TO: Reinsurance (E) Task Force Members, Interested Regulators and Interested Parties

FROM: Bryan Fuller, NAIC Senior Reinsurance Manager

DATE: July 3, 2008

SUBJECT: Reinsurance (E) Task Force Activities

1. The Reinsurance (E) Task Force (RTF) met in regulator-to-regulator meetings in Newark, NJ on March 11-12, May 7-9, and June 25-27, 2008, considered comments received from interested parties and developed the reinsurance regulatory modernization framework outlined in this proposal.

The Reinsurance Task Force notes that comments are included in this document from the following sources:

ABIR – Association of Bermuda Insurers and Reinsurers
ACLI – American Council of Life Insurers
AIA – American Insurance Association
AIG
CEA – CEA Insurers of Europe
Genworth – Genworth Financial
GIAJ – General Insurance Association of Japan
IUA – International Underwriting Association
Lloyd's
NAMIC – National Association of Mutual Insurance Companies
PCI – Property Casualty Insurers Association of America
RAA – Reinsurance Association of America

General comments are included at the beginning of this document. Paragraph or section specific comments are inserted throughout in the relevant sections.

General Comments:

ACLI: **ACLI Position** - Our membership wants and needs comprehensive reform of state-based life reinsurance regulation. Reinsurance is a fundamental and necessary risk spreading practice for the life sector. A dynamic regulatory regime for the practice is equally fundamental and necessary. We believe it is not desirable or feasible to revise a narrow piece of the current reinsurance regulatory regime in isolation, as this proposal attempts to do. The majority of our members believe that modernizing US reserving and risk assessment methodologies is a necessary precondition to reform of the current state-based reinsurance regulatory regime.

ACLI Recommendations - We have watched this Task Force struggle for many years with finding consensus on how states' reinsurance collateral requirements should be changed. We have concluded that this circumscribed objective cannot be met in this context, for two reasons. First, neither the NAIC nor individual states are constitutionally empowered to impose legal burdens on each other, as this framework proposes. Second, based on history, we believe it is politically impossible to enact and uniformly enforce across the states a revision to the Model Law on Credit for Reinsurance similar to the Proposal.

We have two recommendations that we believe all the stakeholders could endorse. First, we believe that reforming state collateral requirements uniformly is only feasible with the help of Congress. We therefore suggest your support of federal legislation such as HR 1065, the Nonadmitted and Reinsurance Reform Act of 2007. Second, we urge you to focus on comprehensive life reinsurance regulation reform. In particular, we draw your attention to the archaic risk transfer requirements now applicable to cessions by life insurers and life reinsurers. We are concerned that those rules have not kept pace with the market and are, indeed, an impediment to sound risk management.

More generally, the ACLI is concerned about maintaining the competitiveness of the US life insurance sector. Achieving state-of-the-art supervision that conforms to or sets the standards for international best practices in supervising reinsurance is key to that competitiveness. As an initial step, the ACLI Board of Directors recently established principles to guide our advocacy of reinsurance regulation reform. We believe they articulate best practices of reinsurance supervision that must be endorsed and implemented by US insurance and reinsurance supervisors in order for the US life insurance sector to maintain its competitive position globally.

ACLI General Technical Comments - We incorporate below the ACLI Policy on Reinsurance Regulation, as adopted by our Board of Directors in January 2008. We have compared the Proposal to our Board policy and describe our initial observations, noting that our Board has directed that any one reinsurance reform consistent with the policy must be considered in light of other reforms and pursued only after the full effect of such action is considered and understood.

Purpose and Scope of Life Reinsurance Regulation
Principle 1. The purpose of reinsurance regulation is to ensure that reinsurance provides sound financial support to ceding insurers so they can deliver on their promises to policyholders. Reinsurance regulation should be efficient and free from unnecessarily burdensome requirements, recognizing that reinsurance transactions are contractual arrangements between commercial parties. Reinsurance regulation should foster competition by treating domestic and foreign insurers equally without discrimination.

Subprinciple 1.1. Reinsurance should be subject to reporting requirements and oversight no more stringent than that for direct written risks.

Subprinciple 1.2. Reinsurance regulation should not disadvantage reinsurance vis-à-vis competing forms of risk mitigation.

The Proposal discriminates between foreign and domestic reinsurers. It would confer upon a POE supervisor the "ultimate determination [with respect to a financial determination by a POE supervisor concerning a POE reinsurer]." A national reinsurer that is a US reinsurer has no such recourse under the Proposal.

Purpose and Scope of Life Reinsurance Regulation
Principle 2. The domestic regulator (i.e., state, federal or foreign) of a ceding or assuming insurer should be the sole regulator of its reinsurance.

The Proposal does not improve uniformity among the states with respect to reinsurance reserve credit requirements. This has been and remains a critical issue with respect to cessions by life insurers.

Capital Adequacy and Accounting
Principle 3. The determination of increases or decreases in assets, liabilities and required capital related to reinsurance should reflect, under any valuation system, the actual value of the risks transferred and all other terms in the reinsurance contract, as measured by the valuation system.

Subprinciple 3.1. Although a rules-based system to value insurance and reinsurance may be acceptable for an interim period, the favored approach is a principles-based valuation system that reflects the specific risk profile of the party.

Subprinciple 3.2. Accounting for reinsurance should show the separable impact of the reinsurance.

We are disappointed by the continuation of archaic risk transfer requirements in state law and statutory accounting. We have attempted on several occasions to begin a dialogue with this Task Force about these legacy rules and the unreasonable and imprudent restriction they impose on company risk management practices. We have been disappointed to learn that LHATF is considering exporting that formulaic, one-size-fits-all definition of risk transfer into a stochastic framework under a principles-based reserving regime.

Counterparty Credit Risk & Collateral

Principle 4. Regulation of reinsurance should focus on the capital adequacy of the counterparties to a reinsurance agreement.

Subprinciple 4.1. Reinsurance collateral should not be required by law or regulation but rather negotiated between the counterparties to a reinsurance agreement.

Subprinciple 4.2. Any counterparty credit risk arising from a reinsurance agreement should be reflected in the counterparty's risk-based capital.

Subprinciple 4.3. Counterparty credit risk evaluation should consider the probability of recovering reported reinsurance recoverables, including the creditworthiness of the assuming insurer, the amount and quality of any collateral deposited with the ceding insurer or to which it has legally perfected access, and the regulatory framework applicable to the assuming insurer.

Assuming US life insurers are concerned for three reasons about the proposed terms of a new collateral requirement that might be applicable to them. First, life reinsurance contracts are typically long-term, frequently spanning decades. Assuming life insurers cannot cancel them retroactively. Any life reinsurance contract entered into after the effective date of this Proposal by a RSRD-rated reinsurer would be subject to a springing collateral requirement. The mere existence of that requirement would inject significant contagion risk into the entire US life insurance sector and raise its cost of capital. Second, if the RSRD uses only one rating agency per reinsurer, it would exacerbate the contagion risk. Finally, US "national" life reinsurers would not have access to the dispute resolution mechanisms available to non-US POE reinsurers under the Proposal. ACLI has historically opposed any collateral requirement imposed by another country on US assuming life insurers operating in that country.

Reinsurance Contract Terms
Principle 5. Counterparties should be free to manage risk through reinsurance by negotiating the form and substance of a reinsurance contract, without direct or indirect regulation of the contract terms.

ACLI believes that the current indirect regulatory limitation on forms of risk transfer by life insurers is unwise and counter to best practices under the current statutory reserving regime.

ACLI Specific Technical Comments
ACLI has previously asked this Task Force to recommend modernizing the current risk transfer requirements applicable to life reinsurance. Our reasoning has been and continues to be that current US risk transfer limitations on life insurers are based on risk assessment and risk management standards that are inferior to current regulatory best practices; an outmoded paradigm of "commandand- control" regulation; a model of silos in the financial sector; and rudimentary valuation theories.

ACLI supports the Academy recommendation that a new paradigm on risk transfer be incorporated into the new principles-based reserving methodology. We have been disappointed to learn that a subgroup of LHATF working on the new Valuation Manual chapter on reinsurance has not accepted the Academy's recommendation on modernizing risk transfer under the new reserving regime. We understand that LHATF will be reviewing that decision shortly and we urge you to advocate the Academy's recommendation.

AIA: AIA opposes the draft framework because it seeks to eliminate or sharply reduce collateral requirements for reinsurance assumed by alien reinsurers who choose to remain unlicensed in any state and who may maintain no assets in the U.S. Eliminating collateral for such reinsurers will place new burdens on U.S. insurers and will likely make it much more difficult for U.S. insurers to receive prompt and appropriate reinsurance payments and may unnecessarily threaten the solvency of certain U.S. insurers. If collection of reinsurance payments becomes more uncertain and problematic, a likely result is a reduction in capacity in the U.S. primary market for underwriting certain large U.S. risks, such as natural catastrophes and other coverages--at a time when increasing capacity for such risks is a critical public policy goal.

The current collateral system has worked effectively for decades. Advocates of change have been unable to identify any problems with the current system or any real benefits to U.S. insurers that would result from the proposed framework. The lone argument that collateral requirements for reinsurers who refuse to become licensed in any

U.S. state or maintain assets in the U.S. are discriminatory is a red herring aiming to mislead U.S. regulators. The U.S. collateral system is more open than systems used in other countries because it offers foreign reinsurers a *choice*: become licensed in an accredited state and not post collateral *or* refuse to become licensed in any accredited state and not be required to maintain assets in the U.S. and instead post collateral to cover expected losses. The U.S. collateral option is more friendly to foreign reinsurers than the requirements other countries impose on U.S. reinsurers. Citing one example, the European Union's Reinsurance Directive authorizes member EU countries to treat U.S. reinsurers on an unequal basis vis-à-vis EU reinsurers. The Directive prohibits U.S. reinsurers from "passporting" into other EU countries and allows member states such as France, Spain and Portugal to retain current collateral requirements against U.S. reinsurers while demanding elimination of such collateral requirements for EU reinsurers. As LeBoeuf, Lamb has advised its U.S. reinsurer clients regarding the EU Directive: "It is unlikely that non-EU reinsurers will be able to avoid new regulatory and financial burdens, which may affect their competitiveness in the EU." LeBoeuf warned its U.S. clients that "This distinction [between EU reinsurers and U.S. reinsurers] should already start ringing the bells in the head offices of such reinsurers, who all other things being equal, may find themselves in a less competitive position vis-à-vis EU cedents than EU reinsurers. A copy of the LeBoeuf article "A New Regulatory Landscape for EU Reinsurance" is available at http://www.deweyleboeuf.com/files/News/de12dcc2-a111-402b-96ee-977ab9df7e62/Presentation/NewsAttachment/96855e21-e5c3-4d9e-b900-33afbde69a17/article_868.pdf

The draft framework also violates fundamental principles of insurance financial regulation. A bedrock principle of the state regulatory system is that the domiciliary regulator of the U.S. ceding insurer evaluates and administers the financial health of its state insurers. The framework would reverse this long-established principle and make the collateral determination of the port of entry regulator binding on the domiciliary regulator of the U.S. cedent. All financial determinations regarding the financial health of a U.S. licensed state insurer should be made by the domiciliary regulator in charge of the U.S. insurer and not by the port of entry state selected by the alien reinsurer.

The draft framework also relies too heavily on the nationally recognized statistical rating organizations. The rating organizations have a history of being too slow to react to changing financial conditions and the recent subprime mortgage fiasco should provide sufficient cause of concern that upending a collateral system that has worked for decades without problem in favor of an untested new system relying on NRSRO ratings may be imprudent.

The draft framework also fails to adequately discuss how the new reinsurance supervision review department (RSRD) will evaluate eligible foreign jurisdictions. The standards for determining whether a country is eligible for port of entry status is critical in evaluating how the framework will work in practice. Yet the framework contains little or no specific information regarding the standards to be applied by the RSRD. Indeed the framework is silent on critical issues such as countries that permit solvent schemes of arrangement or involuntary transfers of risks even though the task force's December 2, 2007 Framework Memorandum provided assurances that these would be issues discussed and addressed in the framework. Another issue that the framework is completely silent on is creation of a security or guaranty fund. Again, the December 2, 2007 memorandum stated that this would be an issue addressed during framework discussions yet there is no mention of the issue in the current draft.

AIA opposes the draft framework and believes the current collateral system works effectively and should remain in place. The proposed new system unfairly places all risks and burdens on the U.S. insurer while providing all the benefits to alien reinsurers.

Genworth: **...**We are strong proponents of a level playing field for all competitors in any given jurisdiction.

We have been closely following the activities of the NAIC's Reinsurance (E) Task Force (along with the proposals put forth by the Departments in New York and Florida) related to the subject of reinsurance modernization. We have previously communicated our position on this topic directly to several of the U.S. Commissioners.

In those communications, we have expressed serious concern about the immediate removal or reduction of collateral requirements for non-U.S. reinsurers and the potential that it may exacerbate an already tilted playing field that favors writers and reinsurers of life insurance who are headquartered outside the U.S. over those headquartered in the U.S.

U.S. regulators have established demanding solvency standards (both reserves and Risk Based Capital) for U.S. life insurance companies. In many cases, these standards are significantly in excess of those required of insurers writing similar coverages in other jurisdictions around the world.

U.S. collateral requirements for reinsurance were implemented primarily to assure collectibility. However, setting that issue aside, they have also served the less public purpose of helping to provide support for a level playing field for both the direct and reinsurance life insurance markets in the U.S.

In the current U.S. life reinsurance market, alien insurers either reinsure business directly or from a U.S. subsidiary to an offshore affiliate. In either form, they have to provide collateral for the ceded reserves (either through funds withheld, trusted assets or a letter of credit), but they avoid U.S. RBC requirements. Business naturally migrates to jurisdictions with the lowest capital requirements and this capital advantage (in many cases coupled with a tax advantage) is why there are few U.S. life reinsurers left today.

In this environment, we believe that use of collateral to maintain a consistent level of the reserves required to back liabilities is both an appropriate and necessary function for regulators. Regulators need to address the reserve standards for U.S. based companies, but however they are set, it is important that all carriers operating in the U.S. market are meeting the same standards.

If U.S. collateral requirements for reinsurance are removed (or eased materially), without corresponding reductions in U.S. reserve requirements, any highly-rated foreign insurer will be able to create or buy a U.S. subsidiary, reinsure the bulk of its business to an off-shore affiliate and have a significant advantage over a U.S headquartered company competing for the same business. If such an advantage is allowed to exist for even a few years, we believe the viability U.S. life direct writers will be materially compromised

We urge the NAIC to coordinate the issue of collateral reduction with its work on principles based reserves and capital, so that collateral requirements are not reduced before "equivalent" reserve and capital standards are in place.

In closing we reiterate our strong support for a level playing field and look forward to the removal of collateral requirements as soon as the reserve and capital redundancies for U.S. carriers have been eliminated.

GIAJ: **In general -** For an insurer, securing efficient reinsurance cover at an affordable/justifiable price is critically important as a means of managing the risks they underwrite. The importance of reinsurance is further increasing in light of growing catastrophe risks such as natural disasters. In order to further develop the reinsurance market, and given the fact that the reinsurance business is "B to B" transaction between sophisticated and professional parties, our basic position is that any collateral requirement (as well as any other preconditions and prerequisites) should be removed. In that sense, the "Reinsurance Evaluation Office (REO)" proposal which was adopted at the NAIC Winter Meeting in 2006 was a step forward in the right direction. By evaluating reinsurers based on the soundness of their financial condition and not on their state or country of domicile, and the same thing can also be said regarding the proposals to relax reinsurance collateral requirements released by the States of NY and FL in 2007.

However, the latest proposal for reinsurance regulation (as well as the "Draft Proposal to Grant Recognition of Regulatory Equivalence to Non-U.S. Insurance Supervisors" released in September last year) is much more complex, costly, and labor intensive than the REO proposal, especially regarding conditions and approval process to obtain reduced reinsurance collateral. We are extremely concerned that this proposal would hinder sound development of the reinsurance market. Even if this proposal were implemented, it is difficult to see how this framework would work properly without at least resolving the following issues [comments inserted throughout].

NAMIC: …**Continuing reservations -**The facts of the marketplace in the United States demonstrate that alien reinsurers are dominant and, for reason of that dominance, we believe it is difficult for anyone to assert that any restriction on international trade has been imposed by any design or connivance. Legislation that may be premised on any supposed disadvantage to aliens who wish to enter the reinsurance market in this country may cause the Task Force to believe it must act, yet there is every reason for the Task Force to reject any such premise and to consider the weight, or lack of it, to be accorded such legislation.

Credit for reinsurance based on full collateral has served well for many years. It can be argued that what is now proposed in the framework results in more efficient use of reinsurers' capital, diminishing the friction costs of collateral. It may simultaneously be argued, however, that insolvency costs to be borne by primary insurers in the United States and its territories will inevitably rise. In other words, when an alien reinsurer does not meet its obligations to a cedent in this country and collateral is not otherwise available, the guaranty-fund system will assess other insurers domiciled in this country. Primary companies, via reduction of collateral, are caused to assume a greater increment of the risk of failure of reinsurers.

With respect to a level playing field—taxation already favors alien reinsurers—as may exist between the market in this country and in the EU countries, we have not seen in the Task Force's materials any country-by-country itemization of collateral regimes that forces the conclusion that state regulation in this country discriminates against EU domiciled reinsurers. EU countries may or may not, to the extent of our knowledge, recognize full credit for reinsurance where collateral is less than 100 per cent. A strong argument based on reciprocal reduction of collateral is not, in other words, visible.

In summary, the substance of the framework document—and we do not take issue with the entirety of its content—would appear to accommodate alien reinsurers with respect to a) consequences of their non-payment and b) consolidation of state licensure. These accommodations, however, provide no assurance that alien reinsurers will be more willing to assume catastrophe risk but do give us caution with respect to solvency.

PCI: By way of overview, PCI continues to oppose collateral reduction for alien reinsurers. We still do not understand nor see the need for making a change to collateral rules here in the United States. We do see potential harm to solvency regulation and the guaranty association system in the U.S. Nothing prevents an alien reinsurer from doing business in the U.S. Nor is an alien reinsurer subject to more onerous requirements than a U.S. reinsurer. Collateral is an *additional* (emphasis added) way that an alien reinsurer may do business in the U.S. The collateral requirement is part of accreditation of states, a system by which the states determined what was necessary for good solvency regulation. The proposal seeks to force the states to accept reduced or zero collateral under an optionally free of collateral (OFC) system in addition to the existing ways of doing business in the U.S.

While we reiterate many of our comments submitted in the past, it is appropriate for PCI to comment to the proposed OFC system. Our comments are geared toward improving the proposal. They should not be taken as conditions under which PCI would no longer oppose the proposal. For that, the proposal would have to give the ceding companies the same level of security that collateral does.

PCI remains very concerned that the proposals place very onerous burdens on the ceding insurers. These are burdens that should be placed upon the reinsurers, the home, POE and host states, but not on ceding companies. These should be clear in contractual provisions.

Under this proposal, ceding insurers will have to closely monitor rating downgrades of their, often numerous, reinsurers. Slow-paying reinsurers will have to be monitored closely by the relevant regulator. Even if that occurs, the proposal lacks sufficient penalty for overdue reinsurance recoverables. We are concerned not only with the time lag related to requesting increased collateral but also the time lag to receive collateral, if at all. Here is one example of the time lags built into the proposal. Should the home or POE state seek to downgrade a reinsurer, there presumably would be an administrative procedure (and related appeals) to the downgrade. Meanwhile, the ceding company could have a reinsurer balking for months, perhaps years at funding the increase in collateral requirement. By the time the reinsurer is finally downgraded under the proposal, its ceding companies may have been downgraded by their rating agencies for a failure to obtain collateral. It may be then too late to obtain increased collateral.

The use of rating agencies in the proposal appears excessive. We reference the subprime crisis in the broadest sense. Looking at the timeline of the proposal, an entity is downgraded, then there must be notice of the existence of the downgrade, then additional collateral must be requested and finally collateral must actually be increased. There is one entity affected should this go wrong: the ceding company.

At the spring NAIC meeting, there was a paper released regarding the constitutionality of rating the regulation of a foreign country. PCI remains concerned in this area.

We are concerned that full solvency regulation by a host state over its domestic ceding insurers no longer exists with this proposal.

PCI has continuously raised the issues of Schemes of Arrangement and Part VII Transfers and must do so here. Run-offs need further examination prior to any proposal. Where a scheme of arrangement or Part VII transfer is used, existing collateral provision should apply. Any impact of the proposal for collateral reduction and collateral reduction as related to run-offs should be, as with the proposal itself, prospective only. Yet there is no mention of these in the proposal. We also believe that no jurisdiction offering schemes of arrangement or Part VII transfers should be certified for reduced collateral for its reinsurers of U.S. cedents. An alternative might be that for any group in which any affiliate that has ever applied for or applies for a scheme of arrangement, Part VII transfer or similar mechanism, all entities in the group or if a single reinsurer that reinsurer, must post 100% collateral.

There is a great deal of pressure in the EU to meet the stringent capital requirements of Solvency II. Accordingly, the envelope is being pushed to use solvent schemes of arrangement and Part VII transfers to cull out discontinued books and assign obligations to lower-rated, less well-capitalized companies. This has the effect of increasing the credit risk to U.S. cedents and negating original contract commitments. PCI notes that HM Treasury in the U.K. has a document entitled "Consultation on Amendments to Part 7 FSMA." We urge the NAIC and/or the Reinsurance Task Force to participate with HM Treasury to express U.S. regulator and ceding company concerns with such transfers. We believe a constructive "dialogue" is critical in relation to Part VII transfers and potential impact on U.S. ceding companies.

RAA: First, the RAA is very concerned that the current draft of the Framework Proposal is missing one of the three core components - the mutual recognition component - which was an essential element in the Framework Proposal draft that the NAIC plenary passed in March 2008. A key element in the original November 8, 2007 Framework Memorandum (which was repeated in the December 2, 2007 Framework Memorandum that was passed by the RTF, E Committee and Plenary) was "assessing regulatory effectiveness through an 'outcomes-oriented' approach" to "determine which non-US jurisdictions are entitled to enter into mutual recognition agreements." The Framework Proposal identified several "Outstanding Issues" to be addressed including "determination of how mutual recognition agreements should be negotiated, enforced and terminated". The Framework Proposal also identified several potential areas where mutual recognition parties would determine that their counterparts apply appropriate legal standards and regulatory requirements. This key component has virtually disappeared in the July 3 Memorandum.

This is surprising for many reasons, including the fact that the NAIC's April 5, 2008 letter to Senator Jack Reid asking the Senate to not consider the reinsurance section of H.R. 1065, the Nonadmitted and Reinsurance Reform Act of 2007, is based upon the fact that the NAIC RTF had adopted a framework for the reinsurance modernization initiative that "included 3 critical components: (1) mutual recognition of different regulatory regimes (both within and outside the US) and a process to attain mutual recognition; (2) the concept of a single US regulator for reinsurers within the US; and (3) the concept of a single state regulator for non-US reinsurers through which non-US reinsurers could access the US marketplace." Three months after this representation to Congress, however, the first critical component appears to have disappeared without explanation and with it the ability to implement the objectives of the 3rd point – the equivalent treatment of non-U.S. reinsurers pursuant to a process which assures the appropriate protection to the U.S. insurance market through assessment of non-U.S. jurisdictions to determine if they employ substantially equivalent legal standards and regulatory requirements.

The RAA would also caution the Task Force that the IAIS Guidance Paper on Mutual Recognition has changed significantly from the draft referenced and relied upon in earlier versions of the RTF framework proposals. It now is, in fact, much broader than the title would suggest as it addresses all the possible options for recognition of other supervisory authorities (unilateral, bilateral and multilateral). During drafting sessions of this paper at IAIS meetings, international regulators were clear that they wanted the paper to address all of these options but that individual countries could and would do what they deemed appropriate. It is noteworthy that, with the broadening of the IAIS paper to include additional forms of supervisory recognition, the "Benefits of mutual recognition" section set forth in the July 18, 2007 IAIS draft has been revised. Several important benefits of mutual recognition to the insurance industry, its regulators and the public have been deleted, presumably because they may not be realized

under some of the forms of supervisory recognition now encompassed in the IAIS draft. We urge this Task Force to again include "mutual recognition" of other supervisory regimes in its proposal.

Inherent in this concept of "mutual recognition" is the idea that U.S. reinsurers would get the same benefits and access to non-U.S. jurisdictions that non-U.S. reinsurers from recognized jurisdictions would receive in the U.S. The U.S. is the largest consumer of property/casualty reinsurance in the world. There is no doubt that the U.S. needs the global reinsurance marketplace to meet its demands. At the same time, however, U.S. regulators should also seek to preserve the domestic reinsurance market by not only streamlining the regulatory process within the U.S. but also by assuring similar treatment of its companies abroad. The method for accomplishing this will be addressed in the implementation phase.

Second, and as set forth in more detail below, the RAA is very concerned about the July 3 Memorandum's requirement of numerous mandatory contract terms in reinsurance agreements. Reinsurance transactions are between sophisticated business entities with relatively equivalent bargaining power. There is no need to dictate explicit clause language to ceding and assuming insurers and doing so would be inconsistent with current NAIC and international regulatory practice. Such a move is in the opposite direction of principles-based regulation, which the NAIC is exploring. Finally, the specific referenced clauses go beyond what is necessary to ensure an entity's solvency.

Addressing these two critical issues is of the utmost importance as the Task Force moves forward in both the design and implementation phases of its reinsurance regulatory modernization framework.

Definition of Terms

"Domiciled" means the jurisdiction in which the insurer is incorporated or organized.

Comments:

AIG: The definition of "Domiciled" seems incorrectly worded. Considering the actual definition shown, we suggest the item be labeled as: "Domiciliary jurisdiction". Then "Domiciled" could be defined as: "The domiciliary jurisdiction where the insurer or company is incorporated or organized."

"Home state" means the qualifying state where the national reinsurer is licensed and domiciled.

"Home state supervisor" means the supervisor of a national reinsurer.

"Host state" means the domicile of the ceding company.

"Host state supervisor" means the ceding company's domestic regulator.

"National reinsurer" means a reinsurer that is licensed and domiciled in a home state and approved by such state to write reinsurance assumed business across the United States while submitting solely to the regulatory authority of the home state supervisor for purposes of its reinsurance business.

Comments:

AIG: Under the definition of "National reinsurer", under the current system of state-specific licensing laws, we don't see how this model can universally allow a "home state" as defined in the model to approve a reinsurer "to write reinsurance across the United States".

NAMIC: …with respect to entries in the Definition of Terms, "National Reinsurer" is described as submitting "solely to the regulatory authority of the home state …," but certain actions, particularly those related to rating of financial strength, appear, in fact, very closely tied to actions of the RSRD.

RAA: The RAA suggests the following revisions to the definitions: "National reinsurer" means a reinsurer that is licensed and domiciled in a home state and approved by such state to ~~write reinsurance~~ **transact** assumed **reinsurance** business across the United States while submitting solely to the regulatory authority of the home state supervisor for purposes of its reinsurance business.

The amendment more accurately reflects standard reinsurance technology.

"Non-U.S. Jurisdiction supervisor" means the domiciliary supervisor of a reinsurer from a non-U.S. jurisdiction.

