards (including collateral requirements) no less favorable to the other's reinsurers than the other's laws applied to the former's reinsurers. The agreement requires each jurisdiction to harmonize its rules to this reciprocity principle within five years.

Group supervision. Over this period at the NAIC, amendments to the insurance holding company act and other aspects of supervision of insurance groups (affiliated

companies) also reflected a doubling-down on reciprocity. The NAIC imposed new requirements on insurers within groups to file "enterprise risk" reports (identifying the insurer's group-wide risks) and "own risk and solvency assessments" (self-examinations on the amount of required capital across the group). These measures required insurers or their groups to file these reports principally with the "lead" state, that is, the jurisdiction of domicile of the most consequential insurer in the group, even if other insurers in the group were domiciled elsewhere.

Three developments since roughly the end of the 2010-2017 period illustrate a possible check on reciprocity principles, however.

Policy statement on U.S./EU reciprocity. The Trump Administration adopted the U.S./EU Covered Agreement in September 2017 but, in its announcement doing so, emphasized the primacy of state insurance regulation in the U.S. and seemed to contrast it against "expansive EU reporting requirements". While not repudiating the concept of reciprocity, the policy statement suggested that promoting U.S. interests would not take a back seat to any international aspiration of equal treatment. The statement in particular also noted certain limits of the Covered Agreement, such as its inapplicability to existing reinsurance contracts.

Requiring consensus positions on IAIS reforms. Similarly, under a broader regulatory-reform bill enacted by Congress and signed by President Trump in May 2018, the Executive Branch and the Federal Reserve are required, before taking a position with respect to certain international insurance proposals, to "achieve consensus positions with" state regulators through the NAIC. The most proximate concern of this provision is the ongoing effort by the International Association of Insurance Supervisors (a global consortium of regulators) to formulate uniform capital standards for insurance groups straddling national boundaries. The legislation reflects the Administration's policy position (generally aligned with that of the NAIC) disfavoring the perceived encroachment of international rules—even reciprocal ones—on U.S. insurance business.

In a regulated industry such as insurance, **trends in reciprocity,** including among the 50 states but also between the U.S. and other nations, can reflect broader political developments and illuminate consequential public policy debates in a key sector of the economy.

Codifying U.S./EU reciprocity in state law. The NAIC is in the process of conforming its model credit for reinsurance law to the U.S./EU Covered Agreement. A draft model amendment released by the NAIC in June 2018 and currently under discussion specifies that credit will be allowed where the assuming insurer is domiciled in a "Reciprocal Jurisdiction" (generally, a jurisdiction that is a party to a Covered Agreement) and certain other conditions are met. Some of these other conditions, however, arguably hinge on the regulator's discretion, including financial requirements. As of this writing the draft has attracted criticism in part because of the perception that, by empowering the local regulator to adopt additional conditions for credit, the model does not achieve true reciprocity. The draft is subject to additional discussion and ultimate adoption at the NAIC, and then it would have to be adopted in any given state in order to be effective.

Conclusion

This cross-section of reciprocity issues illustrates the push and pull of individual jurisdictions' policy preferences—and protection of local actors—against a backdrop of increasing globalization of the insurance and reinsurance sector. The extent to which a jurisdiction chooses to "do unto others" as it would have done unto it, on these and related matters, will be a key indicator of how policymakers navigate this globalization in coming years and decades.

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