REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Regulation: 806 KAR 5:025
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(1) Provide a brief summary of:

(a) What this administrative regulation does: This administrative regulation establishes requirements for reinsurers to become accredited, certified, or use trust agreements in Kentucky. The administrative regulation ensures the ceding insurer may credit amounts reinsured to these assuming insurers on their financial statements. The administrative regulation also stipulates the process for becoming a qualified jurisdiction where a reinsurer may be domiciled and become certified. The qualified jurisdiction is critical as it means the country has passed a specific regulatory test to provide certainty that insurers within its jurisdiction adhere to similar and strict regulatory rules. The changes included within the administrative commence the process of conforming Kentucky law to the United States covered agreements with the European Union and United Kingdom regarding reinsurance collateral requirements. It moves away from recognizing only 100% collateral as the way to judge financial stability, and moves to a more rounded approach and review of both the company and regulatory jurisdiction where the company is domiciled.

(b) The necessity of this administrative regulation: This administrative regulation is necessary to conform Kentucky law to the United States Covered Agreement with the European Union or else face federal preemption from the Federal Insurance Office (FIO). Historically, U.S. regulators did not impose direct control over non-U.S. reinsurers. Instead, they regulated non-U.S. reinsurance markets by only allowing a statutory credit on the ceding insurer's balance sheet when the non-U.S. reinsurer maintained 100% collateral for its reinsurance obligations. U.S. regulators then began requesting more information from non-U.S. based reinsurers to ensure they were compliant with the requirement and the statutory credit was permissible. This created a tightening of the market for reinsurance, restricted the free flow of capital, and reduced the potential investments an insurer and reinsurer could make. It also created a global fragmented regulatory system, especially within the United States, creating a barrier for many reinsurance companies to operate. The United States Department of Treasury and the European Union entered into intense negotiations to develop a regulatory framework reforming the collateral requirements for reinsurers in and outside the United States, and on September 22, 2017, the parties entered into a Covered Agreement. The agreement requires states to eliminate reinsurance collateral requirements within five (5) years, or risk preemption under the Covered Agreement.

(c) How this administrative regulation conforms to the content of the authorizing statutes: This administrative regulation provides further clarity on the manner to become an accredited or certified reinsurer pursuant to KRS 304.5-140.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This administrative regulation provides specific details and a process for the commissioner to accredit or certify reinsurers, as well as, determine qualified jurisdictions.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: This amendment incorporates a process to determine the reciprocal and qualified jurisdiction list. These amendments derive from the June 2019 "red-lining" of the National Insurance Commissioner's Model Law 786. The statue also requires the Commissioner to design a list of such jurisdictions within the regulation.

(b) The necessity of the amendment to this administrative regulation: This amendment is necessary to include a specific process for accreditation and certification of reinsurers following the 2018 statutory amendments to KRS 304.5-140, and the United States covered agreement with the European Union and United Kingdom. The Department has also been required by the NAIC to incorporate the June 201 amendments in order to abide by their Financial Accreditation process, which ensures reciprocity and uniformity across states.

(c) How the amendment conforms to the content of the authorizing statutes: This amendment uses the authority provided to the commissioner by KRS 304.5-140 to establish a list of reciprocal and qualified jurisdictions of reinsurers.

(d) How the amendment will assist in the effective administration of the statutes: This amendment is based on the most recent version of the NAIC's Model Regulation 786, and meets the requirements set forth in KRS 304.5-140 to establish a list of reciprocal and qualified jurisdictions of reinsurers. It is necessary to ensure reinsurers meet the new standards negotiated by the United States federal government and incorporated within KRS 304.5-140.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: The administrative regulation will impact those domestic insurers that reinsure risks in the United States and through entities outside of the United States.

(4) Provide an analysis of how the entities identified in the previous question will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions each of the regulated entities have to take to comply with this regulation or amendment: Reinsurers interested in taking advantage of the ceding process will need to comply with the new filing requirements in order to become an accredited or certified reinsurer.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities: The requirements included within the administrative regulation are part of an NAIC Model Law and Regulation, and are required to be enacted in every jurisdiction across the United States. In the event states do not uniformly enact the changes, the Federal Insurance Office will assert federal preemption based on the covered agreement. Therefore, it will not cost regulated entities any amount to comply with these requirements as they have been enacted in other jurisdictions previously.

(c) As a result of compliance, what benefits will accrue to the entities: The requirements set forth in this administrative regulation will expand the pool of reinsurance available to insurers, and allow them to utilize capital in more productive manners other than unnecessarily holding it in reserve. Additionally, more reinsurers will qualify to allow ceding insurers to take advantage of the credit, so reinsurance will be more widely available and potentially cheaper. Reinsurers will also greatly benefit from the uniform standards making it easier, cheaper, and more efficient for them to do business in the United States.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: Implementation of this amendment is not anticipated to have an initial cost on the Department of Insurance.

(b) On a continuing basis: Implementation of this amendment is not anticipated to have an on-going cost on the Department of Insurance.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: The Department will use funds from its current operational budget to perform the tasks necessary.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment: An increase of fees will not be necessary because additional personnel is likely unnecessary.

(8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: This administrative regulation does no establish any fees directly or indirectly.

(9) TIERING: Is tiering applied? Explain why or why not. No, tiering is not applied as it applies to all ceding and assuming insurers equally.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

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(1) What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? The Department as the implementer.

(2) Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 304.5-140 and the September 22, 2017 United States Covered agreement with the European Union and the United Kingdom.

(3) Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect. If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? The administrative regulation will not generate any revenue for state or local government.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? No revenue is expected to be generated.

(c) How much will it cost to administer this program for the first year? No cost is expected, this will be handled on the Department's current operating budget.

(d) How much will it cost to administer this program for subsequent years? No cost is expected, this will be handled on the Department's current operating budget.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

(4) Revenues (+/-): Neutral

(5) Expenditures (+/-): Neutral

(6) Other Explanation: The program including receipt and review of new filings will be handled by internal personnel. At this point, the Department anticipates all duties will be handled by current personnel due to the minimal nature of Kentucky specific filings. If filings exceed expectations additional staff may become necessary; however, the overseas reinsurance is not large for the small number of Kentucky domestic insurers. Thus, we anticipate a low volume of overall filings.