"Port of Entry reinsurer" means a non-U.S. assuming reinsurer that is certified in a port of entry state and approved by such state to provide creditable reinsurance to the U.S. market. No physical presence in the U.S. is permitted.

Comments:

ABIR: Definition of Terms, Port of Entry Reinsurer. This definition contains a phrase: "*No physical presence in the US is permitted*." We'd recommend this phrase be changed to the proposed language provided herein. The current language is potentially problematic since non-US insurers may own substantial US subsidiary corporations. We may also have back office support operations that do no underwriting. What we propose is draft language and we will continue to consider refinements to this language as this document moves from the outline stage into actual regulatory text. "Port of Entry reinsurer means a non-US assuming reinsurer that is certified in a port of entry state and approved by such state to provide creditable reinsurance to the US market. A Port of Entry reinsurer shall not have a 'U.S. Underwriting Office', meaning a fixed location within the United States (including the District of Columbia, the Commonwealth of Puerto Rico and the U.S. Virgin Islands) from which the Port of Entry reinsurer conducts reinsurance underwriting. The term a U.S. Underwriting Office shall not include any representative or liaison offices of the reinsurer; any underwriting officers of the reinsurer which underwrite exclusively non-US risks; nor any U.S. office lawfully maintained by any subsidiary, parent company or other affiliate of the Port of Entry reinsurer."

"Port of Entry state" means the state where a non-U.S. assuming reinsurer is certified in order to provide creditable reinsurance to the U.S. market.

"**Port of Entry supervisor"** means the insurance supervisory agency of the port of entry state.

Comments:

NAMIC: The section labeled Definition of Terms should include at least identification and brief description of what is a new regulatory entity, the "Reinsurance Supervision Review Department," or RSRD. This entity is at the very nexus of operation of this proposal, and, although later explained, would seem appropriate for identification in "Terms."

Purpose and Structure

2. U.S. insurance regulators have developed a framework that would allow for a state with the appropriate regulatory capacity to be a sole U.S. regulator of a reinsurer writing assumed business in the United States. The framework provides for two new classes of reinsurers in the United States, national reinsurers and port of entry (POE) reinsurers. Each would be supervised by a single state (the home state or port of entry state). National reinsurers would be licensed by the home state and port of entry reinsurers would be certified by the port of entry state.

Comments:

AIG: A fundamental question becomes: Can a company domiciled in State A choose to be a national reinsurer with a "Home state" of State B whether or not State A qualifies under the model as a home state? Our reading of the model indicates an answer of "No" to this question. Is that a correct understanding? Additionally, what is the standard for "appropriate regulatory capacity"?

3. In order to qualify as a home state supervisor or a port of entry supervisor, a state must meet a set of standards as established by the supervisory board of the NAIC Reinsurance Supervision Review Department (RSRD). Under the framework, a certification mechanism will be established so that those states that have the resources, expertise and experience to regulate reinsurance can do so as a home state or POE supervisor which will have exclusive jurisdiction over its reinsurers reinsurance business. Under the framework, a consultative process will be created to facilitate the resolution of disputes among insurance regulators regarding reinsurance issues. This consultative process shall be localized within the supervisory board of the RSRD which will consist of state insurance regulators. After consultation, the decision by the home state or POE supervisor with respect to the financial solvency of the reinsurer will be final.

Comments:

AIG; In the first line of the paragraph after the phrase "home state supervisor", for clarity, we suggest adding the phrase "for the purpose of establishing national reinsurer status hereunder". At the end of the fifth line "reinsurers" should be "reinsurers'". Relative to the consultative process and as reflected in the comment relative to paragraph 10, the construct of the consultative process described is unclear. Additionally, as to the last sentence of the paragraph, it is unclear how matters not related to financial solvency (e.g., corporate governance, market conduct, etc.) are to be handled.

PCI: **Item 3.** There is discussion of a consultative process, but in the end, “the decision by the home state or POE …will be final.” It is unrealistic to conclude that there will be uniformity in reinsurance regulation, given the broad discretionary factors that come into play for the home state or POE to evaluate the reinsurer (see #20 in the proposal). One home or POE state may consider 100 day overdue recoverables unacceptable, another may allow explanations as to recoverables, and another may not consider 100 day over due recoverables material. There is no objective assignment of rating, nor objective value given to each factor listed in #20.

RAA: **Paragraph 3**: The RAA is concerned about the NAIC through the RSRD, which is not a governmental body and which is not accountable to any governmental body, having responsibility for establishing and implementing the certification mechanism for evaluating and determining which states should be single state regulators. As we have previously suggested, consideration should be given to the appropriate federal role and/or “federal tools” that may be necessary to enable effective implementation of the certification aspect of the Proposal.

4. The reinsurance regulatory modernization framework will be available to companies that write primarily reinsurance business with no more than 5% of their gross premiums written other than assumed reinsurance. This requirement to primarily write reinsurance will not apply to a group including incorporated and individual unincorporated underwriters (i.e. Lloyd’s).

Comments:

ABIR: Pure Reinsurer Provision, Paragraph 4. This provision disqualifies a "mixed insurer/reinsurer" from qualifying for a national passport under the port of entry provision for its reinsurance business. The language as written contains an exception for a reinsurer that writes no more than 5% of its gross premiums in insurance; and a Lloyds' exception that allows Lloyd's syndicates to write both insurance and reinsurance. As we understand it, this "pure" reinsurer provision is included for two reasons:

a. A belief that it is mirroring the effect of the EU Reinsurance Directive;
b. Concern about creating unfair competitive advantages in the US for mixed insurers (or creating more risk for their policyholders) based on their ability to obtain a national passport when their commercial insurer competitors can not obtain such a passport.

ABIR recommends that the limitation on national passporting to an insurer that conducts primarily a reinsurance business be dropped. Instead the national passport should be written to apply to the reinsurance line of business written by an insurance company. It does not matter that the reinsurance is written by a company that does both insurance and reinsurance and the exceptions to the current definition prove the point that trying to shoe horn in a "professional reinsurer" provision creates marketplace inequities. We ask your consideration of these points:

a. The EU Reinsurance Directive is not a template to follow for this provision. The Reinsurance Directive was created to apply to reinsurers because no European wide regulation existed at the time for so-called "pure" reinsurers. The Reinsurance Directive thus created a first time reinsurance regulatory framework and a passport for the reinsurance business. Cross border access by third country reinsurers into the EU is a country by country decision.
b. The EU Directives dealing with direct insurance allow an insurer to write both insurance and reinsurance. The "mixed" insurer can passport throughout the EU with its single license and conduct either an insurance or a reinsurance business as long as it is writing reinsurance on a line of business it is authorized to write. With the implementation of Solvency II the same solvency requirements will apply to insurers and reinsurers. Furthermore, Solvency II will not limit the ability of mixed insurers to conduct a reinsurance business.
c. A port of entry insurer that writes a sizeable portion of reinsurance does not gain a competitive advantage over US commercial insurers. The passport that it would receive would only apply to the reinsurance line of business. No commercial line of business advantage is gained.
d. The RSRD will be assuring that non US jurisdictions meet the standards set by the NAIC for qualifying jurisdictions. In addition, the port of entry reinsurer must be in good standing in that jurisdiction and meet the financial strength standards of the reinsurance regulatory modernization framework. The mix of business in the non-US reinsurer does not detract from the financial standing of the insurer. In fact, some argue that the mix of business provides diversification benefits that strengthen the financial standing of the insurer.
e. The Lloyd's exception makes our point that mixed businesses should be allowed a national passport for their reinsurance business. The Lloyd's exception points out the need for equitable treatment of all non-US mixed insurers including ABIR members. For example, eight ABIR members own Lloyd's syndicates. Under the proposal, these members could access the US market via Lloyds, but could not access the US market from their more highly capitalized Bermuda operating companies. As we noted, the exception makes our point that the reinsurance modernization framework ought to be available to port of entry insurers for their reinsurance business.
f. We estimate that 12 of our 22 members provide reinsurance from operating companies that write both insurance and reinsurance. A requirement to compel these companies to segregate capital, establish new operating companies, obtain new rating agency assessments and new audited financials will constrain capacity rather than increase capacity available to the US.
g. Substantial portions of the California, Florida and Texas catastrophe reinsurance is written by "mixed" insurers which write reinsurance.

AIG: The rationale for not having the 5% direct business allowance apply to essentially Lloyds is not made clear. Presumably, it's because Lloyds also writes directly on a surplus lines basis. However, this seems patently unfair to US assuming companies that may write, for example, 10% of their total business on a direct basis.

CEA: **Reinsurance-only Provision** - We do not understand the rationale behind the inclusion of a provision limiting the new framework to pure reinsurers only. In our opinion, it is inappropriate to deny the benefits of the proposed regime to entities simply because they also write direct insurance business. Such a restriction is also not prudentially justified. We therefore recommend the NAIC remove the reinsurance-only restriction.

GIAJ: **Preferential treatment given to reinsurers -** According to the latest draft proposal, preferential treatment is only applicable to reinsurers that write at least 95% of their gross premiums by the reinsurance business (paragraph 4). Such discrimination should be removed since there is no rationale to make a difference between "pure-reinsurers" and insurers writing both reinsurance and direct insurance. Such discrimination can not be found in the principles of the IAIS. The Global Reinsurance Market Report published by the IAIS Reinsurance Transparency Group (RTG), for example, treats re/insurers equally regardless of their reinsurance business ratio out of their total business. In this Report, creditworthiness of reporting entities has never been differentiated because of type of their main business.

IUA: **"Reinsurance Only" Provision - Paragraph 4** of the Memorandum provides that the new framework will only be available for companies that "write primarily reinsurance business with no more than 5% of their gross premiums written other than assumed reinsurance". Our members who write insurance and reinsurance are particularly concerned about this provision. We confess that we do not see any rationale for this provision and we see a number of practical problems in enforcing it.

In considering this provision, we note that we are not certain why it has been added. Some have suggest it was added in an effort to be consistent with the EU Reinsurance Directive, which applies to those who write reinsurance only. If this is true, we respectfully note that it is a misdirected attempt at consistency. The Reinsurance Directive was made applicable to those who only write reinsurance because it was targeted at the one sector of the EU insurance industry that was not yet covered by the EU insurance directives. The Reinsurance Directive was adopted in order to put pure reinsurers in the same position in terms of solvency regulation, passporting rights and other regulatory requirements as mixed insurers. It was not done to create special rules for reinsurers. It was adopted for exactly the opposite reason.

Beyond the precedents set by the EU Reinsurance Directive, we would note that creating separate rules for those who write reinsurance only is not sound as a commercial or regulatory matter. Many companies write both insurance and reinsurance. This diversification is recognized as a positive factor by rating agencies and regulators. We believe that it is proper to restrict the application of the framework only to the reinsurance operations of an insurer/reinsurer. For example a U.S. company that writes insurance and reinsurance would be able to transact reinsurance business throughout the U.S. based on its domestic state license. To write insurance, however, it would need to obtain appropriate state licenses. This rule would easily be enforced.

The wisdom of reinsurers writing insurance and reinsurance is evidenced by the exceptions provided to the reinsurance only provision. The provision has been amended to provide and exception to Underwriters at Lloyd's, London. Lloyds writes a substantial amount of insurance and reinsurance and it is appropriate to permit the Lloyds market to operate under the framework. The same argument is equally valid for every carrier who, for good commercial reasons, elects to write both insurance and reinsurance.

We also note that for any reinsurer, there is a 5% of gross written premiums exception to the reinsurance only requirement. We wonder why it would be permissible for a reinsurer which write 5% of its business as insurance to conduct its reinsurance operations under the framework but not a reinsurer for which 10%, 20%, even 50% of its premium volume is insurance?

We also wonder how the 5% exception will work in practice. When do you apply the 5% test, daily, quarterly, yearly? What is a reinsurer had direct premiums equal to 4.5% of its business for the first two quarters of the year and then its insurance premiums increase to 6.5% of its business. What happens? We also suggest that there will be contracts – particularly some facultative reinsurance agreements – where it will be very difficult to distinguish between what is insurance and reinsurance.

The reinsurance only provision will impose dramatically different regulatory requirements on various reinsurers. It will create undesirable market distortions. This provision should be dropped.

Lloyd's: We are grateful for the specific provisions added to the memorandum to address and resolve issues arising from the structure of the Lloyd's market. While these provisions address Lloyd's specific issues, we feel a commitment to the RTF to assist it in making the framework as good as it can be for the market as a whole. In this spirit, we believe the ideal approach would be to broaden the scope of the framework to cover all those entities writing reinsurance, provided they meet the regulatory jurisdiction standard and the financial criteria. We understand that a number of international "mixed insurers" have strong views that this distinction between those reinsurers that do and do not write direct insurance should be removed from the framework. Like them, we are unsure of the rationale for restricting the proposal in this way. We believe it should be possible to clarify that direct business written by mixed insurers is outside the scope of the framework and would continue to be fully subject to all applicable U.S. regulatory requirements for direct insurance activity.

PCI: **Item 4.** The 5% limitation of gross premium written other than assumed reinsurance seems on its face to be an acceptable standard for defining a primary reinsurer. However, PCI can envision intercompany pooling arrangements or intercompany reinsurance agreements where one of the entities might not meet this qualification. From other sections of the proposal, it appears that the affiliate might have to meet these requirements for reduced collateral. There needs to be clarification as to how all intercompany pooling or reinsurance agreements would be handled.

RAA: **Paragraph 4**: For purposes of calculating "assumed reinsurance" in determining a company's eligibility under the Framework, when a reinsurer writes surety reinsurance and has related co-surety arrangements, the fact that the reinsurer may face potential direct liability should not change the classification of the surety reinsurance business. Such business should properly be classified as "assumed reinsurance."

5. National reinsurers or POE reinsurers shall have a minimum capital requirement of $ 250 million to be eligible to be a national reinsurer or a POE reinsurer. This requirement may also be satisfied by a group including incorporated and individual unincorporated underwriters (i.e. Lloyd's) having capital equivalents (net of liabilities) of at least $ 250 million and a Central Fund containing a balance of at least $ 250 million.

Comments:

AIG: The first seems unclear and we suggest it be rephrased as: "In order to achieve status as a national reinsurer or a port of entry reinsurer, a reinsurer must have a minimum *surplus* of $250 million." Use of the phrase, "Minimum capital", a defined term in many statutes, would seem to require a company's "capital" account to be $250 million, not, we think, the Proposal's intended standard. Then, the question arises as to what happens if the surplus falls below that amount subsequent to achieving national reinsurer or port of entry reinsurer status? As to Lloyds, does the standard apply to each syndicate or all the syndicates at Lloyds in the aggregate? We would also point out (as we did in our prior comments) that the $250 million requirement is arbitrary in that it bears no relationship to underlying risk. A reinsurer with $50 million of surplus and $25 million of liability is much stronger, all other things being equal, to a reinsurer with $250 million of surplus and $10 billion of liability.

GIAJ: To become certified as a National reinsurer and a POE reinsurer, foreign reinsurers must have a minimum capital of 250 million dollars (paragraph 5). It is far from rational treatment to require such an additional burden. It is unnecessary additional layer over reinsurers already evaluated by rating.

6. Other aspects of this single state regulatory system for national reinsurers include:

a. A host state will be required to grant credit for reinsurance ceded by one of its domestic insurers to a national reinsurer; and

Comments:

AIG: As to sub-paragraphs a. of each paragraph, how can a host state "be required to grant credit for reinsurance ceded by one of its domestic insurers to a national reinsurer"? That could only happen if the host state adopts changes to its law; it's not dependent on a company achieving national reinsurer or port of entry reinsurer status.

PCI: **Items 6&7, (a).** This crams down reduced collateral upon the ceding company and prevents the host state regulator from any review of the credit quality of its domiciled insurer's reinsurance, effectively telling the domicile to regulate for solvency, but be powerless over one aspect of perhaps the largest balance sheet item, reinsurance.

b. The ceding insurer's domiciliary regulator retains the same authority it has under existing law to determine whether the contract transfers risk.

Comments:

RAA: **Paragraphs 6(b) and 7(b)**: leave the determination of risk transfer to the ceding company's domiciliary regulator. The RAA is concerned that a regulator could use this authority to require additional contract terms and conditions in order for a contract to qualify as transferring risk. The Proposal should explicitly state that risk transfer should be determined in a consistent manner in accordance with statutory accounting rules and that the ceding company's domiciliary regulator has no authority to require additional contract terms or conditions.

7. Other aspects of this single state regulatory system for POE reinsurers include:

a. States will be required to grant credit for reinsurance ceded by their domestic insurers to a POE reinsurer;

Comments:

AIG: As to sub-paragraphs a. of each paragraph, how can a host state "be required to grant credit for reinsurance ceded by one of its domestic insurers to a national reinsurer"? That could only happen if the host state adopts changes to its law; it's not dependent on a company achieving national reinsurer or port of entry reinsurer status.

PCI: **Items 6&7, (a).** This crams down reduced collateral upon the ceding company and prevents the host state regulator from any review of the credit quality of its domiciled insurer's reinsurance, effectively telling the domicile to regulate for solvency, but be powerless over one aspect of perhaps the largest balance sheet item, reinsurance.

b. The ceding insurer's domiciliary regulator retains the same authority it has under existing law to determine whether the contract transfers risk; and

Comments:

RAA: **Paragraphs 6(b) and 7(b)**: leave the determination of risk transfer to the ceding company's domiciliary regulator. The RAA is concerned that a regulator could use this authority to require additional contract terms and conditions in order for a contract to qualify as transferring risk. The Proposal should explicitly state that risk transfer should be determined in a consistent manner in accordance with statutory accounting rules and that the ceding company's domiciliary regulator has no authority to require additional contract terms or conditions.

c. In order to be certified as a POE reinsurer, a company/reinsurer must be organized in and licensed by a non-U.S. jurisdiction recommended as eligible for recognition by the RSRD. Once the non-U.S. jurisdiction has been recommended as eligible by the RSRD, and so long as it maintains that status, the reinsurer could then be certified by the POE state to access the U.S. market through the POE state.

Comments:

RAA: Paragraph 7(c)'s: second sentence should be amended as follows so that the terminology is in accord with the Definitions section: Once the non-U.S. jurisdiction has been recommended as eligible by the RSRD, and so long as it maintains that status, the reinsurer could then be certified by the POE state to access provide creditable reinsurance to the U.S. market through the POE state.

As noted above, Paragraph 7(c) states that in order to be certified as a POE reinsurer, a company/reinsurer "must be organized and licensed by a non-US jurisdiction recommended as eligible for recognition by the RSRD." Requiring reciprocity and/or entering into a mutual recognition arrangement, which was a cornerstone of the Framework

Proposal passed by Plenary, is absent and should be re-inserted here to make clear that is a significant component of the Proposal that needs to be addressed in the implementation phase.

8. U.S. licensed insurers providing reinsurance who do not choose to become a national reinsurer would have the option to continue to operate under the current regulatory framework. Non-U.S. insurers providing reinsurance that do not choose to become a national reinsurer or a port of entry reinsurer would have the option to continue to operate under the current regulatory framework. The four methods of conducting reinsurance business in the U.S. under this proposal include the following:

Comments:

AIG: The Model appears to be designed to allow a Port of Entry reinsurer, i.e., an alien reinsurer entered through a Port of Entry designated state, to conduct business throughout the United States. As noted relative to the paragraph 1, there is a question as to whether the NAIC model can actually do that. It would seem that could only occur if the various other states pass accommodating legislation.

RAA: Paragraph 8: fails to refer to the "substantially similar" category of authorization in the NAIC model credit for reinsurance law.

a. As a national reinsurer;

b. As a POE reinsurer;

c. As a licensed or accredited reinsurer under the current NAIC Model Credit for Reinsurance Law; and

d. As a reinsurer (non-U.S. or U.S.) not licensed in all states by posting 100% collateral.

Comments:

PCI: **Item 8.** This is a clear statement of the optional nature of the proposal and the fact that reinsures will now have two new ways, items (a) and (b) to do business along with the existing structure, items (c) and (d). Current collateral requirements (item d) are merely an additional way in the U.S. a company can be a reinsurer (the other way being item c). Stated differently, item 8 says that there is no discrimination by the U.S. against alien reinsurers. PCI does not see the need for this proposal.

RAA: **Paragraph 8(d)** references 100% collateral as the current status quo, however, this is not always the case with respect to individual funding mechanisms. The amount of collateral required under the current system must be equal to the amount of credit taken, which is not necessarily 100% in all cases. This point should be clarified.

9. The proposed reinsurance regulatory modernization initiative, including changes to collateral requirements and any amendments to current credit for reinsurance rules, will apply only on a prospective basis. An appropriate implementation period will be developed.

Comments:

AIG: The paragraph does not clarify what it means where it states the model "will apply only on a prospective basis." Does that mean it will apply only to ceded reinsurance contracts effective after some date certain, perhaps the date the law is adopted by the last state adopting the template that makes the template national in scope? We note that the language in paragraph 17 seems clearer on this point; however, the "effective date of this proposal" is, as yet, unclear. Is that when the Model is adopted, when a state adopts the Model or when all states have adopted the Model? Or, some other point?

PCI: **Item 9.** PCI appreciates the comment that the proposal would operate only on a prospective basis. However, as the proposal is "fleshed out," it is important to maintain clear prospective application as the standard and avoid any provisions that may indicate otherwise. Therefore, we would seek a clear statement to this effect.

Role and Structure of the RSRD

Comments:

GIAJ: The legal authority of RSRD over each state regulator has not been clarified in the latest proposal, and this will lead to a vulnerable regulatory framework. Therefore it is doubtful that this regulatory framework would actually bring an intended effect.

10. The supervisory board of the RSRD will consist of state insurance regulators and will:

Comments:

AIG: How many RSRD board member states will there be, how will they be selected and for what terms will they be selected? Concerning item b, will the RSRD board also consider collateral increase criteria?

NAMIC: A larger and crucial question to be posed about the RSRD is its governance: Is a "supervisory board" of state regulators fully empowered to manage the RSRD, or is power to manage personnel and crucial functions vested at NAIC headquarters. We believe that industry, both representatives of primary insurers and reinsurers, should be part of RSRD governance and, further, that an oversight committee be established within the NAIC structure.

PCI: **Item 10:** While the goals of this item are laudatory, we do not believe the reality of the proposal would effectuate these goals.

a. facilitate communication and dispute resolution among home state, host state, POE, and other supervisors;

Comments:

PCI: For example, in (a) the RSRD is to facilitate dispute resolution. Yet elsewhere it appears that the decisions of the home or POE state are final, preempting regulation of reinsurance by the host state of a ceding company. Thus, should a host state be extremely concerned about the slow payment of a reinsurer to a domestic insurer, the rating of the reinsurer might not change because the home or POE state refuses to do so. Interestingly, should the host state be able to argue that it needs a rating downgrade of a reinsurer to seek additional collateral, should that reinsurer not post the additional collateral, it is the host state's domestic that would take the surplus hit. If significant enough, it is the host state with an insolvent insurer based on the decision of the home or POE state.

b. maintain, revise and update collateral reduction eligibility criteria; and

Comments:

PCI: In (b) the RSRD is to maintain, revise and update collateral reduction eligibility criteria. One concern here is that the RSRD becomes a legislator. It appears the RSRD at best is an administrative entity, empowered to enforce laws the states enact. PCI is not certain exactly what the status of the RSRD is. We do not see how a legislature can delegate its legislative duty to the RSRD to create law. The "collateral reduction criteria" must be set by statute, with the RSRD perhaps the entity to enforce those statutes.

This raises another concern relating to part (a). If the RSRD is to enforce, not create the statutes, then it should not, and constitutionally should not, judicially interpret the provisions. Yet it appears the RSRD seeks to be the legislative, executive and judicial branch in relation to collateral reduction.

RAA: Paragraph 10(b): provides that the RSRD will maintain, revise and update collateral reduction eligibility criteria. As explained more fully elsewhere in our comments, the RAA believes a system of collateral criteria is unnecessary in a regulatory regime with meaningful recognition standards that ensure all reinsurers transacting assumed business or providing creditable reinsurance in the U.S. are subject to substantially equivalent regulatory standards and enforcement. If such a recognition system is in place, neither a national reinsurer nor a POE reinsurer from an eligible, recognized jurisdiction should be required to post collateral except as expressly provided for under the recognition arrangement with the non-U.S. jurisdiction.

c. establish uniform standards for home state and POE supervisors.

Comments:

PCI: Part (c) raise related concerns, some very practical. To the extent the RSRD establishes uniform standards, only in the event each host state accepts each home or POE state determination will the proposal work. Another practical issue, mentioned earlier, how would the RSRD establish the uniform standards, especially relate to item #20, so that each state uniformly interprets and applies those standards? There could be as many different applications of the #20 standards as there are home and POE states. In fact, a state which might be both a home state and POE state might apply those standards differently in the home and POE context, since, for example, home states would be working with SAP accounting and POE states with, at best, reconciled SAP accounting. Or home states need not consider enforceability of judgments by other states, but POE states must consider enforceability of judgments of foreign countries.

11. The functions of the RSRD will include but not be limited to the following:

Comments:

AIG: There is no reference to confidentiality as to the RSRD. Can such a division of the NAIC have confidentiality grant in a manner similar to a state regulator?

NAMIC: With respect to Paragraph 11., "functions of the RSRD," it would appear to be necessary to include some means of administrative process to treat disputes as to rating of a reinsurer and, further, for de-certifation of an insurer or de-certification of a jurisdiction. It may be suggested these are functions wholly to be performed by the state or states of the cedents, yet this may not be a practical expectation. A "purposes and procedures" manual is contemplated for enforcement actions, yet the source of sanction seems ambivalent as between states and the RSRD—which would not appear to have any official power. The SVO may stand as the model analytic office here, yet it would seem some explication is warranted of the source for authority of sanctions—changes in ratings or removals of certifications—that occur at the RSRD level. It is understood that paragraph 12. leaves state regulators in charge of related actions at the state level, yet it would appear that many of such state-level actions would begin at the RSRD level as specified at 12. f.

RAA: Paragraph 11: addresses the functions of the RSRD. There are many important functions that the RSRD can perform, including participating in the development of standards and making recommendations, which must then be accepted by the regulator. It is critical to remember that the RSRD is not a governmental body and it cannot perform governmental functions or make governmental decisions. For example, the RSRD can perform the assessment of the jurisdiction and make a recommendation to the regulator that the jurisdiction meets the appropriate standards; the regulator must then accept (or reject) this recommendation for it to have any legally binding effect. The regulatory recognition should then either be embodied in an agreement wherein each supervisory authority identifies those areas where the host jurisdiction will defer to and rely upon the exclusive exercise of the home jurisdiction's supervision, or it may be effected through other lawfully prescribed methods (e.g., regulatory certification, authorization) that provide reciprocal legal benefits for the licensees of each jurisdiction. It is critical that this regulatory recognition be accomplished in a lawful manner (either at the federal level or by an appropriate authorization from the federal government to the state(s)).

This supervisory recognition should be founded upon a mutual determination by the supervisory authorities that each maintains substantially equivalent regulatory standards and enforcement capabilities. The recognition process (whether by supervisory agreement, regulatory certification, authorization, bilateral agreement or as otherwise prescribed by local law and regulation) should be preceded by an exchange of, and thorough evaluation of, all relevant information regarding the form and nature of regulation in each jurisdiction, and a conclusion that each system maintains and applies substantially equivalent legal standards and regulatory requirements for:

A. Licensing, including an assessment of the quality and competence of licensee ownership and management;

B. Financial condition, including capitalization, risk based capital, solvency, investment and reserving requirements;

C. Periodic examination of the financial condition and operating practices of licensees;

D. Financial accounting and reporting;

E. Regulating insurance holding company systems;

F. Procedures for the prompt enforcement of final judgments and arbitration awards rendered in the other jurisdiction.

Each supervisory authority should also demonstrate that it: (1) maintains sufficient resources and qualified personnel to implement effectively these standards and requirements; (2) will commit to an exchange of all relevant information necessary for ongoing assessment of the above-listed standards and requirements during the period of recognition; and (3) will provide reciprocal regulatory treatment to licensees of the other jurisdiction.

Thus, once a jurisdiction is vetted and approved pursuant to this process, i.e., where a U.S. reinsurer is licensed and domiciled in a Home state, or a Port of Entry reinsurer is licensed and domiciled in an approved jurisdiction, additional requirements to provide creditable reinsurance in the U.S. would be unnecessary (unless, for example, the regulatory authorities have negotiated in their recognition arrangement that there should be some collateral requirement). This approach gives the appropriate value to being licensed by an approved jurisdiction and reflects true recognition of another supervisory authority.

This critical element of "mutual recognition" as part of a modernized, uniform system of reinsurance regulation has disappeared from the Task Force's proposal. The concern first arises in Paragraph 7(c). If the eligibility requirements of the RSRD included a process for recognition of jurisdictions that maintain a substantially equivalent level of reinsurance regulation and which provide for reciprocal legal benefits for the licensees of each jurisdiction, the spirit of the original Framework Memorandum would remain. However, that is not the case under the current draft of the Proposal. Paragraph 11(b) merely states that "the RSRD will determine the appropriate supervisory recognition approach for non-U.S. jurisdictions." Paragraph 11(c) goes further in stating the RSRD will develop a protocol for unilateral recognition – a term which is undefined in the Proposal. The Proposal notes that the IAIS Guidance Paper on Mutual Recognition should serve as a reference document, yet that paper is based upon recognition of "acceptable" regimes. A standard of "acceptability" likely will not give Host states comfort that reinsurers from that "acceptable" jurisdiction are regulated on an equally strong basis as reinsurers in the U.S. At best, the current proposal is unclear as to the standard that will be applied by the RSRD in recommending recognition.

Additionally, the Proposal imposes collateral requirements on U.S. reinsurers that are subject to robust regulation in their Home state while their competitors that remain in the 50-state system (i.e. that are not passporting) need not post collateral. This disadvantages the similarly heavily regulated U.S. entities that are passporting vis-à-vis their competitors who remain in the current system.

a. The RSRD will be the repository for relevant data concerning reinsurers (U.S. and non-U.S) and the reinsurance markets.

Comments:

PCI: **Item 11 (a).** PCI is very concerned with the RSRD as the "repository for relevant data concerning reinsurers and the reinsurance markets." This is vague and raises a number of concerns. It is not clear what "relevant" data are. Confidentiality of data held by the RSRD is another issue. Still another is what financial (and other) information about reinsurers, U.S. and alien, required by this process will be publicly available? Since the RSRD proposal preempts host state solvency regulation as to collateral, transparency becomes an issue, not only for host state regulators, but for ceding insurers. Ceding insurers must have full access to as much RSRD data as possible on reinsurers in order to make informed decisions as to reinsurers.

RAA: **Paragraph 11(a)** should be amended to make it clear that since the RSRD is a non-governmental entity, it will be a repository for non-privileged information.

b. The RSRD will determine the appropriate supervisory recognition approach for non-U.S. jurisdictions and create a list of jurisdictions eligible to be recognized by POE states.

[Drafting Note: The IAIS Guidance Paper on Mutual Recognition should serve as a reference document for this purpose]

Comments:

AIG: Under item b, a key question has to do with reserving requirements, particular with reference to term life cessions. Currently, US reserving requirements are much stronger that other jurisdictions' requirements creating an unlevel playing field. Notwithstanding New York's Regulation 20's mirror imaging reserve requirement for life cessions and noting most other states do not have such a requirement, it is not clear whether this factor is within the ambit of the RSRD's matters to consider under this item. Moreover, we do not know whether as the world moves to IFRS whether the reserves required under any ultimately developed standard within IFRS will be equivalent to US reserves as currently required under GAAP and SAP or as resultant under SAP due to principles-based reserving precepts.

PCI: **Item 11(b).** The RSRD is to determine the appropriate supervisory recognition approach for non-U.S. jurisdictions and create a list of eligible jurisdictions. PCI continues to believe there is no constitutional authority for the RSRD to "vet" foreign countries. We do not recall seeing a system under which such could constitutionally occur absent an act of Congress.

RAA: **Paragraph 11(b)** should make clear that the RSRD can only conduct the evaluation and make a recommendation to the appropriate regulatory authority; it cannot make the decision or enter into any supervisory agreements. Moreover, the requirement of reciprocal legal/regulatory treatment from the non-US jurisdiction and/or entering into mutual recognition arrangements with that jurisdiction is missing from this provision and should be included for the reasons set forth above.

c. The RSRD will develop a sample supervisory recognition agreement and a protocol for unilateral recognition.

Comments:

AIA: **No Standards Specified for Eligible Foreign Jurisdictions**: The draft framework fails to provide specifics on the standards that the reinsurance supervision review department (RSRD) shall apply in determining whether a particular country is "eligible" to have its reinsurers apply for port of entry status. The framework and the task force during prior discussions focuses almost exclusively on credit risk, but there are other equally important risks such as political, legal and enforcement risks. The lack of any real standards for determining the eligibility of a foreign country is a significant omission and raises concerns regarding the practical application of the proposed framework.

One issue of legal risk that should be addressed is whether any country that permits solvent schemes of arrangement or involuntary transfers of risk shall be eligible for collateral elimination or reduction. The task force's December 2, 2007 Framework Memorandum states that solvent schemes of arrangement and involuntary transfers would be considered during discussions. However, these issues have not yet been raised by the framework.

AIA wishes to bring the task force's attention to a submission recently filed by Goodrich Corporation, Exxon Mobil Corporation, and Textron Corporation to the NAIC Financial Regulatory Services Division's Restructuring Mechanism for Troubled Companies Subgroup. These large U.S. policyholders stated that "Solvent schemes of arrangement in the UK have harmed American policyholders by unilaterally terminating years of valuable insurance coverage while allowing fully solvent carriers to back out of unprofitable insurance contracts." The U.S. policyholders requested that "solvent schemes imposed by foreign jurisdictions should be opposed by US regulators as unfair to policyholders." According to the U.S. policyholders, "solvent and profitable insurance companies doing business in the London Market have used a provision of UK law to extinguish years or decades of valuable coverage held by US policyholders." A copy of the U.S. policyholders' submission to the NAIC on solvent schemes is attached.

In regard to involuntary transfers of risks in the UK, several U.S. cedents responded to the threat by including a termination clause in to their agreements. Unfortunately both UK courts and UK Treasury have maintained that such contractual terms shall be considered void. AIA believes the framework needs to specify that any foreign country that permits solvent schemes of arrangement or involuntary transfers of risk shall be barred from being an eligible country for collateral reduction.

Likewise any country that does not enforce the proposed credit for reinsurance provision should be barred from the list of eligible countries.

PCI: **Item 11(c).** We do not understand the concept of "unilateral" recognition. This seems to confirm the "one-way" nature of the concept of collateral reduction as a benefit to non-U.S. companies with no mutuality.

RAA: **Paragraph 11(c)** states that the RSRD will develop a standard supervisory recognition agreement and a protocol for unilateral recognition. We would note that the RSRD does not have authority to enter into supervisory recognition agreements. Furthermore, the RTF (unlike the IAIS Guidance Paper) should define "unilateral recognition" to clearly include a requirement that each jurisdiction provide reciprocal legal benefits to the licensees of the other jurisdiction and maintain substantially equivalent regulatory standards and enforcement capabilities.

d. The RSRD will develop a sample information sharing and regulatory cooperation agreement between the non-U.S. Jurisdiction and the POE supervisor;

e. The RSRD will develop the criteria for a state to qualify as a home state or POE supervisor which will include but not be limited to the following:

   i. Appropriate staff expertise (reinsurance contract law, international accounting, reinsurance industry, etc.);
   ii. Accreditation through the NAIC's Financial Regulation Standards and Accreditation Program;

Comments:

RAA: **Paragraph 11(e)(ii)** requires accredited status however we would urge the addition of the following language at the end of the sentence: "or financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation."

   iii. Experience in regulating sophisticated market participants including undertaking appropriate enforcement actions as needed;
   iv. Appropriate staff size and depth; and
   v. Sufficient ceded premium volume.

Comments:

AIG: Additionally, as to item e. v., what does "(s)ufficient ceded premium volume mean"?

PCI: **Item 11(e).** These are mandatory criteria for qualifying home and POE states. Other criteria may exist. Part (ii) requires accreditation of the state. Currently, that would exclude New York from being either a home or POE state. It is not clear what would happen in the event a home or POE state loses its accreditation. Parts (iii-v) discriminate against smaller states. Assuming that a small state might have expertise and staff size, part (v) is a simple exclusion for states without "sufficient (undefined) ceded premium volume." Part (v) excludes a small state regardless of how otherwise qualified it might be to be a home or POE state.

f. The RSRD will provide a purposes and procedures manual for home state and POE supervisors.

g. The RSRD will develop mandatory contractual clauses for both ceding insurers and reinsurers which shall be uniform across the country. Such clauses shall include, but are not limited to the following:

Comments:

AIG: Concerning item g., it would seem that what would be required would be adoption by all US jurisdictions in order to achieve uniformity "across the country."

IUA: **Mandatory Contract Clauses - Paragraph 11(g)** of the Memorandum provides that the RSRD will develop mandatory contract clauses. Throughout the global markets, insurance regulators have recognized that ceding insurers and reinsurers, as sophisticated commercial parties, should have the freedom to draft contracts as they want. In the U.S., regulators have mandated contract clauses in only a few areas: insolvency, intermediary obligations, service of suit and submission to jurisdiction. Although each of these have been imposed for sound reasons, there have been problems when different states impose specific and at times inconsistent contract language. We would urge you to limit the number of mandatory clauses and to ensure that there are not state by state variations in form of substance regarding these clauses.

Lloyd's:…the U.S. has for a number of years conditioned balance sheet credit for reinsurance upon the reinsurance agreement containing a few mandatory contract provisions, such as the standard insolvency and service of suit clauses. We note that paragraph 11 (g) in the July 3 memorandum goes further and mandates several additional clauses that we do not believe have heretofore been mandated. We believe that, while the imposition of some contractual requirements may be appropriate, the global reinsurance market benefits from allowing ceding insurers and their reinsurers to freely negotiate the terms and conditions of their agreements. For this reason, we believe that mandatory clauses should be kept to the minimum necessary to promote sound regulation and that any mandatory clauses that are imposed should be made uniform across the country.

RAA: **Paragraph 11(g)** empowers state regulators to mandate numerous reinsurance contract terms and to make those contract terms uniform, meaning that specific language will be required. This is a departure from the current NAIC model laws and accounting guidance, which require only a few specific contract clauses and do not dictate specific language. International regulatory practice follows the same approach. The departure from this custom puts the Proposal at odds with the way reinsurance is commonly transacted on a national and global basis. Reinsurance involves contracts between sophisticated entities and therefore the terms and conditions of reinsurance agreements should be left to the marketplace. RAA policy strongly supports freedom to contract in a competitive market with respect to terms and conditions, other than those uniformly required by SSAP 62.

i. **Parties to the Agreement Clause** - would stipulate that the policyholder is not ordinarily a party to the reinsurance contract, and does not have direct rights against the reinsurer.

ii. **Net Retained Lines Clause –** would clarify which portion of the company's business will be subject to the agreement and states the uncollectibility of other reinsurance.

iii. **Premium Clause –** would state the method of calculating premiums and the schedule of payments.

Comments:

AIG: As to item g's enumeration of proposed required clauses, item iii, the "Premium clause", should be reworded to state: "the amount of premium under the reinsurance contract and how remittances are to be made." The "method of calculating" premium is usually different as to every contract, a matter of some proprietary consideration and reflects the results of negotiation. We believe that reinsurance contracts should set forth the premium and its determination, but using the phrase "method of calculation" has a different connotation.

iv. **Reinsurance Intermediary Clause –** would stipulate that the credit risk for the intermediary is on the reinsurer. In other words, payment from the ceding company to the broker is deemed paid to the reinsurer. However, payment to the broker from the reinsurer does not relieve the obligations of the reinsurer to the ceding company.

Comments:

RAA: **Intermediary Clause:** The proposal should not mandate inclusion of an intermediary clause. Whether to include this type of clause is better left to the negotiation between the parties. It long has been established as a matter of law that the typical activities of a reinsurance intermediary create an agency relationship between the intermediary and the ceding company. (*See In the Matter of Pritchard & Baird, Inc.*, 8 B.R. 265 (D.N.Y. 1980)) This principal-agent relationship between the ceding company and its intermediary broker is underscored by the NAIC Model Intermediary Act's definition of an intermediary broker and the requirements that the cedent and the broker enter into a written contract. Dictating a specific intermediary clause attempts to alter fundamental principal-agent law that payments made to an agent constitute payments to principal. Instead, the mandated clause attempts to shift credit risk to a third party (the reinsurer) with whom there is no contractual relationship or control over the intermediary broker. While commercial parties can (and, in the context of reinsurance transactions, often do) negotiate contract terms that shift credit risk, the RSRD has no authority to change fundamental agency law principles to require a third party to bear the credit risk for payments made to a principal's agent.

v. **Service of Suit Clause –** National reinsurers and POE reinsurers must designate their home state or POE state Insurance Commissioner as their legal agent for the service of process.

Comments:

AIG: As to clause v, "Service of Suit Clause", it is noted that what is proposed seems fine as long as it is not requiring an exclusive service of suit jurisdiction.

vi. **Insolvency Clause –** Reinsurance is payable directly to the liquidator or successor without diminution regardless of the status of the ceding company.

Comments:

RAA: **Insolvency Clause:** The insolvency clause is a clause properly mandated in reinsurance agreements. An appropriate insolvency clause must recognize a balancing of interests—that the reinsurer must pay even though the estate cannot first pay the claim—but that the reinsurer also has the ability to protect itself from improper payment by participating in the adjudication of the underlying claim. To the extent the Task Force believes that specific insolvency clause language is necessary, the **RAA suggests the following language:**

(1) No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance, unless the reinsurance contract provides, in substance, that in the event of the insolvency of the ceding insurer, the reinsurance shall be payable under a contract(s) reinsured by the assuming insurer on the basis of reported claims allowed by the liquidation court, without diminution because of the insolvency of the ceding insurer. Such payments shall be made directly to the ceding insurer or to its domiciliary liquidator except: (a) where the contract or other written agreement specifically provides another payee of such reinsurance in the event of the insolvency of the ceding insurer, or (b) where the assuming insurer, with the consent of the direct insured(s), has assumed such policy obligations of the ceding insurer as direct obligations of the assuming insurer to the payees under such policies and in substitution for the obligations of the ceding insurer to such payees.

(2) The reinsurance agreement may provide that the domiciliary liquidator of an insolvent ceding insurer shall give written notice to the assuming insurer of the pendency of a claim against such ceding insurer on the contract reinsured within a reasonable time after such claim is filed in the liquidation proceeding. During the pendency of such claim, any assuming insurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defenses which it deems available to the ceding insurer, or its liquidator. Such expense may be filed as a claim against the insolvent ceding insurer to the extent of a proportionate share of the benefit which may accrue to the ceding insurer solely as a result of the defense undertaken by the assuming insurer. Where two or more assuming insurers are involved in the same claim and a majority in interest elect to interpose a defense(s) to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance agreement as though such expense had been incurred by the ceding insurer.

vii. **Credit for Reinsurance Clause –** This clause would read as follows:

1. “If, at any time, the reinsurance provided by a Reinsurer participating in this Contract does not qualify for full statutory accounting credit for reinsurance such that a financial statement penalty to the Company would result on any statutory statement or report the Company is required to make or file with insurance regulatory authorities (or a court of law in the event of insolvency), the Reinsurer shall secure the Reinsurer’s share of Obligations by the posting of such collateral as may be required to avoid the imposition of the aforementioned financial statement penalty by those authorities in a manner, form, and amount acceptable to all applicable insurance regulatory authorities.”

Comments:

ABIR: Mandatory Contract Clauses. This section includes broad new powers for state regulators to mandate at the minimum seven reinsurance contract terms. Not only is the power created to mandate the inclusion of a contract provision, but the power includes making such reinsurance contract terms uniform which means that specific language will be dictated to the ceding and assuming insurers. This is a departure from both the NAIC and the global regulatory practice of supporting freedom to contract in reinsurance agreements. The current NAIC practice is to require a few specific contract clauses to be included, but not to mandate specific language. This freedom to contract has served reinsurance markets well and should not be replaced by new mandated reinsurance agreement language. We’d recommend the following:

a. That the RSRD carry forward the existing reinsurance contract approach in the regulatory modernization framework. By doing so, the NAIC can be assured that reinsurance agreement dictates are consistent throughout the reinsurance market (those reinsurers that are in the new framework and those that are not).
b. Existing state law and regulation govern agreements today including the insolvency clause, the service of suit and submission to jurisdiction clause, and the intermediary clause. The national or port of entry reinsurer could be made subject to the existing reinsurance agreement provisions of the state of domicile/entry. Those contract terms would have to be accepted by the regulators in the other states subject to the condition on granting of credit tied to risk transfer that is left to the ceding insurer’s state of domicile. This allocation of -- and acquiescence to -- regulatory authority should address the current critique about contradictory or inconsistent contract clauses that informs the current regulatory modernization debate. (See sections 6 and 7 of the regulatory framework.)
c. The one exception to this rule would be the new clause identified as the “credit for reinsurance clause”. This “downgrade” clause is unique to the new regulatory framework and thus is appropriately mandated as part of this regulation. We continue to review the language of this provision and we note for the record that downgrade clauses in and of themselves create problems for an operating company.

AIA: **Credit for Reinsurance Clause May Be Ineffective in Practice**: The draft framework sets forth a mandatory contractual term requiring the reinsurer to post additional collateral where the reinsurance provided does not qualify for full statutory accounting credit. AIA supports this proposed provision. While the proposed requirement is an important step in the right direction, such mandatory provisions may have limited practical impact. Where an alien reinsurer is not licensed in the U.S. and has no assets in the U.S., there may be little teeth in a contractual provision that the reinsurer simply ignores.

Moreover, foreign countries may refuse to enforce the contractual term. For example, recently UK courts and the UK Treasury have simply ignored contractual terms placed in contracts by U.S. cedents to respond to UK reinsurers attempts to enforce Part 7 involuntary transfers of their reinsurance contractual obligations. Many U.S. cedents in response to UK involuntary transfers of reinsurance contracts had provisions placed in the agreements terminating the contracts if an involuntary transfer took place. UK courts have held such contractual terms as void as against public policy and UK Treasury modified regulations to specify that UK Treasury “considers it appropriate for the Courts…to be able to override such contractual restrictions.” Similar rulings may be expected from the UK and other foreign countries in response to the proposed credit for reinsurance provision.”

AIG: As to item g vii 1, It doesn't appear that the designation "1" is necessary since it's the only item shown, the use of the word "Company" (twice in the third and fourth lines) should be replaced by "ceding insurer" (in both cases) and what if the standard shown is not representative of both parties' wishes?

As to clause vii, Credit for Reinsurance Clause", the language used, "financial statement penalty", is generally not applicable to US ceding life insurers. In general, US life ceding companies cannot take credit for reinsurance in certain defined circumstances whereas US property/casualty ceding insurers, in some defined circumstances, take credit for reinsurance in their underwriting liability items but then establish a separate penalty liability for the credit thus taken.

GIAJ: It is unclear what kind of specific situation paragraph 11-g-vii is designed to address and clarification is thus needed. The current clause seems excessively preferential for ceding insurers.

PCI: **Item 11(g).** The mandatory contractual provisions are an intrusion into what is properly the role of the legislature. Assuming for the sake of argument that the RSRD should establish mandatory provisions, there will not be uniformity as the proposal allows any reinsurer to operate under the current credit for reinsurance system; including posting collateral to avoid disfavored RSRD mandated contractual provisions. Should it be maintained that these mandated provisions occur only under an optionally free of collateral (OFC) system, then this option confirms that alien reinsurers can operate in the U.S. under the current system and the RSRD is an additional option, not elimination of discriminatory collateral requirements.

RAA: **Credit for Reinsurance Clause:** Furthermore, we strongly object to the inclusion of the new "downgrade" credit for reinsurance clause that requires a reinsurer to provide the necessary amount of collateral to enable the cedent to take "full statutory accounting credit." For the reasons set forth elsewhere in our comments (#14), there should not be any obligation to post collateral for a U.S. reinsurer that is licensed and domiciled in a Home state. Further, the RAA strongly objects to statutorily mandated "downgrade" clauses in reinsurance agreements as a matter that should be left to the parties to negotiate. Mandating inclusion of such a clause does not encourage the proper type of risk management where parties appropriately identify and capitalize risk. Notwithstanding the above, current credit for reinsurance laws recognize situations where the cedent may take credit only for the amount of collateral provided (i.e., less than 100%). We suggest that at a minimum this provision be modified to allow this to continue.

The term "Obligations" needs to be defined as it is unclear what is included (i.e., is IBNR included? Cedents and reinsurers sometimes disagree on the valuation of liabilities. Under the proposal who decides what the Reinsurer's share of Obligations will be? Because of these concerns, collateral for IBNR clearly should not be required.)

Finally, we would note that the RSRD could properly consider, in evaluating regulatory regimes, whether the supervisory system makes adequate provision for evaluating reinsurance agreements in a manner similar to that set forth in SSAP 62. In this way, the RSRD can ensure
that non-U.S. reinsurance regulatory systems adequately address credit risk allocation, insolvency obligations and other key provisions without dictating specific clause language.

RSRD General Comment:
NAMIC: Our reading of the proposal shows means for states to support their role, if chosen, as regulators of national or port-of-entry reinsurers. Yet provision of revenue for expenses of the RSRD seems not to be included. What is contemplated with respect to establishment and support of the RSRD?

Role of Home State Supervisor

Comments:
AIG: The content of this paragraph is dependent on the answer to the question relative to paragraph 2 above being correct as we stated it.

12. The home state supervisor shall be responsible for:

    a. approving a reinsurer for licensure as a national reinsurer;

b. examining its national reinsurers for solvency and compliance with applicable laws;

c. establishing the appropriate rating for collateral purposes of its national reinsurers and adjusting that rating as circumstances require;

Comments:

PCI: **Item 12(c).** Also as applied to the POE states, absent a host state statutorily accepting the evaluation of a home or POE state, it may not be constitutional for the home or POE state to impose its determination on a host state. Uniformity is clearly not met under this section as the home state is to be responsible for establishing the "appropriate" rating of national reinsurers and adjusting that rating. A reinsurer seeking to be a national reinsurer might seek out the home state that, given all else equal, grants the reinsurer the highest rating. There is an element of the "race to the bottom" here.

d. responding to inquiries from other supervisors concerning national reinsurers under its supervision;

e. participating in the consultative process at the supervisory board of the RSRD concerning the resolution of disputes regarding its national reinsurers;

Comments:

PCI: **Item 12(e).** It is unclear as to what is meant by this item. Elsewhere, it seems the determination of the home state is final, unless the home state decides to change its position.

f. initiating enforcement actions against its national reinsurers and notifying all host state supervisors immediately of any enforcement action, formal or informal, taken; and

g. receiving an annual fee from each national reinsurer it supervises.

Comments:

AIG: Also, as to sub-item g, what is the nature of the fee? Is it concordant with a licensing fee generally levied by states?

Role of the Port of Entry Supervisor

13. The port of entry supervisor shall be responsible for:

Comments:

CEA: Port of Entry State - In contrast to the current proposals in the Memorandum, we do not see any need or justification for a non-US reinsurer to be subject to the additional oversight of a US Port of Entry State where the reinsurer's non-US jurisdiction is found to be equivalent to the US regulatory system.

IUA: POE Regulator - The Memorandum requires a non-U.S. reinsurer domiciled in a recognized jurisdiction to also apply for approval by a POE regulator. We believe that a more efficient system would be to have the RSRD determine what jurisdictions should be recognized and then permit reinsurers domiciled in those countries to reinsure U.S. ceding companies, provided they comply with the other requirements of the Memorandum (including the collateral requirements). This would be consistent with how most countries including EU countries regulate reinsurance – indeed most countries grant even more liberal access to their markets. It would also be consistent with the efforts of the IAIS to move toward a system of mutual or unilateral recognition of qualified jurisdiction. This approach has much to recommend it and has broad international support.

Alternatively, we urge you to make the POE state more a point of "registration rather than regulation". We believe this is what is contemplated by the Memorandum, but clarification of this point would be important.

PCI: **Item 13:** PCI continues to have concerns regarding the POE provisions and the constitutionality of states in dealing with foreign countries.

RAA: Paragraph 13: does not address the situation where multiple states serve as POE supervisors to several different reinsurers in a single jurisdiction. Does the Proposal contemplate that each POE state will need to enter into an agreement with the non-U.S. jurisdiction?

a. entering into a supervisory recognition framework with the Non-U.S. jurisdiction supervisor and entering into appropriate regulatory cooperation and/or information sharing arrangements;

b. certifying a reinsurer as a POE reinsurer which shall include, but not be limited to, the receipt by the supervisor of a properly executed Form AR-1, which is a certificate of assuming insurer, that stipulates that the reinsurer submits to the jurisdiction of U.S. courts, appoints an agent for service of process in the United States, and agrees to post 100% collateral for its United States liabilities if it resists enforcement of a valid and final U.S. judgment. The Form AR-1 will not be accepted from any reinsurer which is domiciled in a country or state which the POE supervisor or RSRD has determined does not adequately and promptly enforce valid U.S. judgments or arbitration awards;

Comments:

AIA: **Form AR-1 Requirement Needs Revision**: The draft framework requires that the alien reinsurer execute a Form AR-1, which certifies that the reinsurer submits to the jurisdiction of U.S. courts and agrees to post 100% collateral if it resists enforcement of a "valid and final U.S. judgment." The draft framework also states that Form AR-1 will not be accepted from any reinsurer domiciled in a country that does not "adequately and promptly enforce valid U.S. judgments or arbitration awards." The word "valid" should be removed from these two provisions. An alien reinsurer must agree to respect any final U.S. judgment or arbitration award for the Form AR-1 to have any meaning. The fear of U.S. cedents is that alien reinsurers, with either no or insufficient assets in the U.S., will simply ignore U.S. court and arbitration awards, forcing relitigation of all issues in the foreign country. The cost and delays of relitigating these issues in a foreign country is an incredible burden on the U.S. insurer. The alien reinsurer will not simply state it is refusing to recognize U.S. judgments—it will argue that for some reason or another the U.S. court judgment or arbitration award is somehow not "valid." There are foreign countries that do not recognize U.S. judgments as "valid" if they are obtained on procedural grounds (defaults for failure to appear) or if they contain awards against public policy (coverage for punitive damages). The reinsurer must certify that it will submit to, and the foreign jurisdiction's legal system must promptly enforce, all *final* U.S. court judgments or arbitration awards and not just those that the alien reinsurer or the foreign jurisdiction considers "valid."

It should be noted that even if the word "valid" is stricken form the draft framework, the Form AR-1 is not a cure-all for potential enforcement issues. If the foreign reinsurer maintains no assets in the U.S. the U.S. insurer and the port of entry regulator still would have no real power to enforce the AR-1 requirement, which is why retaining current collateral requirements is critical to U.S. ceding insurers.

AIG: Item b seems to indicate that if port of entry reinsurer resists even one claim, it then has to post collateral for all of its US liabilities. Is that understanding correct? Then, there is the question as to what happens if said reinsurer doesn't post collateral? Will all host state reinsurers ceding to that reinsurer effectively be penalized? As to item b, we do not see the need to describe a final US judgment as "valid". A final judgment is a final judgment. Using the word "valid" as an additional descriptor seems to broaden the possibilities for challenge.

PCI: **Item 13(b):** Twice here the term "valid" judgment appears. This word should be deleted if there is to be certainty (and to some degree, mutuality since it is our understanding the U.S. honors foreign judgments) of outcomes. Otherwise, a perfectly valid judgment within the U.S. can be considered as not being "valid" by the foreign country. The refusal to accept an AR-1 from any reinsurer in a jurisdiction that does not promptly and fully enforce final U.S. judgments is confusing. Any such jurisdiction should not be certified in the first place. Failure to enforce a final U.S. judgment should result in removal of certification of that jurisdiction. PCI is concerned as there does not seem to be a "decertification" process in the proposal. Decertification is problematic to all U.S. ceding companies of any such reinsurer(s) who now lose annual statement credit if collateral is not posted at 100% within three months.

c. establishing the appropriate rating for collateral purposes of its POE reinsurers and adjusting that rating as circumstances require;

Comments:

AIA: **Need to Prevent Forum Shopping in Choice of Port of Entry State**: The NRSRO credit rating for an alien foreign reinsurer is the reinsurer's maximum tier rating. The port of entry regulator is authorized to lower the tier rating for the reinsurer based on its evaluation of the foreign reinsurer. The port of entry state regulator's evaluation considers the following: a "list of all disputed or overdue recoverables"; the "reinsurer's reputation for prompt payment of valid claims under reinsurance agreements, including the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute"; the "business practices of the reinsurer in dealing with their ceding insurers"; "regulatory actions against the reinsurer"; a review of an annual report in the form of Blank Schedule F; a clean independent audit opinion of the reinsurer; and an audited financial statement reconciled to U.S. GAAP or Statutory Accounting Principles.

While including these factors in the reinsurer's evaluation is a positive development, there is some concern that the NRSRO rating may simply become the de facto tier level. The NRSRO rating is an objective standard while all the other factors are more subjective, so it may be that the port of entry regulator will simply default to the NRSRO rating. In any event, there is likely to be a "race to the bottom." An alien reinsurer can apply for certification as a port of entry reinsurer in any port of entry state. If a reinsurer gets "dinged" by a particular port of entry state regulator for failure to pay claims in a timely manner or some other factor, there is nothing in the draft framework to prevent the reinsurer from applying at other port of entry states until some state provides the foreign reinsurer with the maximum tier level. Language is needed to prohibit "forum shopping" by the alien reinsurer. For example, a provision should be added that once a port of entry state has lowered a foreign reinsurer's tier rating based on factors other than the reinsurer's NRSRO's ratings, the foreign reinsurer cannot seek certification from another port of entry state in an attempt to receive a higher tier level.

PCI: **Item 13(c).** Same comment as with 12(c). From 12(c) - Also as applied to the POE states, absent a host state statutorily accepting the evaluation of a home or POE state, it may not be constitutional for the home or POE state to impose its determination on a host state. Uniformity is clearly not met under this section as the home state is to be responsible for establishing the "appropriate" rating of national reinsurers and adjusting that rating. A reinsurer seeking to be a national reinsurer might seek out the home state that, given all else equal, grants the reinsurer the highest rating. There is an element of the "race to the bottom" here.

Lack of Specifics Regarding Tier Level Evaluation Process: The framework, in addition to lacking any real specifics on standards for determining whether a state should be authorized as a port of entry state, also lacks any specific standards regarding how an authorized port of entry state is to evaluate a foreign reinsurer applicant for determining tier level. The draft framework states that the port of entry state is to evaluate an alien reinsurer for disputed claims and late payments but fails to specify what is acceptable or not. The lack of standards means the port of entry state is doing little more than guessing and will likely just revert to using the objective NRSRO rating as the de facto rating. The framework needs to be revised to provide clear guidance to the port of entry regulator. For example, the framework should require that any alien reinsurer who is below average in timely claim payments or number of disputes be lowered at least one tier from its maximum tier level based on the NRSRO rating. Those who are more than a standard deviation from the average scale should be required to post 100% collateral. Unless specifics are set forth in the framework, the danger is that the port of entry regulator will have no clear guidance and will simply fall back on the NRSRO rating.

d. responding to inquiries from other supervisors concerning POE reinsurers under its supervision;

e. serving as the conduit for and consulting with the non-U.S. jurisdiction supervisor concerning any issues regarding the POE reinsurer and advising all host states as appropriate;

f. participating in the consultative process at the supervisory board of the RSRD concerning the resolution of disputes regarding its POE reinsurers; and

g. receiving an annual fee from each POE reinsurer it supervises.

Comments:

GIAJ: Proposed scheme where annual fee is paid by POE reinsurers to a POE supervisor should be reviewed carefully so as to avoid conflicts of interest and other potential legal issues. There is no such case in other countries.

Lloyd's: As Lloyd's has commented before, we suggest that where the RSRD has recognized another jurisdiction as having a system of regulation that is equivalent to that in place in the United States and as otherwise meeting the standards set forth in the memorandum, the regulator in that jurisdiction should be treated as being equal of its U.S. colleagues. Thus, we would respectfully submit that it is duplicative for a reinsurer from that jurisdiction and subject to that regulator's supervision to also be subject to the additional oversight of a U.S. Port of Entry State. We believe the ultimate goal must be full mutual recognition among effective regulators in the global reinsurance market, both here and abroad.

14. A POE reinsurer must file the following reports quarterly with the POE supervisor:

Comments:

ABIR: Rather than quarterly filings, those filings be required upon a triggering action such as a change in domiciliary license status, a change in rating, etc. Quarterly filings are unnecessary unless triggered by a meaningful change in the status of the reinsurer.

PCI: **Item 14.** These quarterly reports are material to any ceding company within the U.S. and must be available to any potential ceding insurer.

RAA: **Paragraph 14:** The provisions are ambiguous as to what would be required and leave too much discretion to the POE supervisory authority. Many of the items are more properly the subject of any applicable recognition arrangement.

a. A statement either certifying that there has been no change in the provisions of its domiciliary license or any of its NRSRO ratings, or a statement describing such changes and the reasons therefore, as well as any changes in its directors and officers;

b. Information comparable to relevant provisions of the NAIC financial statement modified as deemed appropriate by the POE supervisor for use by insurance markets;

Comments:

ABIR: Reference to financial statements comparable to the NAIC financial statement should be replaced with language that financial statements from the domiciliary jurisdiction should be filed. Supplemental material may be required, but it should not be expected that the reinsurer will file something consistent with a NAIC financial statement.

AIG: As to item b, it is not clear how "comparable" the information has to be considering the variances in accounting standards. Would the information have to be comparable per SAP or just by its nature?

IUA: **Filing of quarterly financial information - Paragraph 14(b)** of the Memorandum requires a POE reinsurer to file quarterly "information comparable to relevant provision of the quarterly NAIC financial statement". We are not certain what is contemplated by this phrase. We believe that is should not be necessary to have quarterly filings from reinsurers who are domiciled in countries which you have recognized as an equivalent reinsurance regulator. We urge you to delete this requirement.

c. An updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers; and

Comments:

ABIR: The reinsurance disputes and overdue reinsurance amounts should be subject to a materiality threshold. Information is already available from the ceding insurer on these matters. For the reinsurer, filings should be compelled on materially relevant information that relates to the reinsurer's own financial condition. Here is an example of a materiality threshold: overdue recoverables or amounts in dispute between the reinsurer and its retrocessionaires that aggregate to an amount in excess of 10% of the reinsurer's surplus or $100 million, whichever is less, would require the reinsurer to file a supplemental report about the aggregate amount of recoverables in question.

IUA: **Lists of disputed and overdue claims - Paragraph 14 (c)** and 20(a) require the filing of a list of all disputed and overdue reinsurance claim on a quarterly basis (14(c)) and as part of the initial POE review (20(a)).

We agree that some information regarding disputes and overdue claims can be relevant to the review of the financial integrity or a reinsurer. We would recommend that the instead only disputes in excess of a certain amount be reported. Finally, we would not that there should be some definition of what is a disputed claim. Presumably claims would be in dispute where a notice of intent to commence arbitration has been served or complaint has been filed in a court of competent jurisdiction.

With regard to overdue claims this is another area where the data is readily accessible from the financial statements filed by ceding insurers. We recommend that the POE regulator obtain this information form the NAIC database. If this information raises questions the POE regulator should be free to request additional information from the insurer.

PCI: **Item 14(c).** PCI still does not understand why disputed and overdue reinsurance claims are only material to the process (and the U.S. ceding insurers) if the information relates to reinsurance assumed from U.S. domestic ceding companies. A reinsurer's disputed and overdue reinsurance claims information is relevant whether the business is reinsurer/U.S. cedent or reinsurer/any cedent. Not paying is not paying. The U.S. ceding insurer language should be stricken.

RAA: **Paragraph 14(c)** provides that POE reinsurers must file quarterly reports with their POE supervisor listing all disputed and overdue reinsurance. The information sought by the report is currently available from ceding insurers. Only a change in information materially relevant to a reinsurer's individual financial situation should be required by the POE supervisor. At a minimum, there should be a materiality standard for this reporting requirement.

d. Any other information that the POE supervisor may reasonably require.

Comments:

GIAJ: **GIAJ: Preferential treatment given to U.S. insurers -** To be certified as a "POE reinsurer", a foreign re/insurer is required to meet stringent requirements based on quite complex procedures: i) a state through which a foreign re/insurer would like to do business in the U.S. must meet a set of standards established by the RSRD in order to be certified as a POE supervisor (paragraph 3), ii) the non-U.S. jurisdiction, in which such foreign re/insurer is domiciled , must be recommended as eligible for recognition by the RSRD (paragraph 7-c), iii) a POE supervisor must enter into a supervisory recognition framework with the Non-U.S. jurisdiction supervisor as well as entering into appropriate regulatory cooperation and/or information sharing arrangements (paragraph 13-a), and iv) a POE supervisor must certify a foreign re/insurer as a POE reinsurer (paragraph 13-b). On the other hand, U.S. licensed reinsurers do not have to comply with such complex procedures and consequently, this leads to unfair treatment against foreign re/insurers.

Furthermore, for example, it is too protective to impose on POE reinsurers to comply with requirements of the AR-1 form. Also, reinsurance contracts usually have arbitration clauses, and therefore, careful cost-benefit analysis should be made before binding POE reinsurers to the laws and regulations of the U.S. by setting a legal agent for the service of process. POE reinsurers are required to file quite a few reports with the POE supervisor quarterly (paragraph 14).

This will cause a duplication of regulations of the U.S. and Non-U.S. jurisdiction, thus significantly decreasing benefits of the proposal. In addition, some requirements in the latest proposal (e.g. "Any other information that the POE supervisor may reasonably require") is too discretionary. While the U.S. reinsurers categorized as "Secure-3" or above in the table would be exempted from posting any collateral (paragraph 19), this exemption is not applicable for POE reinsurers. This is apparently aimed at favorable treatment of the U.S. reinsurers.

CEA: **Port of Entry Reporting Requirements** - As stated above, we do not believe that there is a need for non-US reinsurers from equivalent jurisdictions to be subject to supervision by a US Port of Entry State. In addition, the current NAIC proposal refers to the possibility of entering into a mutual recognition agreement but does not apply it consistently and appropriately in order to remove duplicative reporting requirements. If, which we hope is not the case, the NAIC retains the Port of Entry concept in the final framework, we believe that the reporting obligations proposed should be reformed as follows:

No need for the filing of quarterly financial information - The Memorandum requires a POE reinsurer to file quarterly "[i]nformation comparable to relevant provisions of the quarterly NAIC financial statement". We believe that such quarterly reporting requirements are overly burdensome for non-US reinsurers who are domiciled in a jurisdiction that has been recognised as equivalent by the RSRD and when the sharing of the relevant information between the relevant authorities is ensured. We would therefore urge the removal of the requirement to file financial information quarterly.

No need for Schedule F statement - Much of the information that can be obtained by requiring a non-US reinsurer to file a report annually in the form of Schedule F (or S) of the NAIC annual statement blank as is required by the Memorandum, can also be obtained from other sources, such as the Schedule Fs filed by U.S. ceding companies. We would thus recommend the removal of this provision.

To accept IFRS statements from non-U.S. reinsurers instead of reconciled U.S. GAAP or SAP statements - Given that the U.S. Securities & Exchange Commission already agreed earlier this year to accept IFRS statements from foreign issuers, which would include non-US (re)insurance companies, we would strongly urge the extension of the requirement so that non-U.S. reinsurers can either file audited IFRS accounting statements or audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles.

Role of Host State Supervisors

15. The host state supervisor shall:

Comments:

PCI: **Item 15.** There could be an unintentional limitation of the powers of host state supervisors to the enumerated items and no others. This should read, "*In addition to the normal regulatory duties* the host state supervisor shall:"

This provision creates a "catch-22" for the host state. The host state is, by its own statutes, required to regulate its domiciliary insurer for solvency. The proposal would remove host state regulation as to collateral for reinsurance. Major insolvencies have shown that reinsurance is often the largest single part of an insurer's financial statement

RAA: **Paragraph 15:** provides that the "domiciliary state supervisor" retains the authority to require diversification of reinsurance risk for ceding insurers. First, a domiciliary state supervisor should not be permitted to apply diversification requirements in a manner that discriminates against a reinsurer based on its status as a National Reinsurer or a POE reinsurer. Second, the RAA suggests modifying this sentence to require diversification only for unaffiliated reinsurance risk for ceding insurers. Intra-group (retro)cessions can exceed 50% of the cedent's policyholder surplus; because these transactions are already subject to notification and review under holding company act laws, these transactions should be exempt from this requirement. Third, the notice requirement if the cession to a single reinsurer exceeds 20% of the ceding insurer's gross written premium is too low and should be changed to, at a minimum, 50%. The appropriate degree of diversification in a ceding company's reinsurance program depends on many variables that must be considered by that company's management. Setting a low fixed

percentage by rule may encourage imprudent decision-making. Ceding companies should be free to manage their credit risk and reinsurance purchases without regulatory interference so long as they meet RBC levels and overall enterprise risk management requirements.

a. have the right to request specific analysis and/or examination procedures performed by the home state supervisor and the right to receive completed financial analysis and examination work papers from the home state supervisor. Such information is protected under the NAIC's Information Sharing Agreement;

Comments:

AIG: As to item a, some evaluation of the "protection" should be made to ensure appropriate confidentiality levels continue.

PCI: **Item 15(a).** We are not sure how this would work in reality. The host state might receive information about the reinsurer that could seriously jeopardize the solvency, or for that matter the financial position of the host state insurer. Host state insurers, too, should have access to that information.

We believe the end of the first phrase should read, "…home *or POE* state."

b. advise the home state supervisor whenever the host state supervisor has reasonable cause to believe an examination of a national reinsurer is necessary due to an emergency;

Comments:

PCI: **Item 15(b).** This should not be limited to emergencies, the phrase, "…due to an emergency" should be removed. And in the event the home (also should read, "…home *or POE* state…") state does not within a reasonable time commence such an examination, the host state should be empowered to do so (similar wording exists in relation to risk retention groups and non-domicile's ability to perform examinations).

c. have the right to request additional information from the home state or the POE supervisor concerning a national reinsurer or POE reinsurer;

d. evaluate risk transfer of each ceding insurer's reinsurance agreements;

e. retain the authority to require diversification of reinsurance risk for ceding insurers;

Comments:

ABIR: **Paragraph 15, Diversification**. We're looking for clarification of the basis for the diversification provisions of paragraphs e, f and g of this section. Are they drawn from existing NAIC models or existing state based requirements?

AIA: **Diversity Requirements for U.S. Insurers**: The draft framework would place new requirements on U.S. ceding insurers. The framework would require the U.S. ceding insurer to provide notification to its domiciliary regulator if any single reinsurer represents more than 20% of the ceding insurer's gross written premium, or is likely to exceed this limit, except for approved affiliated transactions. The framework would also provide the domiciliary regulator with discretion to require the U.S. ceding insurer to obtain approval if, for any twelve month period, if the reinsurance premium or anticipated change in the ceding insurer's liabilities equals or exceeds 50% of the insurer's surplus to policyholders.

AIA objects to the inclusion of these new diversity requirements. Many primary insurers have extremely divergent views on diversification requirements based on factors such as whether they are a relatively smaller insurer, whether they write a specialized line such as medical malpractice, whether they cede to licensed affiliated companies, or how their reinsurance programs in general are structured. Trying to include diversification requirements in the collateralization proposal is unnecessary, controversial, and would create an unlevel playing field for U.S. insurers.

AIG: As to item e (and with reference to item g), it should be noted that except for the larger ceding company enterprises, adequate levels of reinsurer credit risk diversity can probably not be attained.

f. have the discretion to require the ceding insurer to attain prior written approval if, for any twelve-month period, the reinsurance premium or anticipated change in the ceding insurer's liabilities equals or exceeds fifty percent (50%) of the insurer's surplus to policyholders as of the immediately preceding December 31; and

AIG: In f, (on the second line), "the reinsurance premium" should read "ceded reinsurance premium".

g. require the ceding insurer to provide notification within 30 days if any single reinsurer represents more than twenty percent (20%) of the ceding insurer's gross written premium or if it is likely to exceed this limit, except for approved affiliated transactions.

Comments:

AIA: **Weakened Role of U.S. Domiciliary Regulator**: The draft framework provides that the port of entry state of the reinsurer shall make all determinations regarding credit for reinsurance ceded by a U.S. insurer. This violates the fundamental principle of insurance regulation that supervision of the financial strength of the U.S. ceding insurer is determined by the domiciliary regulator of the U.S. insurer. Collateral requirements are part of the credit for reinsurance laws, which, of course, relate to the financial supervision of the U.S. ceding insurer, not the assuming reinsurer. It is fundamental that supervision of the financial strength of the U.S. ceding insurer should be retained by the domiciliary regulator of the U.S. insurer and should not be determined by whatever port of entry state an alien reinsurer chooses to enter.

NAMIC: **Paragraph 15. g**. seems to except "affiliated transactions," and we assume the intent is to exclude intra-group transactions. We believe it is better that the framework and any model made on it, state affirmatively that intra-group cessions between or among insurers domiciled in the United States are not affected by content of this framework or rule. Similarly, the framework and any model based on it should affirmatively exclude pools among insurers domiciled in the United States.

Collateral Proposals Including Eligibility Criteria

16. The POE or home state supervisor will assign a reinsurer one of five ratings (Secure-1, Secure-2, Secure-3, Secure-4 or Vulnerable-5). The maximum rating that a reinsurer may be assigned will correspond to the reinsurer's Nationally Recognized Statistical Rating Organization (NRSRO) rating as outlined in the table below. The POE or home state supervisor shall use the lowest rating received from an NRSRO in establishing the maximum rating of a reinsurer. A failure to obtain or maintain at least two NRSRO ratings will result in an assignment of a Vulnerable-5 rating. The additional factors listed below may result in a lower rating as determined by the POE or home state supervisor. National reinsurers and POE reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements.

Comments:

AIG: The use of the term NRSRO has been discontinued by the NAIC's Securities Valuation Office and replaced by the term ARO (Approved Rating Organization). Additionally, the model appears to be designed to allow a Port of Entry reinsurer, i.e., an alien reinsurer entered through a Port of Entry designated state, to conduct business throughout the United States. As noted relative to our paragraph 1 comment, there is a question as to whether the NAIC model can actually do that. The references should be changed in this paragraph.

NAMIC: **Paragraph 16.** vests the home-state regulator with responsibility to assign a financial strength rating to a reinsurer. Will, in fact, the home-state regulator be conducting this crucial function, or will the RSRD have the dominant role, given its responsibilities under paragraph 10.? Provision a. under paragraph 10. presumably gives the RSRD a powerful role in settling disputes in this context. The broader function of the RSRD further includes

standard-setting and creation of contract forms and constraints. All of these suggest it will be the site of much decision-making nominally placed with home-state regulators.

With respect to paragraph 16 and subsequent part of the section on Collateral Proposals …, it may be appropriate to note that ceding and assuming insurers are free to adjust collateral to higher levels.

RAA: **Paragraph 16:** states that reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements. We would urge the Task Force to utilize a group rating where a rating agency has either enhanced the rating of a subsidiary, or has assigned the parent's rating to the subsidiary. If regulators are going to rely upon ratings and the rating agency has determined that a legal entity is considered a core subsidiary, that decision should be respected. This paragraph also does not address how individual Lloyd's syndicates will be treated (i.e., will Lloyds' as a group receive a rating? Will the support of the Central Fund be taken into consideration?). This should be specifically addressed.

Paragraphs 16 – 18: also raise a fundamental problem with the rating system – the realities of the impact of such a system on cedents. Importantly, collateral has historically been utilized as a substitute for licensing. A reinsurer's rating may change over time and, under the system outlined in the Proposal, would require cedents to continuously monitor and modify their collateral. A drop in a reinsurer's rating from A to B++ requires the imposition of 55% more collateral on the reinsurer. The reinsurer may have difficulty, or not be able to post, this unnecessary collateral; if that is the case, this should be a licensing issue, not a collateral issue.

Moreover, the current credit crisis has demonstrated again the problems with relying on rating agencies' ratings. Not only did the rating agencies fail to predict situations like Enron and Parmalat but more recently they failed to predict the downgrades of several monoline insurers (in at least once instance, the downgrade occurred after a recent upgrade). In a supervisory recognition situation as outlined above in comment # 9, this would not be an issue because the safeguards built into the recognition process would provide the certainty to regulators that the domiciliary jurisdictions are taking necessary and appropriate action against such entities. A provision such as this defeats that purpose and interferes with the domiciliary regulator's ability to appropriately deal with the company (similarly, requiring such a topping up of collateral in another jurisdiction of a U.S. company would interfere with the U.S. regulator's ability to address a U.S. reinsurer's issues.) True supervisory recognition should be based upon evaluation and reliance upon the other jurisdiction's regulation.

Further, home state and POE supervisors have additional discretion to assign reinsurer ratings based on a list of factors in Paragraph 20. The RAA is concerned that this additional discretion is based on subjective evaluations which will be difficult for reinsurers to predict and could be subject to misuse and abuse.

17. With respect to reinsurance contracts entered into or renewed on or after the effective date of this proposal, a ceding insurer may elect to take credit, in accordance with the provisions of this proposal, for reinsurance ceded to a national or POE reinsurer which maintains, on a stand-alone basis, a financial strength rating from at least two of the rating agencies listed below:

(a) Standard & Poor's;
(b) Moody's Investors Service;
(c) Fitch Ratings;
(d) A.M. Best Company; or
(e) any other rating agency recognized by the NAIC SecuritiesValuation Office (SVO).

AIG: The SVO also recognizes a fifth specific ARO, DBRS. Although fitting within item 17 e, there does not appear to be a reason not to specify that ARO's ratings groupings.

18. The initial collateral calculation would be as follows:

Ratings	Collateral Required	Best	S&P	Moody's	Fitch
Secure – 1	0%	A++	AAA	Aaa	AAA
Secure – 2	10%	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure – 3	20%	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
Secure – 4	75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable - 5	100%	B, B-C++, C+	BB+, BB, BB-	Ba1, Ba2, Ba3	BB+, BB, BB-
		C, C-, D, E, F	B+, B, B-, CCC, CC, C, D, R	B1, B2, B3, Caa, Ca, C	B+, B, B-, CCC+, CC, CCC-, DD

Comments:

AIA: **The Current Collateral System Works Effectively With No Known Problems:** The draft framework proposes changes to the current regulatory and collateral system that are grand in scale. The proposal significantly modifies a collateral system that has worked with no known problems for decades. Under the current collateral system, reinsurance capacity has not been a problem, payment of recoverables from unlicensed reinsurers has not been too problematic, and reinsurance premium amounts have not been a pressing issue. It is difficult to see the need for *any* change, let alone a change as significant as that contemplated by the draft framework.

Collateral Protects U.S. Ceding Insurers: Collateral plays a significant role in protecting U.S. insurer solvency and ensuring payment of reinsurance recoverables when a U.S. cedent purchases reinsurance from an unlicensed foreign reinsurer who outside of the collateral may maintain no assets in the U.S. If collateral is no longer available, it will likely be extremely difficult, time-consuming, and expensive for a U.S. insurer to successfully collect reinsurance recoverables that are due under a reinsurance contract from an alien reinsurer.

Collateral, in the absence of any other assets of the reinsurer in the U.S., is often needed when a ceding insurer seeks to execute on a final U.S. judgment. However, even apart from the issue of seeking to enforce and execute on final U.S. judgments, the fact that collateral exists under the reinsurance agreement is often a vital and necessary component in having the unlicensed foreign reinsurer pay recoverables due in a timely and appropriate manner without resort to either arbitration or court proceedings.

A.M. Best, in a recent analysis of the NAIC's collateral discussions, noted that "Without collateral, cedants often settle for considerably less than 100% of their outstanding balances through commutations. This happened after the ratings downgrades of reinsurers such as PXRE, Converium and Gerling." A.M. Best Research 2007 Special Report, August 13, 2007, p.17.

As stated in the reinsurance task force's own white paper, "Reinsurance collections have become a more difficult and contentious process where the willingness to pay seems to be as big an issue as the ability to pay… Receivers have reported that having access to collateral makes a tremendous difference in the collection process, both in getting timely responses to billings and other correspondence as well as tempering the extreme positions taken by some reinsurers. In some cases, collections from unauthorized reinsurers have been easier due to the existence of the collateral than collections from authorized U.S.-based 'professional' reinsurers." U.S. Collateral White Paper, prepared by the NAIC Reinsurance Task Force of the Financial Condition (E) Committee, p.11.

If collateral is significantly reduced, it can be expected that it will be much more problematic and uncertain for U.S. ceding insurers to be paid recoverables from foreign unlicensed reinsurers in a full, timely, inexpensive and dispute-free manner.

Reducing Collateral May Lessen Capacity in the U.S. Primary Market: An argument offered in support of eliminating/sharply reducing collateral requirements is that it may increase capacity in the reinsurance market.

There is little or no evidence that overturning collateral requirements will increase reinsurance capacity in any sizable manner.

Moreover, and much more importantly, eliminating or significantly reducing collateral may have an adverse impact on capacity in the U.S. primary insurance market. If eliminating or reducing collateral makes it more uncertain, time-consuming, expensive and problematic to receive reinsurance payments from foreign reinsurers, a likely result would be lowered capacity in the U.S. primary market. An insurer will be more hesitant to write direct coverages if it does not feel confident that it will receive its reinsurance payments in a prompt and appropriate manner. This is particularly true in the writing of certain large risks, such as natural catastrophes.

Similarly, if U.S. insurers lose credits on their financial statements either because reinsurance recoverables are no longer being paid within 90 days or alien reinsurers fail to post additional collateral after tier level downgrades, the primary insurers' capacity to underwrite U.S. risks will be adversely impacted.

Security Deposits Are Required for Licensed U.S. Insurers: A majority of states require U.S. primary insurers to post collateral in the form of state deposits. It is difficult to understand why it is good public policy to eliminate or substantially reduce collateral requirements for unlicensed alien reinsurers who maintain no assets in the U.S, while at the same time requiring U.S. insurers to post security deposits in states in which the U.S. insurer is licensed and/or domiciled. If it is unfair or unnecessary for an alien reinsurer, who refuses to obtain a license in any state or to maintain assets in the U.S., to post collateral, certainly an insurer licensed in the U.S., who maintains ample assets in the U.S. and who is subject to the supervisory and regulatory oversight of multiple state insurance departments, should not need to post security deposits in any licensed state. However, in many states, including Florida, New York, New Jersey, and California, security deposits are required for U.S. insurers regardless of whether the U.S. licensed insurer is AAA-rated, AA-rated, A-rated or BBB-rated. In fact, California requires all primary insurers (not just domestic insurers) to *fully collateralize* their workers' compensation liabilities in the state; indeed, California currently is holding billions of dollars of collateral from U.S. primary workers' compensation insurers that hold high ratings from the national rating agencies. It is difficult to justify a proposal that will release alien unlicensed reinsurers with no assets in the U.S. of the prudent requirement to post collateral, yet at the same time retain security deposit requirements for U.S. state-licensed insurers.

Severe Lowering of Collateral: AIA supports retention of the current 100% collateral requirement. However, even if one were to support lowering collateral requirements for certain alien reinsurers based on financial strength and timely claim payment history, the draft framework's proposed reductions in collateral levels are shockingly high. In prior proposals, the task force had recommended lowering collateral requirements for AAA- and above rated reinsurers to 60%, those with an AA- to AA+ rating to 70%, and those with A- to A+ to 80%. Under prior proposals, reinsurers rated BBB+ or lower would need to post 100% collateral. While the prior proposed collateral reductions were significant, they still required the reinsurer to post some critical level of collateral. It is essential that the required collateral level remain significantly high because other than collateral, the unlicensed alien reinsurer may maintain no other assets in the U.S.

The draft framework would reduce collateral requirements to dangerously low amounts. AAA-rated reinsurers would not need to post any collateral. AA- to AA+ reinsurers could reduce collateral to 10% and A- to A+ reinsurers could reduce collateral to 20%. Even BBB- to BBB+ reinsurers could reduce collateral to 75%. Such low levels of collateral would not adequately safeguard the solvency of U.S. insurers and will make timely payment of reinsurance recoverables and enforcement of judgments and awards more problematic and uncertain. AIA recommends that if the task force does support eliminating/reducing collateral, that it reinsert the collateral levels set forth in the task force's prior proposals.

Tier Levels need Revision: The tier levels in the draft framework should be revised and made more precise. As currently drafted, A+, A, and A- reinsurers are all rated the same and placed in Secure Level 3. There is a huge difference between an A+ reinsurer and an A- reinsurer and the companies should be placed in different tier levels. It is extremely dangerous to lower the collateral requirement for an A- reinsurer to only 20% and to pretend that an A- rating is the financial equivalent to an A+ or A rating. An A- rated reinsurer should be placed in Secure Level 4 and be required to post 75% collateral.

Any reinsurer rated below A- should be placed in Vulnerable Level 5 and be required to post 100% collateral. As a practical matter, many U.S. ceding insurers, even under current regulatory requirements, will on solvency grounds refrain from purchasing reinsurance from reinsurers rated below A-. It is shocking that the task force would even consider reducing collateral requirements for BBB+ through BBB- alien reinsurers by 25%. A BBB- reinsurer is dangerously close to junk status and certainly should not be rewarded with a 25% cut in collateral.

Moreover, all alien reinsurers should need to post at least some collateral since otherwise a reinsurer may maintain no assets in the U.S. Reinsurers in Secure Level 1 should need to post some level of collateral, with increasing amounts required for all lower levels.

Reinsurer Ceases Writing in U.S. Market: Experience indicates that collateral is particularly helpful when a reinsurer ceases all writing in the U.S. market. Once a reinsurer stops issuing policies, it has little or no motivation to pay existing claims in an appropriate or timely manner. In the case of an unlicensed reinsurer with 100% collateral, the current collateral rules offer the U.S. cedent (and the receiver) some level of protection if its reinsurer leaves the market. AIA recommends that if indeed the task force decides to reduce the collateral requirements for unlicensed foreign reinsurers, that the proposal at least provide that if a reinsurer ceases writing in the U.S. market, the reinsurer would need to post 100% collateral for all existing contracts. AIA recommends that this 100% collateral requirement also apply to U.S. licensed reinsurers who cease writing.

A Security Fund Must Be Created to Secure Risks: The draft framework contains no mention of the establishment of a security fund. The task force's December 2, 2007 Framework Memorandum states that establishment of a security fund would be considered.

A security fund should be established. One of the major flaws of the current draft framework is that all risks flow to U.S. ceding insurers and all benefits flow to the unlicensed foreign reinsurers. Proponents of the need to overhaul current collateral requirements argue that U.S. ceding insurer's fears of uncollectible reinsurance recoveries from alien reinsurers with no assets in the U.S. are exaggerated. Throughout the years of debate on collateralization, certain U.S. ceding insurers have requested that the advocates of change endorse a security fund whereby the alien reinsurers would be liable for payment of recoverables when a U.S. ceding insurer is not paid on an appropriate claim where collateral is no longer available. The advocates of change have repeatedly rejected this suggestion, perhaps suggesting that in actual practice loss of recoverables due to the absence of collateral may become a common practice.

Statistical Rating Organizations Are Often Too Late in Rating Downgrades: The reinsurer tier level depends in the first instance on the financial rating given to the unlicensed reinsurer by nationally recognized statistical rating organizations (NRSRO's). Reliance on NRSRO ratings is not unreasonable and AIA does not specifically object to the use of NRSRO's if indeed the collateral structure is going to be changed. However, a potential problem with reliance on statistical rating organizations is that they too often are too late with their rating downgrades. The ratings are downgraded only after the fact and after the financial problems of the company being downgraded already have been made public. These after-the-fact downgrades have been seen previously with certain foreign reinsurers and more recently with companies associated with the sub-prime home mortgage fallout.

European regulators in France and Germany have called for investigations of the rating organizations for their underestimating of the subprime risk until the problems were already known to the general public. A similar failure to timely recognize financial stress in the reinsurance market could prove fatal to the solvency of the U.S. insurance market if collateral requirements had been significantly reduced.

Collateral Requirements for Unlicensed Reinsurers is not an Unfair Trade Issue: Despite arguments to the contrary by supporters of eliminating the current collateral rules, requiring collateral from an alien reinsurer who refuses to obtain a license in any U.S. state or maintain assets in the U.S. is not an unfair trade issue or an artificial or discriminatory barrier. The U.S. reinsurance market is actually pro-competitive and offers foreign reinsurers a choice between being licensed and submitting to financial supervision in the U.S. or remaining unlicensed, foregoing regulatory supervision and the need to maintain assets in the U.S., but posting collateral to cover expected losses.

It should be noted that other countries, including members of the European Union, impose barriers against U.S. insurers who do not obtain licenses or maintain assets in their countries. In addition to the remarks of LeBoeuf, Lamb quoted at the beginning section of this letter, other commentators have noted that U.S. reinsurers are not permitted to compete on an equal footing with EU-based reinsurers when competing for business in the EU. ("A non-EU reinsurer with a branch in a member state has no-EU right to provide cross-border business in another member state either in its own right or via a branch; it does not have a passport"). Article by Guy Soussan and Philip Woolfson, "Implications of Directive" printed in Insurance Day January 19, 2007 http://www.steptoe.com/assets/attachments/2869.pdf . *See also* Lloyd's article by James Walmsley, The EU Reinsurance Directive, May 3, 2007 https://www.lloyds.com/Lloyds_Worldwide/International_compliance_news/The_EU_Reinsurance_Directive.htm ("The Directive requires non-EU reinsurers to obtain authorization separately in every member State in which they propose to do business: one authorization does not cover them for the whole EU, unless they establish a subsidiary company in an EU Member State."); AON "Alternative Views p.2 April 2006 http://www.aon.com/risk_management/pdf/captives/newsletters/av_april2006.pdf ("Any reinsurer based outside the EU (i.e. a non-admitted reinsurer) will be required to complete a full authorization procedure prior to providing any reinsurance in any member state" and EU "member states are allowed to introduce indirect supervisory rules" for non-EU reinsurers).

AIG: It is not clear how the collateral percentages were determined especially as between levels Secure-3 and Secure-4. Additionally, the proposal does not describe what happens when a split rating situation occurs. For instance, what happens if Best rates an insurer in the Secure 1 category and S&P rates a company as Secure 3?

CEA: **Collateral Requirements** - We, and indeed the European Commission, have consistently argued that the US system should remove statutorily required collateral obligations and not discriminate between reinsurers on the basis of the country in which the undertaking is domiciled. To our regret, the NAIC's proposal continues to give preferential treatment to US reinsurers over non-US reinsurers in terms of collateral obligations, even in circumstances where the non-US reinsurers are regulated by an equivalent regime and have the same rating as US reinsurers.

Such preferential treatment is particularly inacceptable in a framework that is only accessible for those non-US reinsurers that are domiciled in a jurisdiction that has been recognised as "equivalent" by the NAIC Reinsurance Supervision Review Department (RSRD), and thereby making them subject to – in our opinion unjustified – additional oversight by a US Port of Entry State (see also points 1 and 4).

We therefore strongly urge the removal of the unjustified discriminatory treatment of non-US reinsurers.

GIAJ: **In paragraph 18**, we can not find any reasonable necessity to have the class "Vulnerable-5" so the sliding scale should be reviewed and revised accordingly. In other words, as long as reinsurers categorized as this class are required to post 100% collateral (which they already do under the existing regime without the various compliance requirements of the POE scheme), they should be automatically placed out of this POE framework.

Lloyd's: We certainly recognize the strength of the U.S. insurance regulatory system but we believe that regulatory systems in certain other jurisdictions are equally as strong. As a result, we do not feel that different collateral requirements to those required of U.S. reinsurers are justified for strong, well-regulated non-U.S. reinsurers from a jurisdiction that the RSRD has found to impose a regulatory regime that is equivalent in its effectiveness to that in the U.S. We continue to believe that the framework should treat a strong well-regulated non-U.S. reinsurer the same as its equivalent in the U.S.

PCI: **Item 18.** Reinsurers with an S&P or A.M. Best rating below A- have an extremely difficult time securing future reinsurance business. U.S. cedents are substantially penalized where there reinsurers are in the B range. The S&P capital model penalty for uncollateralized cessions to all BBB rated companies is twice that of A-rated companies. Best's Impairment Rate and Rating Transition Study of U.S. P&C companies indicates reinsurers rated B++/B+ are more than twice as likely to become impaired after a 5 year period than companies rated A/A-.

A-rated reinsurers tend to be perched on a cliff and/or in the early years of rating analysis. PCI recommends requiring 100% for A- rated. It would not be unreasonable to consider reducing the requirement for Class 1 companies (Best A++) and perhaps Class 2 companies (Best A+ rated).

19. Because of the prudential U.S. reinsurance regulatory requirements designed to protect policyholders and to ensure the integrity and stability of the U.S. financial system, national reinsurers would not have to post any collateral for those rated by their home state supervisors in the Secure - 3 tier or above. For those national reinsurers rated in the Secure - 4 tier, 75% collateral would be required and for those in the Vulnerable – 5 tier, 100% collateral would be required. The basis for this determination is that U.S. domiciled reinsurers have been subject for many years to a broad array of regulatory rules developed by the states through the NAIC's Model Law process.

Comments:

IUA: **U.S. v. non-U.S. funding requirements - Paragraph 18** of the Memorandum provides the requisite collateral requirements for rated reinsurers. **Paragraph 19** provides that U.S. licensed reinsurers rated Secure-3 or above will be exempt from any collateral requirements.

The disparity in treatment between U.S. and non-U.S. reinsurers is hard to understand. Only non-U.S. reinsurers who are subject to a level of regulation that is recognized by the RSRD will be able to apply to be rated. These reinsurers will then also have to apply to be listed and approved by a POE regulator. We do not believe it is justified to then provide more onerous collateral requirements on these reinsurers. Under the proposed system, a non-U.S. reinsurer that is, by definition, well regulated by its domestic regulator, reviewed and approved by a POE regulator in the U.S. and rated AA+ (S&P) must post 10% collateral. At the same time, a U.S. reinsurer, licensed in one State (let's assume it is the same which is used as the POE state by the AA+ non-U.S. reinsurance) and rated A- posts 0% collateral. This discriminatory treatment strikes at the heart of what the Reinsurance Task Force has said it wants to do. – treat all well regarded reinsurers the same, regardless of its state or country of domicile. **We believe strongly, that you should delete paragraph 19.**

Even with equivalent collateral requirements, it is important to note that there will still be significant value in having a U.S. license, as opposed to reinsurance on a cross-border basis. U.S. licenses reinsurers will be able to operate from offices in the United States. This proximity to cedents is big commercial advantage.

PCI: **Item 19.** For a long time, the proposals for collateral reduction have spoken of "geographically agnostic." This item and the table show that it is not the case with the proposal at hand. With claims of discrimination against alien insurers as the basis for having a proposal, this is confusing. The current system at least treats the aliens as any other insurer as evidenced by the divisions within item #8, see above.

We must mention that U.S. reinsurers' level of regulatory oversight is well known. In addition, the timeliness and level of disclosure of financial results is very good in comparison to many non-U.S. companies. Accordingly, there should be some level of benefit accorded to U.S. reinsurers.

RAA: **Paragraph 19:** The RAA very much appreciates the NAIC's acknowledgment of the value of a U.S. license and believes that National Reinsurers should not have to post collateral (U.S. domiciled reinsurers have been subject for many years to a broad array of regulatory rules developed by the States through the NAIC Model Law process). However, the more appropriate way to address the regulatory concern regarding potential inability to pay claims may be through licensing/certification. If a regulatory authority believes that a reinsurer may have difficulty in the future paying claim, the appropriate course may be to restrict its ability to write new business rather than impose additional collateral requirements.

20. As part of the evaluation process, factors to be considered by the home state or POE supervisor in determining the appropriate rating of the reinsurer shall include the above chart and the following:

Comments:

AIG: The question arises as to whether standards will be promulgated relative to the items of consideration listed so as to determine whether home state and/or POE supervisors are applying like parameters to arrive at their judgments.

PCI: **Item 20.** There is no specificity, hence no uniformity, as to the amount of "downgrade" that could occur in the event that a reinsurer fails any one or more of these criteria and to differing extents. A prudent ceding company will

have to look at its potential reinsurer in light of each of these factors, "guesstimate" how the home or POE state might or might not consider these relevant and if so how relevant, and then determine if it should run the risk of losing credit for reinsurance to one degree or another. This is another problem with the proposal: It does not give business level certainty to the ceding insurers, yet the ceding insurer must anticipate how a home or POE state will treat the reinsurer.

These items will do the opposite of creating uniformity as states apply some or all of the criteria to one degree or another.

In order for the criteria in #20 to be truly useful, it seems the criteria should be at least the same as if the reinsurer became licensed.

RAA: **Paragraph 20:** is unnecessary for the same reasons the collateral system should be unnecessary in a truly modernized regulatory regime based upon meaningful, enforceable supervisory recognition with reciprocal obligations. A better alternative would be to consider some of these factors during the evaluation process of the non-U.S. jurisdiction. Moreover, consideration of these factors in determining the appropriate rating appears to be very vague and subjective. It is also unclear what weight will be given to each of these factors – i.e., can these factors positively influence a rating or only negatively influence a rating? Is there an appeal process if a reinsurer believes that its assigned rating is not justified?

This Paragraph, along with Paragraph 25, gives unfettered discretion to regulators to assign reinsurer ratings and thereby trigger collateral requirements regardless of financial security. Regulators have other tools available to address concerns over claims paying or market practices without the threat of an arbitrary collateral requirement.

a. a list of all disputed or overdue recoverables;

Comments:

ABIR: A list of amounts overdue and in dispute (Section 20, paragraph a); this information is already available from the ceding insurer in Schedule F filings. For the reinsurer, the NAIC interest would be in material amounts of retrocessional coverage that may be due or disputed -- and that may affect the financial standing of the reinsurer. Therefore a materiality threshold should be created to govern this additional reinsurer financial report.

AIG: As to item a, the standard for determining disputed recoverables is assumed to be that set forth in SAP; however, the SAP definition does not consider the circumstance where a ceding company considers a matter in dispute but receives no confirmation from the assuming company of that circumstance. Thus, an incomplete list may be submitted by the assuming reinsurer. Under items b and c, it is unclear how "reputation" and "compliance" are to be determined.

IUA: **Lists of disputed and overdue claims - Paragraph 14 (c)** and 20(a) require the filing of a list of all disputed and overdue reinsurance claim on a quarterly basis (14(c)) and as part of the initial POE review (20(a)).

We agree that some information regarding disputes and overdue claims can be relevant to the review of the financial integrity or a reinsurer. We would recommend that the instead only disputes in excess of a certain amount be reported. Finally, we would not that there should be some definition of what is a disputed claim. Presumably claims would be in dispute where a notice of intent to commence arbitration has been served or complaint has been filed in a court of competent jurisdiction.

With regard to overdue claims this is another area where the data is readily accessible from the financial statements filed by ceding insurers. We recommend that the POE regulator obtain this information form the NAIC database. If this information raises questions the POE regulator should be free to request additional information from the insurer.

PCI: **Item 20(a).** Under this item "all" disputed or overdue recoverables are to be considered, yet under the reporting section, only those related to U.S. ceding companies are to be considered. "All" is the preferable choice as any disputed or overdue recoverable is relevant to a ceding company.

RAA: Requiring a list of all disputed and overdue recoverables to be updated on a quarterly basis is overly burdensome.

b. The reinsurer's reputation for prompt payment of valid claims under reinsurance agreements, including the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute, including receivables payable to companies that are in administrative supervision or receivership;

Comments:

ABIR: For paragraph b the word "reputation" should be replaced with the word "record". This provision, we believe, is an evaluation of the ceding insurer reports that establish the reinsurer's record in the US with regard to amounts overdue to US cedents or in dispute with US cedents.

RAA: How will a regulator evaluate a reinsurer's reputation for prompt payment of valid claims under Paragraph 20(b) or compliance with reinsurance contractual terms under 20(c)? What information will be utilized and who will provide this information?

c. Compliance with reinsurance contractual terms and obligations (including mandatory contractual clauses);

d. The business practices of the reinsurer in dealing with their ceding insurers;

Comments:

ABIR: For paragraph d, we recommend deletion. We think paragraph b establishes the reinsurer's market record with US clients.

AIG: As to item d, it is unclear how business practices determination will be made.

RAA: It is unclear what is meant by "business practices" in Paragraph 20(d). This term is nebulous and should be defined.

e. For national reinsurers, a review of the most recent NAIC Property and Casualty Annual Filing Blank Schedule F, or for life companies the NAIC Life, Accident & Health Filing Blank Schedule S;

f. For POE reinsurers, a review of a report filed annually in the form of the NAIC Property and Casualty Annual Filing Blank Schedule F, or for life companies the NAIC Life, Accident & Health Filing Blank Schedule S as prescribed by the POE supervisor. For those parts of Schedule F where data is reported by a counterparty whose net reinsurance recoverable or payable in total is less than 5% of statutory surplus, that counterparty may be reported as an aggregated amount. All contracts on Schedule S, regardless of the amount, must be reported individually;

Comments;

ABIR: For paragraph f, we recommend replacement of this section with information required as noted in paragraph ii of our comments above. Non US reinsurers do not report to their domestic regulators information consistent with the seven sections of the NAIC Schedule F. Regulators should fully utilize the voluminous ceding insurer reports available to them, but should not be compelling non-US reinsurers to file a report that is entirely new to them and only created for the purposes of complying with this filing requirement. As noted above, the port of entry regulator is legitimately interested in retrocessional information that may affect the financial standing of the reinsurer. Information on its own retrocessional arrangements and amounts that may not be recoverable are legitimate points of inquiry in the evaluation of the financial standing of the port of entry reinsurer.

GIAJ: It is also quite burdensome for POE reinsurers to file a report in the form of Schedule F. annually (paragraph 20.f).

IUA: **Filing of Schedule F data - Paragraph 20 (f)** of the Memorandum requires a POE reinsurer to file annually a report in the form of Schedule E (or S) of the NAIC annual statement blank. The filing of complete Schedule F's will be substantial administrative burden and cost for non-U.S. reinsurers. Non-U.S. reinsurers do not capture the same data in the same form. We also believe that U.S. regulators can obtain much of the information they require from other sources. In particular, information concerning U.S. business assumed by non-U.S. reinsureres can be

obtained by the Schedule Fs file by U.S. ceding companies. Accordingly, we would urge you not to require the assumed reinsurance portion of Schedule F.

We would recommend that the POE regulator should only require non-U.S. reinsurer to file material information, for example the aggregate amount of retrocession protection they have, and the identity of the material reinsurers, perhaps the identity of their top five reinsurers.

g. Regulatory actions against the reinsurer;

h. A clean independent audit opinion of the reinsurer; and

AIG: Concerning item h (and notwithstanding item i), it is noted that the clean audit opinion will be based on local non-US accounting and audit paradigms.

i. For POE reinsurers, audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles, regulatory filings, actuarial opinion (as filed with the Non-U.S. Jurisdiction supervisor). Upon the initial certification, audited financial statements for the last 3 years filed with its non-U.S. Jurisdiction supervisor.

Comments:

ABIR: For paragraph I, the requirement is to file three years of audited domiciliary financial statements, other "regulatory filings" and actuarial opinions as required by the non-US supervisor. This provision should require filing of the financial statements filed with the non-US regulator. Under the Bermuda law, these financial statements can be made under US GAAP and under IFRS. IFRS filings should be allowed under this provision. Non-US reinsurers should not be compelled to file financial statements which they don't produce for their domestic regulator. The reference to "other" regulatory filings is open ended and should be clarified before this provision is finalized.

AIG: As to item I, it appears that the alien reinsurer applicant has the choice to reconcile to US GAAP or SAP. Is that so? It would seem that the second sentence of item I should be its own individual item, perhaps replacing item h.

GIAJ: **Requirement of financial statements -** POE reinsurers are required to file their financial statements reconciled to U.S. GAAP or Statutory Accounting Principles (paragraph 20-i). It is virtually impossible for POE reinsurers to meet these requirements when they do not prepare U.S. GAAP based financial statements locally.

IUA: **Filing of U.S. GAAP or SAP statements - Paragraph 20(i)** of the Memorandum provides that non-U.S. reinsurers must file with their port of entry ("POE") state audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles. We urge you to amend this provision to accept IFRS accounting statements as well, in light of a clear movement towards such a format.

Reconciling foreign financial statement to U.S. GAAP or SAP involves a considerable expense. We have been advised that for reinsurers of any significant size the accounting and auditing fees alone could be around $1 million. In addition, GAAP or SAP reconciliation requires substantial IT and administrative burdens for the reinsurer. We do not believe that the benefits of this reconciliation will outweigh the substantial costs. Moreover, many regulators worldwide are moving to require or accept IFRS statements, including EU Member States. As you know the U.S. Securities Exchange Commission, earlier this year, agreed to accept IFRS statements from foreign issuers. They are currently considering accepting them form U.S. issuers. This accommodation is being done in the context of promoting retail sales of securities to U.S. consumers. In the context of the reinsurance regulatory framework, IFRS will only be used in a business to business transaction. In light of clear movement toward the acceptance of IFSR, we would urge you to accept such statements from non-U.S. reinsurers.

21. National reinsurers and port of entry reinsurers would not have to post collateral for catastrophe recoverables for a period of one year from the date of a defined catastrophic occurrence. Reinsurance recoverables for the following lines of business as reported on the NAIC annual financial statement related specifically to the catastrophic occurrence will be included in the deferral:

Comments:

AIA: **Postponement of Posting Collateral for Catastrophe Recoverables**: The draft framework would allow alien reinsurers to postpone the posting of collateral for catastrophe recoverables for a period of one year. This is a dangerous provision for the U.S. primary industry. Securing reinsurance recoverables at times of catastrophes is one of the critical roles collateral plays in the current system. Collateral exists to help ensure U.S. insurer solvency and prompt payment of reinsurance recoverables. Reliance and Legion went into liquidation shortly after the World Trade Center incident when there was a significant delay in receiving payments from their reinsurers. The security created by collateral is needed more, not less, after a catastrophe. It is dangerous enough to propose eliminating or severely reducing collateral for alien reinsurers, but it is even more imprudent to compound that danger by delaying the posting of collateral at the times where collateral is needed the most.

AIG: "Catastrophic occurrences" are not defined and as to the second sentence, is it only for the lines of business delineated that collateral can be deferred in placement? The use of the word "included" in the second sentence makes the issue unclear.

NAMIC: Are conventions of the reinsurance business business so strongly embedded that one year must be specified for posting collateral for post-catastrophe recoverables, as is done in paragraph 21. for a number of lines?

PCI: **Item 21.** The presumption that short tail business can have collateral deferred is appropriate only if such reinsurers never become troubled within a year after a catastrophe. PCI believes that there may be reinsurers with heavily weighted catastrophe books of business that are in reality more likely to be troubled immediately after a catastrophe. Additionally, there is no provision in this item for a circumstance where there is short tail business and the reinsurer is downgraded within that year. This is but another instance where the ceding company will have to wait for the collateral. Meanwhile, as with other instances where the ceding company has a downgraded reinsurer, the ceding company itself may be downgraded while waiting for collateral that would, had it existed, prevented a downgrade to the ceding company in the first place.

This concept, if in the proposal at all, should require a showing by the reinsurer why it should be exempt from collateral requirements. The current proposal simply grants the exemption.

a. Line 1: Fire
b. Line 2: Allied Lines
c. Line 3: Farmowners multiple peril
d. Line 4: Homeowners multiple peril
e. Line 5: Commercial multiple peril
f. Line 9: Inland Marine
g. Line 12: Earthquake
h. Line 21: Auto physical damage

[Drafting Note: The NAIC Statutory Accounting Principles Working Group shall establish an audited footnote for the respective NAIC annual filing blank.]

22. The home state or POE supervisor will require all reinsurers to post 100% collateral upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurer.

Comments:

AIG: It is unclear why the placement of an order rehabilitation, liquidation or conservation against the ceding company should trigger a collateral requirement to the assuming reinsurer especially considering that assuming reinsurer would have met the requirements set forth in paragraph 20.

RAA: The RAA strongly objects to Paragraph 22 which requires all reinsurers to post 100% collateral upon the entry of an order of rehabilitation, liquidation or conservation against the cedent. To the extent that this requires a reinsurer to post collateral for IBNR, the RAA strongly opposes this provision based upon valuation and claims acceleration concerns. These unknown liabilities (IBNR) are actuarial estimates that insurers and reinsurers use for accounting

purposes in order to ensure that sufficient funds will be available to pay for any claims which, in the future, may be reported, adjudicated and paid. Reinsurers are not required to pay, under their reinsurance contracts, on the basis of unknown potential losses in the form of IBNR. They are obligated to pay only known claims that have been fully identified, for which liability has been established and value has been determined. IBNR does not meet any of these requirements. Because reinsurance if often the largest asset of an insolvent estate, placing collateralized funds within reach of a receiver presents opportunities for mischief in the face of pressure to maximize estate values.

In addition, the provision unfairly penalizes a reinsurer for the insolvency of its cedent by forcing the posting of 100% collateral when such posting may not be contractually mandated. A.M. Best's special report on insolvency (*Best's Insolvency Study, Property/Casualty U.S. Insurers*, 1969-2002) indicates that reinsurance failures are rarely the cause of ceding company insolvencies. Thus, there is no justification, from a solvency perspective, to require a reinsurer to post collateral when a cedent is in financial difficulty. Cedent insolvencies usually arise from poor management of risk or poor underwriting results, and lead to significant claims which are ceded to reinsurers. To require collateral is to compound the problem for reinsurers.

Additionally, the reinsurers in this situation would be subject to either Home or POE state regulation either directly or through recognition arrangements. Where these reinsurers are timely meeting payment obligations, they should not be required to bear the additional costs of collateral and other associated risks. Where they are not, the Home or POE regulator has regulatory options to deal with the situation.

23. Affiliated reinsurance transactions will receive the same opportunity for reduced collateral requirements as all other reinsurance transactions.

Comments:

ABIR: Paragraph 23, Affiliated Reinsurance. The proposal affords affiliated reinsurance the same collateral reduction as allowed unrelated reinsurance. Since affiliated reinsurance is already subject to additional regulation by the US subsidiary company regulator, affiliated reinsurance should be subject to an additional collateral reduction. Under NAIC holding company law, such transactions are subject to regulatory review and can be rejected. In some states actual approval is required. In August 2007, Zurich, Swiss Re and ABIR supplied this exemption language to the Task Force. Credit for reinsurance shall be allowed:

a. "Where the reinsurance has been ceded by a domestic insurer to any person in its holding company system and, pursuant to (insert citation to state's statutory equivalent to Section 5(A)(2) of the NAIC Model Insurance Holding Company System Regulatory Act), the domestic insurer has notified the commissioner of its intent to enter into such transaction, and the commissioner has not disapproved the transaction within the time period set forth in (insert citation to state's statutory equivalent to Section 5(A)(2) of the NAIC Model Insurance Holding Company System Regulatory Act). The domestic insurer may voluntarily notify the commissioner of a transaction pursuant to (insert citation to state's statutory equivalent to Section 5(A)(2) of the NAIC Model Insurance Holding Company System Regulatory Act), even if notification would not be required under (insert citation to state's statutory equivalent to Section 5 (A)(2)(c) of the NAIC Model Insurance Holding Company System Regulatory Act)."

b. An alternative to this approach would be to allow a "one notch" upgrade where less collateral would then be required for such affiliated transactions.

AIG: Affiliated transactions should be exempt from collateral requirements because they have been pre-approved, non-disapproved or deemed immaterial by US regulators. In any case, it is unclear whether an affiliate can trade off the rating of the group as a whole or needs its own individual rating. What about pooling agreements?

PCI: **Item 23.** While the "no more than 5% of gross premium written on a primary basis" is used to define entities able to avail themselves of the proposal, PCI believes there should be clarity how the proposal applies or not to intercompany pooling arrangements or intercompany reinsurance agreements.

RAA: **Paragraph 23:** places affiliate transactions on the same footing as other reinsurance transactions. As we have stated before, affiliate transactions are subject to direct regulatory review under state holding company laws. This review subjects them not only to the typical risk transfer and other requirements imposed on unaffiliated reinsurance

transactions but also provides a higher standard of regulatory scrutiny by requiring the transaction be fair and reasonable and to result in surplus that is reasonable to liabilities. The holding company laws also require submission of information about the entire holding company system and the controlling entity. Moreover, the non-U.S. affiliated entity has demonstrated a significant capital commitment to the U.S. Finally, all material affiliate reinsurance contracts must be submitted to the U.S. licensee's domestic regulator for prior approval, which approval can be subject to regulatory conditions including the establishment of security sufficient to satisfy any regulatory concerns. Reduced collateral for these transactions is warranted. In the alternative, the Task Force should consider no collateral requirements where the subsidiary has been designated by the rating agencies as a core subsidiary.

Change in or Revocation of Rating

24. The POE or home state supervisor will not have discretion to waive additional collateral required in the case of an NRSRO rating downgrade or other disqualifying circumstance. The POE or home state supervisor may suspend the certification of a reinsurer for collateral reduction purposes if it does not meet the collateral requirements and obligations contained in this proposal.

Comments:

AIG: There are no timetables set forth required for the home state or POE state actions contemplated. There is dichotomy of verbiage used as between paragraph 24 ("may suspend the certification of a reinsurer") as opposed to paragraph 25 ("amend or withdraw a reinsurer's rating"). Why?

PCI: **Item 24.** The suspension of a certification of a reinsurer, or worse, reinsurer(s) jurisdiction causes a number of concerns. One is timing. PCI believes there would be an administrative process to challenge the suspension and after that, judicial review. This delay poses problems for ceding insurers. Their own ratings may be downgraded because the collateral is not increased while this process goes on. They may not receive any collateral until completion of an administrative hearing. Or they may not receive any collateral until after judicial review of the administrative hearing.

25. The POE supervisor or home state supervisor will have the authority to amend or withdraw a reinsurer's rating at any time if a reinsurer fails to meet its obligations under this proposal, or if other financial or operating results of the reinsurer lead the reinsurer's supervisor to reconsider the reinsurer's ability or willingness to meet its contractual obligations.

Comments:

AIG: On the last line, it should read: "...lead the reinsurer's home state or POE supervisor to reconsider...".

PCI: **Item 25.** This item mentions that financial or operating results could be a cause for suspension. Significant delay in payment should be another reason.

26. If the home state supervisor's or port of entry supervisor's rating of a reinsurer improves, it will be permitted to meet the collateral requirements applicable to its new rating on a prospective basis (i.e., for all reinsurance contracts incepting after confirmation of the improved rating). If the home state supervisor's or port of entry supervisor's rating of a reinsurer declines, it will be required to meet the collateral requirements applicable to its new rating for all business covered under this proposal.

Comments:

NAMIC: Paragraph 26. treats what may be one of the most problematic scenarios possible under a new framework of calibrated collateral: Additional collateral will be required in the case of a downgrade of financial strength ratings. We read the requirement as prescribing this for all business, both old and new.

PCI: **Item 26.** The proposal should be modified so that where the rating declines, the reinsurer must **immediately** meet collateral requirements applicable to its new rating. Thus, for reinsurers posting collateral at any reduced rate, they

must regularly monitor loss reserves of their ceding companies in order to immediately effectuate any collateral posting and indicate to the home or POE state the amount of collateral they would need to post to be fully collateralized for all their U.S. ceded business. The time to inquire as to ceding insures' loss reserves should not start when additional collateral is required. The home or POE state should be required to analyze that amount to see if the reinsurer can in fact post such collateral and if not, the rating must be adjusted downward.

27. Notwithstanding the change or withdrawal of a reinsurer's rating, U.S. ceding companies may continue to take financial statement credit for a period of three months for all reinsurance ceded to that reinsurer for which they were previously allowed credit, unless the reinsurance is deemed uncollectible.

Comments:

AIG: It is unclear as to who deems the reinsurance uncollectible. We recommend that at the end of the paragraph, the phrasing be changed to: "...unless the reinsurance is deemed by the ceding company as uncollectible."

NAMIC: We assume that the three months of paragraph 27. is the pratical time limit of such posting of additional collateral.

PCI: **Item 27.** There is nothing in this item as to what recourse the ceding company would have after the three months, or earlier, if the required collateral is not posted. PCI believes that is not addressed as the answer is none. The hit to surplus is a burden to be borne by the ceding companies.

Additional Comments:

CEA: **Implementation Period** - In order for the new framework to become operational, a substantial number of steps still need to be taken. We would therefore urge the NAIC to develop and commit to an appropriate implementation period. In spite of the progress made by the NAIC so far, the CEA is convinced that the framework can and should be further improved in line with the comments made above [inserted throughout document], to ensure a true level playing field for US and non-US insurance undertakings writing reinsurance in the US.

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TO: Reinsurance (E) Task Force Members, Interested Regulators and Interested Parties

FROM: Bryan Fuller, NAIC Senior Reinsurance Manager

DATE: July 3, 2008

SUBJECT: Reinsurance (E) Task Force Activities

1. The Reinsurance (E) Task Force (RTF) met in regulator-to-regulator meetings in Newark, NJ on March 11-12, May 7-9, and June 25-27, 2008, considered comments received from interested parties and developed the reinsurance regulatory modernization framework outlined in this proposal.

Definition of Terms

"Domiciled" means the jurisdiction in which the insurer is incorporated or organized.

"Home state" means the qualifying state where the national reinsurer is licensed and domiciled.

"Home state supervisor" means the supervisor of a national reinsurer.

"Host state" means the domicile of the ceding company.

"Host state supervisor" means the ceding company's domestic regulator.

"National reinsurer" means a reinsurer that is licensed and domiciled in a home state and approved by such state to write reinsurance assumed business across the United States while submitting solely to the regulatory authority of the home state supervisor for purposes of its reinsurance business.

"Non-U.S. Jurisdiction supervisor" means the domiciliary supervisor of a reinsurer from a non-U.S. jurisdiction.

"Port of Entry reinsurer" means a non-U.S. assuming reinsurer that is certified in a port of entry state and approved by such state to provide creditable reinsurance to the U.S. market. No physical presence in the U.S. is permitted.

"Port of Entry state" means the state where a non-U.S. assuming reinsurer is certified in order to provide creditable reinsurance to the U.S. market.

"**Port of Entry supervisor"** means the insurance supervisory agency of the port of entry state.

<u>**Purpose and Structure**</u>

2. U.S. insurance regulators have developed a framework that would allow for a state with the appropriate regulatory capacity to be a sole U.S. regulator of a reinsurer writing assumed business in the United States. The framework provides for two new classes of reinsurers in the United States, national reinsurers and port of entry (POE) reinsurers. Each would be supervised by a single state (the home state or port of entry state). National reinsurers would be licensed by the home state and port of entry reinsurers would be certified by the port of entry state.

3. In order to qualify as a home state supervisor or a port of entry supervisor, a state must meet a set of standards as established by the supervisory board of the NAIC Reinsurance Supervision Review Department (RSRD). Under the framework, a certification mechanism will be established so that those states that have the resources, expertise and experience to regulate reinsurance can do so as a home state or POE supervisor which will have exclusive jurisdiction over its reinsurers reinsurance business. Under the framework, a consultative process will be created to facilitate the resolution of disputes among insurance regulators regarding reinsurance issues. This consultative process shall be localized within the supervisory board of the RSRD which will consist of state insurance regulators. After consultation, the decision by the home state or POE supervisor with respect to the financial solvency of the reinsurer will be final.

4. The reinsurance regulatory modernization framework will be available to companies that write primarily reinsurance business with no more than 5% of their gross premiums written other than assumed reinsurance. This requirement to primarily write reinsurance will not apply to a group including incorporated and individual unincorporated underwriters (i.e. Lloyd's).

5. National reinsurers or POE reinsurers shall have a minimum capital requirement of $ 250 million to be eligible to be a national reinsurer or a POE reinsurer. This requirement may also be satisfied by a group including incorporated and individual unincorporated underwriters (i.e. Lloyd's) having capital equivalents (net of liabilities) of at least $ 250 million and a Central Fund containing a balance of at least $ 250 million.

6. Other aspects of this single state regulatory system for national reinsurers include:

   a. A host state will be required to grant credit for reinsurance ceded by one of its domestic insurers to a national reinsurer; and
   b. The ceding insurer's domiciliary regulator retains the same authority it has under existing law to determine whether the contract transfers risk.

7. Other aspects of this single state regulatory system for POE reinsurers include:

   a. States will be required to grant credit for reinsurance ceded by their domestic insurers to a POE reinsurer;
   b. The ceding insurer's domiciliary regulator retains the same authority it has under existing law to determine whether the contract transfers risk; and
   c. In order to be certified as a POE reinsurer, a company/reinsurer must be organized in and licensed by a non-U.S. jurisdiction recommended as eligible for recognition by the RSRD. Once the non-U.S. jurisdiction has been recommended as eligible by the RSRD, and so long as it maintains that status, the reinsurer could then be certified by the POE state to access the U.S. market through the POE state.

8. U.S. licensed insurers providing reinsurance who do not choose to become a national reinsurer would have the option to continue to operate under the current regulatory framework. Non-U.S. insurers providing reinsurance that do not choose to become a national reinsurer or a port of entry reinsurer would have the option to continue to operate under the current regulatory framework. The four methods of conducting reinsurance business in the U.S. under this proposal include the following:

   a. As a national reinsurer;

   b. As a POE reinsurer;

c. As a licensed or accredited reinsurer under the current NAIC Model Credit for Reinsurance Law; and

d. As a reinsurer (non-U.S. or U.S.) not licensed in all states by posting 100% collateral.

9. The proposed reinsurance regulatory modernization initiative, including changes to collateral requirements and any amendments to current credit for reinsurance rules, will apply only on a prospective basis. An appropriate implementation period will be developed.

Role and Structure of the RSRD

10. The supervisory board of the RSRD will consist of state insurance regulators and will:

a. facilitate communication and dispute resolution among home state, host state, POE, and other supervisors;

b. maintain, revise and update collateral reduction eligibility criteria; and

c. establish uniform standards for home state and POE supervisors.

11. The functions of the RSRD will include but not be limited to the following:

a. The RSRD will be the repository for relevant data concerning reinsurers (U.S. and non-U.S) and the reinsurance markets.

b. The RSRD will determine the appropriate supervisory recognition approach for non-U.S. jurisdictions and create a list of jurisdictions eligible to be recognized by POE states.

[Drafting Note: The IAIS Guidance Paper on Mutual Recognition should serve as a reference document for this purpose]

c. The RSRD will develop a sample supervisory recognition agreement and a protocol for unilateral recognition.

d. The RSRD will develop a sample information sharing and regulatory cooperation agreement between the non-U.S. Jurisdiction and the POE supervisor;

e. The RSRD will develop the criteria for a state to qualify as a home state or POE supervisor which will include but not be limited to the following:

i. Appropriate staff expertise (reinsurance contract law, international accounting, reinsurance industry, etc.);
ii. Accreditation through the NAIC's Financial Regulation Standards and Accreditation Program;
iii. Experience in regulating sophisticated market participants including undertaking appropriate enforcement actions as needed;
iv. Appropriate staff size and depth; and
v. Sufficient ceded premium volume.

f. The RSRD will provide a purposes and procedures manual for home state and POE supervisors.

g. The RSRD will develop mandatory contractual clauses for both ceding insurers and reinsurers which shall be uniform across the country. Such clauses shall include, but are not limited to the following:

i. **Parties to the Agreement Clause** - would stipulate that the policyholder is not ordinarily a party to the reinsurance contract, and does not have direct rights against the reinsurer.

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ii. **Net Retained Lines Clause –** would clarify which portion of the company's business will be subject to the agreement and states the uncollectibility of other reinsurance.

iii. **Premium Clause –** would state the method of calculating premiums and the schedule of payments.

iv. **Reinsurance Intermediary Clause –** would stipulate that the credit risk for the intermediary is on the reinsurer. In other words, payment from the ceding company to the broker is deemed paid to the reinsurer. However, payment to the broker from the reinsurer does not relieve the obligations of the reinsurer to the ceding company.

v. Service of Suit Clause – National reinsurers and POE reinsurers must designate their home state or POE state Insurance Commissioner as their legal agent for the service of process.

vi. **Insolvency Clause –** Reinsurance is payable directly to the liquidator or successor without diminution regardless of the status of the ceding company.

vii. **Credit for Reinsurance Clause –** This clause would read as follows:

1. "If, at any time, the reinsurance provided by a Reinsurer participating in this Contract does not qualify for full statutory accounting credit for reinsurance such that a financial statement penalty to the Company would result on any statutory statement or report the Company is required to make or file with insurance regulatory authorities (or a court of law in the event of insolvency), the Reinsurer shall secure the Reinsurer's share of Obligations by the posting of such collateral as may be required to avoid the imposition of the aforementioned financial statement penalty by those authorities in a manner, form, and amount acceptable to all applicable insurance regulatory authorities."

Role of Home State Supervisor

12. The home state supervisor shall be responsible for:

a. approving a reinsurer for licensure as a national reinsurer;

b. examining its national reinsurers for solvency and compliance with applicable laws;

c. establishing the appropriate rating for collateral purposes of its national reinsurers and adjusting that rating as circumstances require;

d. responding to inquiries from other supervisors concerning national reinsurers under its supervision;

e. participating in the consultative process at the supervisory board of the RSRD concerning the resolution of disputes regarding its national reinsurers;

f. initiating enforcement actions against its national reinsurers and notifying all host state supervisors immediately of any enforcement action, formal or informal, taken; and

g. receiving an annual fee from each national reinsurer it supervises.

Role of the Port of Entry Supervisor

13. The port of entry supervisor shall be responsible for:

    a. entering into a supervisory recognition framework with the Non-U.S. jurisdiction supervisor and entering into appropriate regulatory cooperation and/or information sharing arrangements;

    b. certifying a reinsurer as a POE reinsurer which shall include, but not be limited to, the receipt by the supervisor of a properly executed Form AR-1, which is a certificate of assuming insurer, that stipulates that the reinsurer submits to the jurisdiction of U.S. courts, appoints an agent for service of process in the United States, and agrees to post 100% collateral for its United States liabilities if it resists enforcement of a valid and final U.S. judgment. The Form AR-1 will not be accepted from any reinsurer which is domiciled in a country or state which the POE supervisor or RSRD has determined does not adequately and promptly enforce valid U.S. judgments or arbitration awards;

    c. establishing the appropriate rating for collateral purposes of its POE reinsurers and adjusting that rating as circumstances require;

    d. responding to inquiries from other supervisors concerning POE reinsurers under its supervision;

    e. serving as the conduit for and consulting with the non-U.S. jurisdiction supervisor concerning any issues regarding the POE reinsurer and advising all host states as appropriate;

    f. participating in the consultative process at the supervisory board of the RSRD concerning the resolution of disputes regarding its POE reinsurers; and

    g. receiving an annual fee from each POE reinsurer it supervises.

14. A POE reinsurer must file the following reports quarterly with the POE supervisor:

    a. A statement either certifying that there has been no change in the provisions of its domiciliary license or any of its NRSRO ratings, or a statement describing such changes and the reasons therefore, as well as any changes in its directors and officers;

    b. Information comparable to relevant provisions of the NAIC financial statement modified as deemed appropriate by the POE supervisor for use by insurance markets;

    c. An updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers; and

    d. Any other information that the POE supervisor may reasonably require.

Role of Host State Supervisors

15. The host state supervisor shall:

    a. have the right to request specific analysis and/or examination procedures performed by the home state supervisor and the right to receive completed financial analysis and examination work papers from the home state supervisor. Such information is protected under the NAIC's Information Sharing Agreement;

    b. advise the home state supervisor whenever the host state supervisor has reasonable cause to believe an examination of a national reinsurer is necessary due to an emergency;

c. have the right to request additional information from the home state or the POE supervisor concerning a national reinsurer or POE reinsurer;

d. evaluate risk transfer of each ceding insurer's reinsurance agreements;

e. retain the authority to require diversification of reinsurance risk for ceding insurers;

f. have the discretion to require the ceding insurer to attain prior written approval if, for any twelve-month period, the reinsurance premium or anticipated change in the ceding insurer's liabilities equals or exceeds fifty percent (50%) of the insurer's surplus to policyholders as of the immediately preceding December 31; and

g. require the ceding insurer to provide notification within 30 days if any single reinsurer represents more than twenty percent (20%) of the ceding insurer's gross written premium or if it is likely to exceed this limit, except for approved affiliated transactions.

Collateral Proposals Including Eligibility Criteria

16. The POE or home state supervisor will assign a reinsurer one of five ratings (Secure-1, Secure-2, Secure-3, Secure-4 or Vulnerable-5). The maximum rating that a reinsurer may be assigned will correspond to the reinsurer's Nationally Recognized Statistical Rating Organization (NRSRO) rating as outlined in the table below. The POE or home state supervisor shall use the lowest rating received from an NRSRO in establishing the maximum rating of a reinsurer. A failure to obtain or maintain at least two NRSRO ratings will result in an assignment of a Vulnerable-5 rating. The additional factors listed below may result in a lower rating as determined by the POE or home state supervisor. National reinsurers and POE reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements.

17. With respect to reinsurance contracts entered into or renewed on or after the effective date of this proposal, a ceding insurer may elect to take credit, in accordance with the provisions of this proposal, for reinsurance ceded to a national or POE reinsurer which maintains, on a stand-alone basis, a financial strength rating from at least two of the rating agencies listed below:

(a) Standard & Poor's;
(b) Moody's Investors Service;
(c) Fitch Ratings;
(d) A.M. Best Company; or
(e) any other rating agency recognized by the NAIC SecuritiesValuation Office (SVO).

18. The initial collateral calculation would be as follows:

Ratings	Collateral Required	Best	S&P	Moody's	Fitch
Secure – 1	0%	A++	AAA	Aaa	AAA
Secure – 2	10%	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure – 3	20%	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
Secure – 4	75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable - 5	100%	B, B-C++, C+	BB+, BB, BB-	Ba1, Ba2, Ba3	BB+, BB, BB-
		C, C-, D, E, F	B+, B, B-, CCC, CC, C, D, R	B1, B2, B3, Caa, Ca, C	B+, B, B-, CCC+, CC, CCC-, DD

19. Because of the prudential U.S. reinsurance regulatory requirements designed to protect policyholders and to ensure the integrity and stability of the U.S. financial system, national reinsurers would not have to post any collateral for those rated by their home state supervisors in the Secure - 3 tier or above. For those national reinsurers rated in the Secure - 4 tier, 75% collateral would be required and for those in the Vulnerable – 5 tier, 100% collateral would be required. The basis for this determination is that U.S. domiciled reinsurers have been subject for many years to a broad array of regulatory rules developed by the states through the NAIC's Model Law process.

20. As part of the evaluation process, factors to be considered by the home state or POE supervisor in determining the appropriate rating of the reinsurer shall include the above chart and the following:

a. a list of all disputed or overdue recoverables;

b. The reinsurer's reputation for prompt payment of valid claims under reinsurance agreements, including the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute, including receivables payable to companies that are in administrative supervision or receivership;

c. Compliance with reinsurance contractual terms and obligations (including mandatory contractual clauses);

d. The business practices of the reinsurer in dealing with their ceding insurers;

e. For national reinsurers, a review of the most recent NAIC Property and Casualty Annual Filing Blank Schedule F, or for life companies the NAIC Life, Accident & Health Filing Blank Schedule S;

f. For POE reinsurers, a review of a report filed annually in the form of the NAIC Property and Casualty Annual Filing Blank Schedule F, or for life companies the NAIC Life, Accident & Health Filing Blank Schedule S as prescribed by the POE supervisor. For those parts of Schedule F where data is reported by a counterparty whose net reinsurance recoverable or payable in total is less than 5% of statutory surplus, that counterparty may be reported as an aggregated amount. All contracts on Schedule S, regardless of the amount, must be reported individually;

g. Regulatory actions against the reinsurer;

h. A clean independent audit opinion of the reinsurer; and

i. For POE reinsurers, audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles, regulatory filings, actuarial opinion (as filed with the Non-U.S. Jurisdiction supervisor). Upon the initial certification, audited financial statements for the last 3 years filed with its non-U.S. Jurisdiction supervisor.

21. National reinsurers and port of entry reinsurers would not have to post collateral for catastrophe recoverables for a period of one year from the date of a defined catastrophic occurrence. Reinsurance recoverables for the following lines of business as reported on the NAIC annual financial statement related specifically to the catastrophic occurrence will be included in the deferral:

a. Line 1: Fire
b. Line 2: Allied Lines
c. Line 3: Farmowners multiple peril
d. Line 4: Homeowners multiple peril
e. Line 5: Commercial multiple peril
f. Line 9: Inland Marine
g. Line 12: Earthquake
h. Line 21: Auto physical damage

[Drafting Note: The NAIC Statutory Accounting Principles Working Group shall establish an audited footnote for the respective NAIC annual filing blank.]

22. The home state or POE supervisor will require all reinsurers to post 100% collateral upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurer.

23. Affiliated reinsurance transactions will receive the same opportunity for reduced collateral requirements as all other reinsurance transactions.

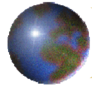
Change in or Revocation of Rating

24. The POE or home state supervisor will not have discretion to waive additional collateral required in the case of an NRSRO rating downgrade or other disqualifying circumstance. The POE or home state supervisor may suspend the certification of a reinsurer for collateral reduction purposes if it does not meet the collateral requirements and obligations contained in this proposal.

25. The POE supervisor or home state supervisor will have the authority to amend or withdraw a reinsurer's rating at any time if a reinsurer fails to meet its obligations under this proposal, or if other financial or operating results of the reinsurer lead the reinsurer's supervisor to reconsider the reinsurer's ability or willingness to meet its contractual obligations.

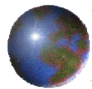
26. If the home state supervisor's or port of entry supervisor's rating of a reinsurer improves, it will be permitted to meet the collateral requirements applicable to its new rating on a prospective basis (i.e., for all reinsurance contracts incepting after confirmation of the improved rating). If the home state supervisor's or port of entry supervisor's rating of a reinsurer declines, it will be required to meet the collateral requirements applicable to its new rating for all business covered under this proposal.

27. Notwithstanding the change or withdrawal of a reinsurer's rating, U.S. ceding companies may continue to take financial statement credit for a period of three months for all reinsurance ceded to that reinsurer for which they were previously allowed credit, unless the reinsurance is deemed uncollectible.



Potential Collateral Impact – Non-U.S.

- **Collateral impact using Standard and Poors Ratings for Non-U.S. reinsurers (most comprehensive international list)**
- **Collateral impact may be different for companies with ratings in different bands.**
- **These figures are only if the current collateral percentages were already in place. Since this proposal is prospective, existing contracts will be collateralized at 100% and will have to runoff to expiration while any new contracts would be addressed under the new framework.**



Potential Collateral Impact – Non-U.S.

($ Billion)

Collateral Reduction	Collateral Required	AM Best	S & P / Fitch	Moody's
$ 0.08	0	A++	AAA	Aaa
$ 34.56	$ 3.84	A+	AA+, AA, AA-	Aa1, Aa2, Aa3
$ 18.83	$ 4.71	A, A-	A+, A, A-	A1, A2, A3
$ 0.04	$ .11	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3
0	100%	B, B-, C++, C+,C, C-, D, E, F	BB+, BB, BB-, B+, B, B- S& P: CCC, (CC, C), (D), R Fitch: CCC+, CCC, CCC-, DD	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C

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July 21, 2008

Via E-Mail
The Honorable Steve Goldman
Chair, NAIC Reinsurance Task Force
Commissioner, Department of Banking and Insurance
20 West State Street
PO Box 325
Trenton, New Jersey 08625-0325

Subject: NAIC Reinsurance Task Force, Reinsurance Regulatory Modernization Framework; Supplemental Comments

Dear Chair Goldman:

On behalf of the Association of Bermuda Insurers and Reinsurers (ABIR) we offer these supplemental comments on the recommendations of the Reinsurance Task Force as published on July 3. This letter supplements the comments we filed on July 17. ABIR represents 22 insurers, all Class 4 Bermuda headquartered companies.

1. Page 2, Pure Reinsurer Provision, Paragraph 4. This provision disqualifies a "mixed insurer/reinsurer" from qualifying for a national passport under the port of entry provision for its reinsurance business. The language as written contains an exception for a reinsurer that writes no more than 5% of its gross premiums in insurance; and a Lloyds' exception that allows Lloyd's syndicates to write both insurance and reinsurance.

   a. ABIR recommends that the limitation on national passporting to an insurer that conducts primarily a reinsurance business be dropped. Instead the national passport should be written to apply to the reinsurance line of business written by an insurance company. It does not matter that the reinsurance is written by a company that does both insurance and reinsurance and the exceptions to the current definition prove the point that trying to shoe horn in a "professional reinsurer" provision creates marketplace inequities. In our previous comment letter we stated our arguments for deletion of this "pure or professional reinsurer" provision. We also provided in our letter our understanding about how the EU Reinsurance Directive works. Since that time we've received an email from Karel Van Hulle, Head of Unit, Insurance and Pensions, European Commission (Financial Institutions, DG Internal Market), which confirms our previous report. With his permission, we provide to you Mr. Van Hulle's explanation on how both third country "pure reinsurers" and "mixed reinsurers" should be allowed access to EU markets on a cross border basis. Mr. Van Hulle's email reads as follows:

From: Karel.Van-Hulle@ec.europa.eu
Sent: Thursday, July 17, 2008 2:33 PM
To: Bradley Kading
Cc: Benedict.CARR@ec.europa.eu; Crispin.WAYMOUTH@ec.europa.eu
Subject: Solvency II and the Reinsurance Directive

Dear Brad,

Thank you for your e-mail of 20 June 2008 on Solvency II and the Reinsurance Directive. I apologise for my later reply but I am sure that you know that we are for the moment rather busy here.

Mixed undertakings (i.e. direct insurers who also conduct reinsurance business) are covered by the life and non-life Directives and consequently have and continue to enjoy full passporting rights in the EU, both with respect to their direct insurance and reinsurance activities. This is the reason why the Reinsurance Directive only applies to pure reinsurers.

With respect to your specific question about Solvency II, the relevant equivalence provision (Article 170 in the latest version) states that the Commission shall, in accordance with the advisory procedure referred to in Article 304(2), adopt decisions, as to whether the solvency regime of a third country applied to reinsurance activities of undertakings with their head office in that third country is equivalent to that laid down in the Directive. Therefore, the equivalence assessment should look at both the solvency regime applied to pure reinsurers and mixed undertakings conducting reinsurance business and if a positive equivalence assessment is made then this should apply to mixed undertakings as well as to pure reinsurers.

I hope that this is clear. Of course, we must await the final text of the Directive. It is however unlikely that things will change in this respect.

As a precaution, I must add that the ultimate decision on how to interpret Community Law rests with the European Court of Justice.

Kind regards,

Karel

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European Commission
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2. Page 7, 21, Catastrophe Recoverables. This section creates a one year collateral deferral for collateralization of catastrophe recoverables. ABIR supports this provision. We think this provision needs to be clarified so that the language will meet the exemption goal. Current NAIC annual statement instructions require the booking of ceded or assumed proportional business into these specific lines of business as listed in this section. For excess of loss business (ceded or assumed), however, the business is booked into Line 30 "Reinsurance –Nonproportional Assumed Property" and Line 31 "Reinsurance – Nonproportional Assumed Liability". Line 30 includes fire, allied lines, ocean marine, inland marine, earthquake, auto physical damage; but Line 31 includes farmowners multiple-peril, homeowners multiple-peril and commercial multiple-peril. To properly cover the affected lines of business and afford a collateralization deferral, these two nonproportional reinsurance lines of business (Lines 30 and 31) need to be added to the current language.

Again, we close by thanking you for the opportunity to submit these comments and we look forward to participating in the July 23-25 meeting in New York. We'd be happy to answer any questions on this written statement which you may have in advance of that meeting.

Sincerely,

Bradley L. Kading
President and Executive Director
Association of Bermuda Insurers and Reinsurers

Cc: Mr. Bryan Fuller, Mr. Ryan Couch, NAIC, for distribution to Task Force members

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July 17, 2008

Via E-Mail
The Honorable Steve Goldman
Chair, NAIC Reinsurance Task Force
Commissioner, Department of Banking and Insurance
20 West State Street
PO Box 325
Trenton, New Jersey 08625-0325

Subject: NAIC Reinsurance Task Force, Reinsurance Regulatory Modernization Framework

Dear Chair Goldman:

On behalf of the Association of Bermuda Insurers and Reinsurers (ABIR) we offer these comments on the recommendations of the Reinsurance Task Force as published on July 3. ABIR represents 22 insurers, all Class 4 Bermuda headquartered companies. Fourteen of our members operate US subsidiary corporations. Our members write approximately 25% of the reinsurance business in the United States and write more than 40% of the property catastrophe reinsurance that protects against catastrophes including hurricanes and earthquakes. (We write approximately the same share of business in Europe.) Bermuda companies in 2005 paid $17 billion in US claims alone for losses from Hurricanes Katrina, Rita and Wilma. These companies are committed to the US market as demonstrated by the fact that after record losses in 2004 and 2005 Bermuda companies expanded their capacity and wrote more US business in the following years. According to AM Best, Bermuda is the domicile to 15 of the top 35 global reinsurance groups. Our members offer US insurers much needed capacity and the ability to diversify their reinsurance counterparties. The Bermuda market was created to fill voids in insurance and reinsurance capacity and these companies are now important contributors to reinsurance markets around the world.

We applaud the Task Force for its progress and leadership in the development of the reinsurance regulatory modernization framework. Great progress has been made and we appreciate the opportunity to offer these comments on our recommended refinements to current framework.

1. page 1, Definition of Terms, Port of Entry Reinsurer. This definition contains a phrase: "*No physical presence in the US is permitted*." We'd recommend this phrase be changed to the proposed language provided herein. The current language is potentially problematic since non-US insurers may own substantial US subsidiary corporations. We may also have back office support operations that do no underwriting. What we propose is draft language and we will continue to consider refinements to this language as this document moves from the outline stage into actual regulatory text. "Port of Entry

reinsurer means a non-US assuming reinsurer that is certified in a port of entry state and approved by such state to provide creditable reinsurance to the US market. A Port of Entry reinsurer shall not have a 'U.S. Underwriting Office', meaning a fixed location within the United States (including the District of Columbia, the Commonwealth of Puerto Rico and the U.S. Virgin Islands) from which the Port of Entry reinsurer conducts reinsurance underwriting. The term a U.S. Underwriting Office shall not include any representative or liaison offices of the reinsurer; any underwriting officers of the reinsurer which underwrite exclusively non-US risks; nor any U.S. office lawfully maintained by any subsidiary, parent company or other affiliate of the Port of Entry reinsurer."

2. page 2, Pure Reinsurer Provision, Paragraph 4. This provision disqualifies a "mixed insurer/reinsurer" from qualifying for a national passport under the port of entry provision for its reinsurance business. The language as written contains an exception for a reinsurer that writes no more than 5% of its gross premiums in insurance; and a Lloyds' exception that allows Lloyd's syndicates to write both insurance and reinsurance. As we understand it, this "pure" reinsurer provision is included for two reasons:
    a. A belief that it is mirroring the effect of the EU Reinsurance Directive;
    b. Concern about creating unfair competitive advantages in the US for mixed insurers (or creating more risk for their policyholders) based on their ability to obtain a national passport when their commercial insurer competitors can not obtain such a passport.

    ABIR recommends that the limitation on national passporting to an insurer that conducts primarily a reinsurance business be dropped. Instead the national passport should be written to apply to the reinsurance line of business written by an insurance company. It does not matter that the reinsurance is written by a company that does both insurance and reinsurance and the exceptions to the current definition prove the point that trying to shoe horn in a "professional reinsurer" provision creates marketplace inequities. We ask your consideration of these points:
    a. The EU Reinsurance Directive is not a template to follow for this provision. . The Reinsurance Directive was created to apply to reinsurers because no European wide regulation existed at the time for so-called "pure" reinsurers. The Reinsurance Directive thus created a first time reinsurance regulatory framework and a passport for the reinsurance business. Cross border access by third country reinsurers into the EU is a country by country decision.
    b. The EU Directives dealing with direct insurance allow an insurer to write both insurance and reinsurance. The "mixed" insurer can passport throughout the EU with its single license and conduct either an insurance or a reinsurance business as long as it is writing reinsurance on a line of business it is authorized to write. With the implementation of Solvency II the same solvency requirements will apply to insurers and reinsurers. Furthermore, Solvency II will not limit the ability of mixed insurers to conduct a reinsurance business.
    c. A port of entry insurer that writes a sizeable portion of reinsurance does not gain a competitive advantage over US commercial insurers. The passport that it would receive would only apply to the reinsurance line of business. No commercial line of business advantage is gained.

d. The RSRD will be assuring that non US jurisdictions meet the standards set by the NAIC for qualifying jurisdictions. In addition, the port of entry reinsurer must be in good standing in that jurisdiction and meet the financial strength standards of the reinsurance regulatory modernization framework. The mix of business in the non-US reinsurer does not detract from the financial standing of the insurer. In fact, some argue that the mix of business provides diversification benefits that strengthen the financial standing of the insurer.

e. The Lloyd's exception makes our point that mixed businesses should be allowed a national passport for their reinsurance business. The Lloyd's exception points out the need for equitable treatment of all non-US mixed insurers including ABIR members. For example, eight ABIR members own Lloyd's syndicates. Under the proposal, these members could access the US market via Lloyds, but could not access the US market from their more highly capitalized Bermuda operating companies. As we noted, the exception makes our point that the reinsurance modernization framework ought to be available to port of entry insurers for their reinsurance business.

f. We estimate that 12 of our 22 members provide reinsurance from operating companies that write both insurance and reinsurance. A requirement to compel these companies to segregate capital, establish new operating companies, obtain new rating agency assessments and new audited financials will constrain capacity rather than increase capacity available to the US.

g. Substantial portions of the California, Florida and Texas catastrophe reinsurance is written by "mixed" insurers which write reinsurance.

3. Page 3 and 4, Mandatory Contract Clauses. This section includes broad new powers for state regulators to mandate at the minimum seven reinsurance contract terms. Not only is the power created to mandate the inclusion of a contract provision, but the power includes making such reinsurance contract terms uniform which means that specific language will be dictated to the ceding and assuming insurers. This is a departure from both the NAIC and the global regulatory practice of supporting freedom to contract in reinsurance agreements. The current NAIC practice is to require a few specific contract clauses to be included, but not to mandate specific language. This freedom to contract has served reinsurance markets well and should not be replaced by new mandated reinsurance agreement language. We'd recommend the following:
   a. That the RSRD carry forward the existing reinsurance contract approach in the regulatory modernization framework. By doing so, the NAIC can be assured that reinsurance agreement dictates are consistent throughout the reinsurance market (those reinsurers that are in the new framework and those that are not).
   b. Existing state law and regulation govern agreements today including the insolvency clause, the service of suit and submission to jurisdiction clause, and the intermediary clause. The national or port of entry reinsurer could be made subject to the existing reinsurance agreement provisions of the state of domicile/entry. Those contract terms would have to be accepted by the regulators in the other states subject to the condition on granting of credit tied to risk transfer that is left to the ceding insurer's state of domicile. This allocation of -- and acquiescence to -- regulatory authority should address the current critique about

contradictory or inconsistent contract clauses that informs the current regulatory modernization debate. (See sections 6 and 7 of the regulatory framework.)

   c. The one exception to this rule would be the new clause identified as the "credit for reinsurance clause". This "downgrade" clause is unique to the new regulatory framework and thus is appropriately mandated as part of this regulation. We continue to review the language of this provision and we note for the record that downgrade clauses in and of themselves create problems for an operating company.

4. Page 5, Paragraph 14, Reinsurer Filings. This section requires quarterly filing by the reinsurer of reports on: change in domicile license status, change in rating agency classification, change in directors and officers, financial statement filings, reinsurance disputes and overdue reinsurance payments due.
   a. ABIR recommends:
      i. Rather than quarterly filings, those filings be required upon a triggering action such as a change in domiciliary license status, a change in rating, etc. Quarterly filings are unnecessary unless triggered by a meaningful change in the status of the reinsurer.
      ii. Reference to financial statements comparable to the NAIC financial statement should be replaced with language that financial statements from the domiciliary jurisdiction should be filed. Supplemental material may be required, but it should not be expected that the reinsurer will file something consistent with a NAIC financial statement.
      iii. The reinsurance disputes and overdue reinsurance amounts should be subject to a materiality threshold. Information is already available from the ceding insurer on these matters. For the reinsurer, filings should be compelled on materially relevant information that relates to the reinsurer's own financial condition. Here is an example of a materiality threshold: overdue recoverables or amounts in dispute between the reinsurer and its retrocessionaires that aggregate to an amount in excess of 10% of the reinsurer's surplus or $100 million, whichever is less, would require the reinsurer to file a supplemental report about the aggregate amount of recoverables in question.

5. Page 5, Paragraph 15, Diversification.
   a. We're looking for clarification of the basis for the diversification provisions of paragraphs e, f and g of this section. Are they drawn from existing NAIC models or existing state based requirements?

6. Page 7, Paragraph 20, Reinsurer Filings. Requirements for review of the non-US reinsurer.
   a. ABIR comments:
      i. A list of amounts overdue and in dispute (Section 20, paragraph a); this information is already available from the ceding insurer in Schedule F filings.

ii. For the reinsurer, the NAIC interest would be in material amounts of retrocessional coverage that may be due or disputed -- and that may affect the financial standing of the reinsurer. Therefore a materiality threshold should be created to govern this additional reinsurer financial report (see previous comment).
iii. For paragraph b the word "reputation" should be replaced with the word "record". This provision, we believe, is an evaluation of the ceding insurer reports that establish the reinsurer's record in the US with regard to amounts overdue to US cedents or in dispute with US cedents.
iv. For paragraph d, we recommend deletion. We think paragraph b establishes the reinsurer's market record with US clients.
v. For paragraph f, we recommend replacement of this section with information required as noted in paragraph ii of our comments above. Non US reinsurers do not report to their domestic regulators information consistent with the seven sections of the NAIC Schedule F. Regulators should fully utilize the voluminous ceding insurer reports available to them, but should not be compelling non-US reinsurers to file a report that is entirely new to them and only created for the purposes of complying with this filing requirement. As noted above, the port of entry regulator is legitimately interested in retrocessional information that may affect the financial standing of the reinsurer. Information on its own retrocessional arrangements and amounts that may not be recoverable are legitimate points of inquiry in the evaluation of the financial standing of the port of entry reinsurer.
vi. For paragraph I, the requirement is to file three years of audited domiciliary financial statements, other "regulatory filings" and actuarial opinions as required by the non-US supervisor. This provision should require filing of the financial statements filed with the non-US regulator. Under the Bermuda law, these financial statements can be made under US GAAP and under IFRS. IFRS filings should be allowed under this provision. Non-US reinsurers should not be compelled to file financial statements which they don't produce for their domestic regulator. The reference to "other" regulatory filings is open ended and should be clarified before this provision is finalized.

7. Page 8, Paragraph 23, Affiliated Reinsurance. The proposal affords affiliated reinsurance the same collateral reduction as allowed unrelated reinsurance. Since affiliated reinsurance is already subject to additional regulation by the US subsidiary company regulator, affiliated reinsurance should be subject to an additional collateral reduction. Under NAIC holding company law, such transactions are subject to regulatory review and can be rejected. In some states actual approval is required. In August 2007, Zurich, Swiss Re and ABIR supplied this exemption language to the Task Force. Credit for reinsurance shall be allowed:
   a. "Where the reinsurance has been ceded by a domestic insurer to any person in its holding company system and, pursuant to (insert citation to state's statutory

equivalent to Section 5(A)(2) of the NAIC Model Insurance Holding Company System Regulatory Act), the domestic insurer has notified the commissioner of its intent to enter into such transaction, and the commissioner has not disapproved the transaction within the time period set forth in (insert citation to state's statutory equivalent to Section 5(A)(2) of the NAIC Model Insurance Holding Company System Regulatory Act). The domestic insurer may voluntarily notify the commissioner of a transaction pursuant to (insert citation to state's statutory equivalent to Section 5(A)(2) of the NAIC Model Insurance Holding Company System Regulatory Act), even if notification would not be required under (insert citation to state's statutory equivalent to Section 5 (A)(2)(c) of the NAIC Model Insurance Holding Company System Regulatory Act)."

b. An alternative to this approach would be to allow a "one notch" upgrade where less collateral would then be required for such affiliated transactions.

Again, we close by thanking you for the opportunity to submit these comments and we look forward to participating in the July 23-25 meeting in New York. We'd be happy to answer any questions on this written statement which you may have in advance of that meeting. Finally, we commend the Task Force for its leadership and progress and we look forward to the successful completion of the reinsurance regulatory modernization framework.

Sincerely,

Bradley L. Kading
President and Executive Director
Association of Bermuda Insurers and Reinsurers

Cc: Mr. Bryan Fuller, NAIC, for distribution to Task Force members

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May 31, 2008

Hon. Steven M. Goldman
Commissioner
New Jersey Department of
Banking and Insurance
20 West State Street
Trenton, New Jersey 08625

Re: NAIC Reinsurance Task Force May 16, 2008 Memorandum ("Proposal")

Dear Commissioner Goldman:

We fully endorse the NAIC goal of modernizing existing US life reinsurance regulation and appreciate the efforts of this task force toward that end. We are still considering the very recent expression of your members' thinking on the subject, but we hope these initial reflections of our membership will be useful.

The American Council of Life Insurers (ACLI) is the principal trade association of the United States life insurance industry, representing the overwhelming majority of US purchasers and sellers of life reinsurance. Our members help individuals, families and businesses protect their assets, accumulate long-term savings, and guarantee a secure retirement.

ACLI Position

Our membership wants and needs comprehensive reform of state-based life reinsurance regulation. Reinsurance is a fundamental and necessary risk spreading practice for the life sector. A dynamic regulatory regime for the practice is equally fundamental and necessary. We believe it is not desirable or feasible to revise a narrow piece of the current reinsurance regulatory regime in isolation, as this proposal attempts to do. The majority of our members believe that modernizing US reserving and risk assessment methodologies is a necessary precondition to reform of the current state-based reinsurance regulatory regime.

ACLI Recommendations

We have watched this Task Force struggle for many years with finding consensus on how states' reinsurance collateral requirements should be changed. We have concluded that this circumscribed objective cannot be met in this context, for two reasons. First, neither the NAIC nor individual states are constitutionally empowered to impose legal burdens on each other, as this framework proposes. Second, based on history, we believe it is politically impossible to enact and uniformly enforce across the states a revision to the Model Law on Credit for Reinsurance similar to the Proposal.

We have two recommendations that we believe all the stakeholders could endorse. First, we believe that reforming state collateral requirements uniformly is only feasible with the help of Congress. We therefore suggest your support of federal legislation such as HR 1065, the Nonadmitted and Reinsurance Reform Act of 2007. Second, we urge you to focus on comprehensive life reinsurance

regulation reform. In particular, we draw your attention to the archaic risk transfer requirements now applicable to cessions by life insurers and life reinsurers. We are concerned that those rules have not kept pace with the market and are, indeed, an impediment to sound risk management.

More generally, the ACLI is concerned about maintaining the competitiveness of the US life insurance sector. Achieving state-of-the-art supervision that conforms to or sets the standards for international best practices in supervising reinsurance is key to that competitiveness. As an initial step, the ACLI Board of Directors recently established principles to guide our advocacy of reinsurance regulation reform. We believe they articulate best practices of reinsurance supervision that must be endorsed and implemented by US insurance and reinsurance supervisors in order for the US life insurance sector to maintain its competitive position globally.

ACLI General Technical Comments

We incorporate below the ACLI Policy on Reinsurance Regulation, as adopted by our Board of Directors in January 2008. We have compared the Proposal to our Board policy and describe our initial observations, noting that our Board has directed that any one reinsurance reform consistent with the policy must be considered in light of other reforms and pursued only after the full effect of such action is considered and understood.

> *Purpose and Scope of Life Reinsurance Regulation*
>
> *Principle 1. The purpose of reinsurance regulation is to ensure that reinsurance provides sound financial support to ceding insurers so they can deliver on their promises to policyholders. Reinsurance regulation should be efficient and free from unnecessarily burdensome requirements, recognizing that reinsurance transactions are contractual arrangements between commercial parties. Reinsurance regulation should foster competition by treating domestic and foreign insurers equally without discrimination.*
>
> > *Subprinciple 1.1. Reinsurance should be subject to reporting requirements and oversight no more stringent than that for direct written risks.*
> > *Subprinciple 1.2. Reinsurance regulation should not disadvantage reinsurance vis-à-vis competing forms of risk mitigation.*

The Proposal discriminates between foreign and domestic reinsurers. It would confer upon a POE supervisor the "ultimate determination [with respect to a financial determination by a POE supervisor concerning a POE reinsurer]." A national reinsurer that is a US reinsurer has no such recourse under the Proposal.

> *Purpose and Scope of Life Reinsurance Regulation*
>
> *Principle 2. The domestic regulator (i.e., state, federal or foreign) of a ceding or assuming insurer should be the sole regulator of its reinsurance.*

The Proposal does not improve uniformity among the states with respect to reinsurance reserve credit requirements. This has been and remains a critical issue with respect to cessions by life insurers.

> *Capital Adequacy and Accounting*
>
> *Principle 3. The determination of increases or decreases in assets, liabilities and required capital related to reinsurance should reflect, under any valuation system, the actual value of the risks transferred and all other terms in the reinsurance contract, as measured by the valuation system.*
>
> > *Subprinciple 3.1. Although a rules-based system to value insurance and reinsurance may be acceptable for an interim period, the favored approach is a principles-based valuation system that reflects the specific risk profile of the party.*
> >
> > *Subprinciple 3.2. Accounting for reinsurance should show the separable impact of the reinsurance.*

We are disappointed by the continuation of archaic risk transfer requirements in state law and statutory accounting. We have attempted on several occasions to begin a dialogue with this Task Force about these legacy rules and the unreasonable and imprudent restriction they impose on company risk management practices. We have been disappointed to learn that LHATF is considering exporting that formulaic, one-size-fits-all definition of risk transfer into a stochastic framework under a principles-based reserving regime.

Counterparty Credit Risk & Collateral

Principle 4. Regulation of reinsurance should focus on the capital adequacy of the counterparties to a reinsurance agreement.

> *Subprinciple 4.1. Reinsurance collateral should not be required by law or regulation but rather negotiated between the counterparties to a reinsurance agreement.*
>
> *Subprinciple 4.2. Any counterparty credit risk arising from a reinsurance agreement should be reflected in the counterparty's risk-based capital.*
>
> *Subprinciple 4.3. Counterparty credit risk evaluation should consider the probability of recovering reported reinsurance recoverables, including the creditworthiness of the assuming insurer, the amount and quality of any collateral deposited with the ceding insurer or to which it has legally perfected access, and the regulatory framework applicable to the assuming insurer.*

Assuming US life insurers are concerned for three reasons about the proposed terms of a new collateral requirement that might be applicable to them. First, life reinsurance contracts are typically long-term, frequently spanning decades. Assuming life insurers cannot cancel them retroactively. Any life reinsurance contract entered into after the effective date of this Proposal by a RSRD-rated reinsurer would be subject to a springing collateral requirement. The mere existence of that requirement would inject significant contagion risk into the entire US life insurance sector and raise its cost of capital. Second, if the RSRD uses only one rating agency per reinsurer, it would exacerbate the contagion risk. Finally, US "national" life reinsurers would not have access to the dispute resolution mechanisms available to non-US POE reinsurers under the Proposal. ACLI has historically opposed any collateral requirement imposed by another country on US assuming life insurers operating in that country.

Reinsurance Contract Terms

Principle 5. Counterparties should be free to manage risk through reinsurance by negotiating the form and substance of a reinsurance contract, without direct or indirect regulation of the contract terms.

ACLI believes that the current indirect regulatory limitation on forms of risk transfer by life insurers is unwise and counter to best practices under the current statutory reserving regime.

ACLI Specific Technical Comments

ACLI has previously asked this Task Force to recommend modernizing the current risk transfer requirements applicable to life reinsurance. Our reasoning has been and continues to be that current US risk transfer limitations on life insurers are based on risk assessment and risk management standards that are inferior to current regulatory best practices; an outmoded paradigm of "command-and-control" regulation; a model of silos in the financial sector; and rudimentary valuation theories.

ACLI supports the Academy recommendation that a new paradigm on risk transfer be incorporated into the new principles-based reserving methodology. We have been disappointed to learn that a subgroup of LHATF working on the new Valuation Manual chapter on reinsurance has not accepted the Academy's recommendation on modernizing risk transfer under the new reserving regime. We understand that LHATF will be reviewing that decision shortly and we urge you to advocate the Academy's recommendation.

Conclusion

We regret that ACLI is unable to endorse the Proposal. We hope that this Task Force and the NAIC membership will direct its attention to undertaking a comprehensive reform of US life reinsurance regulation in a way that gives serious consideration to the principles adopted by our Board of Directors. We stand ready to assist the NAIC in that process.

Sincerely,

Donald G. Preston, Jr.

cc: Bryan Fuller, NAIC

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July 16, 2008

The Honorable Steven M. Goldman
Chair, NAIC Reinsurance Task Force
Commissioner State of New Jersey

Re: Reinsurance Regulatory Modernization Framework

Dear Commissioner Goldman and Members of the Reinsurance Task Force:

The American Insurance Association thanks you for the opportunity to comment on the reinsurance regulatory modernization framework. AIA opposes the draft framework because it seeks to eliminate or sharply reduce collateral requirements for reinsurance assumed by alien reinsurers who choose to remain unlicensed in any state and who may maintain no assets in the U.S. Eliminating collateral for such reinsurers will place new burdens on U.S. insurers and will likely make it much more difficult for U.S. insurers to receive prompt and appropriate reinsurance payments and may unnecessarily threaten the solvency of certain U.S. insurers. If collection of reinsurance payments becomes more uncertain and problematic, a likely result is a reduction in capacity in the U.S. primary market for underwriting certain large U.S. risks, such as natural catastrophes and other coverages--at a time when increasing capacity for such risks is a critical public policy goal.

The current collateral system has worked effectively for decades. Advocates of change have been unable to identify any problems with the current system or any real benefits to U.S. insurers that would result from the proposed framework. The lone argument that collateral requirements for reinsurers who refuse to become licensed in any U.S. state or maintain assets in the U.S. are discriminatory is a red herring aiming to mislead U.S. regulators. The U.S. collateral system is more open than systems used in other countries because it offers foreign reinsurers a *choice*: become licensed in an accredited state and not post collateral *or* refuse to become licensed in any accredited state and not be required to maintain assets in the U.S. and instead post collateral to cover expected losses. The U.S. collateral option is more friendly to foreign reinsurers than the requirements other countries impose on U.S. reinsurers. Citing one example, the European Union's Reinsurance Directive authorizes member EU countries to treat U.S. reinsurers on an unequal basis vis-à-vis EU reinsurers. The Directive prohibits U.S. reinsurers from "passporting" into other EU countries and allows member states such as France, Spain and Portugal to retain current collateral requirements against U.S. reinsurers while demanding elimination of such collateral requirements for EU

reinsurers. As LeBoeuf, Lamb has advised its U.S. reinsurer clients regarding the EU Directive: "It is unlikely that non-EU reinsurers will be able to avoid new regulatory and financial burdens, which may affect their competitiveness in the EU." LeBoeuf warned its U.S. clients that "This distinction [between EU reinsurers and U.S. reinsurers] should already start ringing the bells in the head offices of such reinsurers, who all other things being equal, may find themselves in a less competitive position vis-à-vis EU cedents than EU reinsurers. A copy of the LeBoeuf article "A New Regulatory Landscape for EU Reinsurance" is available at http://www.deweyleboeuf.com/files/News/de12dcc2-a111-402b-96ee-977ab9df7e62/Presentation/NewsAttachment/96855e21-e5c3-4d9e-b900-33afbde69a17/article_868.pdf

The draft framework also violates fundamental principles of insurance financial regulation. A bedrock principle of the state regulatory system is that the domiciliary regulator of the U.S. ceding insurer evaluates and administers the financial health of its state insurers. The framework would reverse this long-established principle and make the collateral determination of the port of entry regulator binding on the domiciliary regulator of the U.S. cedent. All financial determinations regarding the financial health of a U.S. licensed state insurer should be made by the domiciliary regulator in charge of the U.S. insurer and not by the port of entry state selected by the alien reinsurer.

The draft framework also relies too heavily on the nationally recognized statistical rating organizations. The rating organizations have a history of being too slow to react to changing financial conditions and the recent subprime mortgage fiasco should provide sufficient cause of concern that upending a collateral system that has worked for decades without problem in favor of an untested new system relying on NRSRO ratings may be imprudent.

The draft framework also fails to adequately discuss how the new reinsurance supervision review department (RSRD) will evaluate eligible foreign jurisdictions. The standards for determining whether a country is eligible for port of entry status is critical in evaluating how the framework will work in practice. Yet the framework contains little or no specific information regarding the standards to be applied by the RSRD. Indeed the framework is silent on critical issues such as countries that permit solvent schemes of arrangement or involuntary transfers of risks even though the task force's December 2, 2007 Framework Memorandum provided assurances that these would be issues discussed and addressed in the framework. Another issue that the framework is completely silent on is creation of a security or guaranty fund. Again, the December 2, 2007 memorandum stated that this would be an issue addressed during framework discussions yet there is no mention of the issue in the current draft.

AIA opposes the draft framework and believes the current collateral system works effectively and should remain in place. The proposed new system unfairly places all risks and burdens on the U.S. insurer while providing all the benefits to alien reinsurers.

Following are AIA's objections to the draft framework:

● **<u>The Current Collateral System Works Effectively With No Known Problems:</u>** The draft framework proposes changes to the current regulatory and collateral system that are grand in scale. The proposal significantly modifies a collateral system that has worked with no known problems for decades. Under the current collateral system, reinsurance capacity has not been a problem, payment of recoverables from unlicensed reinsurers has not been too problematic, and reinsurance premium amounts have not been a pressing issue. It is difficult to see the need for *any* change, let alone a change as significant as that contemplated by the draft framework.

● **<u>Collateral Protects U.S. Ceding Insurers</u>**: Collateral plays a significant role in protecting U.S. insurer solvency and ensuring payment of reinsurance recoverables when a U.S. cedent purchases reinsurance from an unlicensed foreign reinsurer who outside of the collateral may maintain no assets in the U.S. If collateral is no longer available, it will likely be extremely difficult, time-consuming, and expensive for a U.S. insurer to successfully collect reinsurance recoverables that are due under a reinsurance contract from an alien reinsurer.

Collateral, in the absence of any other assets of the reinsurer in the U.S., is often needed when a ceding insurer seeks to execute on a final U.S. judgment. However, even apart from the issue of seeking to enforce and execute on final U.S. judgments, the fact that collateral exists under the reinsurance agreement is often a vital and necessary component in having the unlicensed foreign reinsurer pay recoverables due in a timely and appropriate manner without resort to either arbitration or court proceedings.

A.M. Best, in a recent analysis of the NAIC's collateral discussions, noted that "Without collateral, cedants often settle for considerably less than 100% of their outstanding balances through commutations. This happened after the ratings downgrades of reinsurers such as PXRE, Converium and Gerling." A.M. Best Research 2007 Special Report, August 13, 2007, p.17.

As stated in the reinsurance task force's own white paper, "Reinsurance collections have become a more difficult and contentious process where the willingness to pay seems to be as big an issue as the ability to pay… Receivers have reported that having access to collateral makes a tremendous difference in the collection process, both in getting timely responses to billings and other correspondence as well as tempering the extreme positions taken by some reinsurers. In some cases, collections from unauthorized reinsurers have been easier due to the existence of the collateral than collections from authorized U.S.-based 'professional' reinsurers." U.S. Collateral White Paper, prepared by the NAIC Reinsurance Task Force of the Financial Condition (E) Committee, p.11.

If collateral is significantly reduced, it can be expected that it will be much more problematic and uncertain for U.S. ceding insurers to be paid recoverables from foreign unlicensed reinsurers in a full, timely, inexpensive and dispute-free manner.

● **Reducing Collateral May Lessen Capacity in the U.S. Primary Market**: An argument offered in support of eliminating/sharply reducing collateral requirements is that it may increase capacity in the reinsurance market. There is little or no evidence that overturning collateral requirements will increase reinsurance capacity in any sizable manner.

Moreover, and much more importantly, eliminating or significantly reducing collateral may have an adverse impact on capacity in the U.S. primary insurance market. If eliminating or reducing collateral makes it more uncertain, time-consuming, expensive and problematic to receive reinsurance payments from foreign reinsurers, a likely result would be lowered capacity in the U.S. primary market. An insurer will be more hesitant to write direct coverages if it does not feel confident that it will receive its reinsurance payments in a prompt and appropriate manner. This is particularly true in the writing of certain large risks, such as natural catastrophes.

Similarly, if U.S. insurers lose credits on their financial statements either because reinsurance recoverables are no longer being paid within 90 days or alien reinsurers fail to post additional collateral after tier level downgrades, the primary insurers' capacity to underwrite U.S. risks will be adversely impacted.

● **Security Deposits Are Required for Licensed U.S. Insurers**: A majority of states require U.S. primary insurers to post collateral in the form of state deposits. It is difficult to understand why it is good public policy to eliminate or substantially reduce collateral requirements for unlicensed alien reinsurers who maintain no assets in the U.S, while at the same time requiring U.S. insurers to post security deposits in states in which the U.S. insurer is licensed and/or domiciled. If it is unfair or unnecessary for an alien reinsurer, who refuses to obtain a license in any state or to maintain assets in the U.S., to post collateral, certainly an insurer licensed in the U.S., who maintains ample assets in the U.S. and who is subject to the supervisory and regulatory oversight of multiple state insurance departments, should not need to post security deposits in any licensed state. However, in many states, including Florida, New York, New Jersey, and California, security deposits are required for U.S. insurers regardless of whether the U.S. licensed insurer is AAA-rated, AA-rated, A-rated or BBB-rated. In fact, California requires all primary insurers (not just domestic insurers) to *fully collateralize* their workers' compensation liabilities in the state; indeed, California currently is holding billions of dollars of collateral from U.S. primary workers' compensation insurers that hold high ratings from the national rating agencies. It is difficult to justify a proposal that will release alien unlicensed reinsurers with no assets in the U.S. of the prudent requirement to post collateral, yet at the same time retain security deposit requirements for U.S. state-licensed insurers.

● Severe Lowering of Collateral: AIA supports retention of the current 100% collateral requirement. However, even if one were to support lowering collateral requirements for certain alien reinsurers based on financial strength and timely claim payment history, the draft framework's proposed reductions in collateral levels are shockingly high. In prior proposals, the task force had recommended lowering collateral requirements for

AAA- and above rated reinsurers to 60%, those with an AA- to AA+ rating to 70%, and those with A- to A+ to 80%. Under prior proposals, reinsurers rated BBB+ or lower would need to post 100% collateral. While the prior proposed collateral reductions were significant, they still required the reinsurer to post some critical level of collateral. It is essential that the required collateral level remain significantly high because other than collateral, the unlicensed alien reinsurer may maintain no other assets in the U.S.

The draft framework would reduce collateral requirements to dangerously low amounts. AAA-rated reinsurers would not need to post any collateral. AA- to AA+ reinsurers could reduce collateral to 10% and A- to A+ reinsurers could reduce collateral to 20%. Even BBB- to BBB+ reinsurers could reduce collateral to 75%. Such low levels of collateral would not adequately safeguard the solvency of U.S. insurers and will make timely payment of reinsurance recoverables and enforcement of judgments and awards more problematic and uncertain. AIA recommends that if the task force does support eliminating/reducing collateral, that it reinsert the collateral levels set forth in the task force's prior proposals.

● **Tier Levels need Revision**: The tier levels in the draft framework should be revised and made more precise. As currently drafted, A+, A, and A- reinsurers are all rated the same and placed in Secure Level 3. There is a huge difference between an A+ reinsurer and an A- reinsurer and the companies should be placed in different tier levels. It is extremely dangerous to lower the collateral requirement for an A- reinsurer to only 20% and to pretend that an A- rating is the financial equivalent to an A+ or A rating. An A- rated reinsurer should be placed in Secure Level 4 and be required to post 75% collateral.

Any reinsurer rated below A- should be placed in Vulnerable Level 5 and be required to post 100% collateral. As a practical matter, many U.S. ceding insurers, even under current regulatory requirements, will on solvency grounds refrain from purchasing reinsurance from reinsurers rated below A-. It is shocking that the task force would even consider reducing collateral requirements for BBB+ through BBB- alien reinsurers by 25%. A BBB- reinsurer is dangerously close to junk status and certainly should not be rewarded with a 25% cut in collateral.

Moreover, all alien reinsurers should need to post at least some collateral since otherwise a reinsurer may maintain no assets in the U.S. Reinsurers in Secure Level 1 should need to post some level of collateral, with increasing amounts required for all lower levels.

● **Postponement of Posting Collateral for Catastrophe Recoverables**: The draft framework would allow alien reinsurers to postpone the posting of collateral for catastrophe recoverables for a period of one year. This is a dangerous provision for the U.S. primary industry. Securing reinsurance recoverables at times of catastrophes is one of the critical roles collateral plays in the current system. Collateral exists to help ensure U.S. insurer solvency and prompt payment of reinsurance recoverables. Reliance and Legion went into liquidation shortly after the World Trade Center incident

when there was a significant delay in receiving payments from their reinsurers. The security created by collateral is needed more, not less, after a catastrophe. It is dangerous enough to propose eliminating or severely reducing collateral for alien reinsurers, but it is even more imprudent to compound that danger by delaying the posting of collateral at the times where collateral is needed the most.

● **Reinsurer Ceases Writing in U.S. Market**: Experience indicates that collateral is particularly helpful when a reinsurer ceases all writing in the U.S. market. Once a reinsurer stops issuing policies, it has little or no motivation to pay existing claims in an appropriate or timely manner. In the case of an unlicensed reinsurer with 100% collateral, the current collateral rules offer the U.S. cedent (and the receiver) some level of protection if its reinsurer leaves the market. AIA recommends that if indeed the task force decides to reduce the collateral requirements for unlicensed foreign reinsurers, that the proposal at least provide that if a reinsurer ceases writing in the U.S. market, the reinsurer would need to post 100% collateral for all existing contracts. AIA recommends that this 100% collateral requirement also apply to U.S. licensed reinsurers who cease writing.

● **Form AR-1 Requirement Needs Revision**: The draft framework requires that the alien reinsurer execute a Form AR-1, which certifies that the reinsurer submits to the jurisdiction of U.S. courts and agrees to post 100% collateral if it resists enforcement of a "valid and final U.S. judgment." The draft framework also states that Form AR-1 will not be accepted from any reinsurer domiciled in a country that does not "adequately and promptly enforce valid U.S. judgments or arbitration awards." The word "valid" should be removed from these two provisions. An alien reinsurer must agree to respect any final U.S. judgment or arbitration award for the Form AR-1 to have any meaning. The fear of U.S. cedents is that alien reinsurers, with either no or insufficient assets in the U.S., will simply ignore U.S. court and arbitration awards, forcing relitigation of all issues in the foreign country. The cost and delays of relitigating these issues in a foreign country is an incredible burden on the U.S. insurer. The alien reinsurer will not simply state it is refusing to recognize U.S. judgments—it will argue that for some reason or another the U.S. court judgment or arbitration award is somehow not "valid." There are foreign countries that do not recognize U.S. judgments as "valid" if they are obtained on procedural grounds (defaults for failure to appear) or if they contain awards against public policy (coverage for punitive damages). The reinsurer must certify that it will submit to, and the foreign jurisdiction's legal system must promptly enforce, all *final* U.S. court judgments or arbitration awards and not just those that the alien reinsurer or the foreign jurisdiction considers "valid."

It should be noted that even if the word "valid" is stricken form the draft framework, the Form AR-1 is not a cure-all for potential enforcement issues. If the foreign reinsurer maintains no assets in the U.S. the U.S. insurer and the port of entry regulator still would have no real power to enforce the AR-1 requirement, which is why retaining current collateral requirements is critical to U.S. ceding insurers.

● **Credit for Reinsurance Clause May Be Ineffective in Practice**: The draft framework sets forth a mandatory contractual term requiring the reinsurer to post additional collateral where the reinsurance provided does not qualify for full statutory accounting credit. AIA supports this proposed provision. While the proposed requirement is an important step in the right direction, such mandatory provisions may have limited practical impact. Where an alien reinsurer is not licensed in the U.S. and has no assets in the U.S., there may be little teeth in a contractual provision that the reinsurer simply ignores.

Moreover, foreign countries may refuse to enforce the contractual term. For example, recently UK courts and the UK Treasury have simply ignored contractual terms placed in contracts by U.S. cedents to respond to UK reinsurers attempts to enforce Part 7 involuntary transfers of their reinsurance contractual obligations. Many U.S. cedents in response to UK involuntary transfers of reinsurance contracts had provisions placed in the agreements terminating the contracts if an involuntary transfer took place. UK courts have held such contractual terms as void as against public policy and UK Treasury modified regulations to specify that UK Treasury "considers it appropriate for the Courts…to be able to override such contractual restrictions." Similar rulings may be expected from the UK and other foreign countries in response to the proposed credit for reinsurance provision."

● **Weakened Role of U.S. Domiciliary Regulator**: The draft framework provides that the port of entry state of the reinsurer shall make all determinations regarding credit for reinsurance ceded by a U.S. insurer. This violates the fundamental principle of insurance regulation that supervision of the financial strength of the U.S. ceding insurer is determined by the domiciliary regulator of the U.S. insurer. Collateral requirements are part of the credit for reinsurance laws, which, of course, relate to the financial supervision of the U.S. ceding insurer, not the assuming reinsurer. It is fundamental that supervision of the financial strength of the U.S. ceding insurer should be retained by the domiciliary regulator of the U.S. insurer and should not be determined by whatever port of entry state an alien reinsurer chooses to enter.

● **Diversity Requirements for U.S. Insurers**: The draft framework would place new requirements on U.S. ceding insurers. The framework would require the U.S. ceding insurer to provide notification to its domiciliary regulator if any single reinsurer represents more than 20% of the ceding insurer's gross written premium, or is likely to exceed this limit, except for approved affiliated transactions. The framework would also provide the domiciliary regulator with discretion to require the U.S. ceding insurer to obtain approval if, for any twelve month period, if the reinsurance premium or anticipated change in the ceding insurer's liabilities equals or exceeds 50% of the insurer's surplus to policyholders.

AIA objects to the inclusion of these new diversity requirements. Many primary insurers have extremely divergent views on diversification requirements based on factors such as whether they are a relatively smaller insurer, whether they write a specialized line such as medical malpractice, whether they cede to licensed affiliated companies, or

how their reinsurance programs in general are structured. Trying to include diversification requirements in the collateralization proposal is unnecessary, controversial, and would create an unlevel playing field for U.S. insurers.

● **No Standards Specified for Eligible Foreign Jurisdictions**: The draft framework fails to provide specifics on the standards that the reinsurance supervision review department (RSRD) shall apply in determining whether a particular country is "eligible" to have its reinsurers apply for port of entry status. The framework and the task force during prior discussions focuses almost exclusively on credit risk, but there are other equally important risks such as political, legal and enforcement risks. The lack of any real standards for determining the eligibility of a foreign country is a significant omission and raises concerns regarding the practical application of the proposed framework.

One issue of legal risk that should be addressed is whether any country that permits solvent schemes of arrangement or involuntary transfers of risk shall be eligible for collateral elimination or reduction. The task force's December 2, 2007 Framework Memorandum states that solvent schemes of arrangement and involuntary transfers would be considered during discussions. However, these issues have not yet been raised by the framework.

AIA wishes to bring the task force's attention to a submission recently filed by Goodrich Corporation, Exxon Mobil Corporation, and Textron Corporation to the NAIC Financial Regulatory Services Division's Restructuring Mechanism for Troubled Companies Subgroup. These large U.S. policyholders stated that "Solvent schemes of arrangement in the UK have harmed American policyholders by unilaterally terminating years of valuable insurance coverage while allowing fully solvent carriers to back out of unprofitable insurance contracts." The U.S. policyholders requested that "solvent schemes imposed by foreign jurisdictions should be opposed by US regulators as unfair to policyholders." According to the U.S. policyholders, "solvent and profitable insurance companies doing business in the London Market have used a provision of UK law to extinguish years or decades of valuable coverage held by US policyholders." A copy of the U.S. policyholders' submission to the NAIC on solvent schemes is attached.

In regard to involuntary transfers of risks in the UK, several U.S. cedents responded to the threat by including a termination clause in to their agreements. Unfortunately both UK courts and UK Treasury have maintained that such contractual terms shall be considered void. AIA believes the framework needs to specify that any foreign country that permits solvent schemes of arrangement or involuntary transfers of risk shall be barred from being an eligible country for collateral reduction.

Likewise any country that does not enforce the proposed credit for reinsurance provision should be barred from the list of eligible countries.

● **Port of Entry State Criteria Lacks Specifics**: The RSRD is authorized to establish criteria for a state to qualify as a port of entry state. The criteria outlined in the draft framework is very general and non-specific. The criteria includes staff expertise,

accreditation by the NAIC, experience, staff size and "sufficient ceded premium volume." More specific guidance and standards need to be set forth for determining whether a state is eligible to be certified as a port of entry state. For example, some part of the evaluation must include whether the port of entry state is actually evaluating the claims payment history of the foreign reinsurers or whether the port of entry state simply relies on the NRSRO rating to determine the alien reinsurer's tier level. The RSRD should be required to de-certify a state as a port of entry state if it fails to undertake proper evaluations of claim payment histories of its port of entry reinsurers and fails to lower tier levels of foreign reinsurers who are below standards in such categories as number of disputes and timeliness of payments.

Based on the relative absence of any specific criteria, it would appear any state that wishes to be a port of entry state would likely satisfy the standard. If there are too many port of entry states, there is a danger of a "race to the bottom" as foreign reinsurers will have an incentive to pick the most lax and liberal state to assign the reinsurer to the highest tier level possible for that reinsurer.

● **Need to Prevent Forum Shopping in Choice of Port of Entry State**: The NRSRO credit rating for an alien foreign reinsurer is the reinsurer's maximum tier rating. The port of entry regulator is authorized to lower the tier rating for the reinsurer based on its evaluation of the foreign reinsurer. The port of entry state regulator's evaluation considers the following: a "list of all disputed or overdue recoverables"; the "reinsurer's reputation for prompt payment of valid claims under reinsurance agreements, including the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute"; the "business practices of the reinsurer in dealing with their ceding insurers"; "regulatory actions against the reinsurer"; a review of an annual report in the form of Blank Schedule F; a clean independent audit opinion of the reinsurer; and an audited financial statement reconciled to U.S. GAAP or Statutory Accounting Principles.

While including these factors in the reinsurer's evaluation is a positive development, there is some concern that the NRSRO rating may simply become the de facto tier level. The NRSRO rating is an objective standard while all the other factors are more subjective, so it may be that the port of entry regulator will simply default to the NRSRO rating. In any event, there is likely to be a "race to the bottom." An alien reinsurer can apply for certification as a port of entry reinsurer in any port of entry state. If a reinsurer gets "dinged" by a particular port of entry state regulator for failure to pay claims in a timely manner or some other factor, there is nothing in the draft framework to prevent the reinsurer from applying at other port of entry states until some state provides the foreign reinsurer with the maximum tier level. Language is needed to prohibit "forum shopping" by the alien reinsurer. For example, a provision should be added that once a port of entry state has lowered a foreign reinsurer's tier rating based on factors other than the reinsurer's NRSRO's ratings, the foreign reinsurer cannot seek certification from another port of entry state in an attempt to receive a higher tier level.

● **Lack of Specifics Regarding Tier Level Evaluation Process**: The framework, in addition to lacking any real specifics on standards for determining whether a state

should be authorized as a port of entry state, also lacks any specific standards regarding how an authorized port of entry state is to evaluate a foreign reinsurer applicant for determining tier level. The draft framework states that the port of entry state is to evaluate an alien reinsurer for disputed claims and late payments but fails to specify what is acceptable or not. The lack of standards means the port of entry state is doing little more than guessing and will likely just revert to using the objective NRSRO rating as the de facto rating. The framework needs to be revised to provide clear guidance to the port of entry regulator. For example, the framework should require that any alien reinsurer who is below average in timely claim payments or number of disputes be lowered at least one tier from its maximum tier level based on the NRSRO rating. Those who are more than a standard deviation from the average scale should be required to post 100% collateral. Unless specifics are set forth in the framework, the danger is that the port of entry regulator will have no clear guidance and will simply fall back on the NRSRO rating.

● **A Security Fund Must Be Created to Secure Risks**: The draft framework contains no mention of the establishment of a security fund. The task force's December 2, 2007 Framework Memorandum states that establishment of a security fund would be considered.

A security fund should be established. One of the major flaws of the current draft framework is that all risks flow to U.S. ceding insurers and all benefits flow to the unlicensed foreign reinsurers. Proponents of the need to overhaul current collateral requirements argue that U.S. ceding insurer's fears of uncollectible reinsurance recoveries from alien reinsurers with no assets in the U.S. are exaggerated. Throughout the years of debate on collateralization, certain U.S. ceding insurers have requested that the advocates of change endorse a security fund whereby the alien reinsurers would be liable for payment of recoverables when a U.S. ceding insurer is not paid on an appropriate claim where collateral is no longer available. The advocates of change have repeatedly rejected this suggestion, perhaps suggesting that in actual practice loss of recoverables due to the absence of collateral may become a common practice.

● **Statistical Rating Organizations Are Often Too Late in Rating Downgrades**: The reinsurer tier level depends in the first instance on the financial rating given to the unlicensed reinsurer by nationally recognized statistical rating organizations (NRSRO's). Reliance on NRSRO ratings is not unreasonable and AIA does not specifically object to the use of NRSRO's if indeed the collateral structure is going to be changed. However, a potential problem with reliance on statistical rating organizations is that they too often are too late with their rating downgrades. The ratings are downgraded only after the fact and after the financial problems of the company being downgraded already have been made public. These after-the-fact downgrades have been seen previously with certain foreign reinsurers and more recently with companies associated with the sub-prime home mortgage fallout.

European regulators in France and Germany have called for investigations of the rating organizations for their underestimating of the subprime risk until the problems were already known to the general public. A similar failure to timely recognize financial stress in the reinsurance market could prove fatal to the solvency of the U.S. insurance market if collateral requirements had been significantly reduced.

● **Collateral Requirements for Unlicensed Reinsurers is not an Unfair Trade Issue**: Despite arguments to the contrary by supporters of eliminating the current collateral rules, requiring collateral from an alien reinsurer who refuses to obtain a license in any U.S. state or maintain assets in the U.S. is not an unfair trade issue or an artificial or discriminatory barrier. The U.S. reinsurance market is actually pro-competitive and offers foreign reinsurers a choice between being licensed and submitting to financial supervision in the U.S. or remaining unlicensed, foregoing regulatory supervision and the need to maintain assets in the U.S., but posting collateral to cover expected losses.

It should be noted that other countries, including members of the European Union, impose barriers against U.S. insurers who do not obtain licenses or maintain assets in their countries. In addition to the remarks of LeBoeuf, Lamb quoted at the beginning section of this letter, other commentators have noted that U.S. reinsurers are not permitted to compete on an equal footing with EU-based reinsurers when competing for business in the EU. ("A non-EU reinsurer with a branch in a member state has no-EU right to provide cross-border business in another member state either in its own right or via a branch; it does not have a passport"). Article by Guy Soussan and Philip Woolfson, "Implications of Directive" printed in Insurance Day January 19, 2007 http://www.steptoe.com/assets/attachments/2869.pdf . *See also* Lloyd's article by James Walmsley, The EU Reinsurance Directive, May 3, 2007 https://www.lloyds.com/Lloyds_Worldwide/International_compliance_news/The_EU_Reinsurance_Directive.htm ("The Directive requires non-EU reinsurers to obtain authorization separately in every member State in which they propose to do business: one authorization does not cover them for the whole EU, unless they establish a subsidiary company in an EU Member State."); AON "Alternative Views p.2 April 2006 http://www.aon.com/risk_management/pdf/captives/newsletters/av_april2006.pdf ("Any reinsurer based outside the EU (i.e. a non-admitted reinsurer) will be required to complete a full authorization procedure prior to providing any reinsurance in any member state" and EU "member states are allowed to introduce indirect supervisory rules" for non-EU reinsurers).

AIA thanks you for your consideration of these issues

Steven Bennett
Assistant General Counsel
American Insurance Association

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March 24, 2008

VIA ELECTRONIC MAIL

Mr. David Vacca
Senior Financial Analysis and Receivership Manager
NAIC Financial Regulatory Services Division
Restructuring Mechanism for Troubled Companies Subgroup
dvacca@naic.org

Re: Response to Call for Comment

Dear Mr. Vacca:

The enclosed materials are offered in response to the Call for Comment issued by the Restructuring Mechanism for Troubled Companies Subgroup.

This response is presented on behalf of Goodrich Corporation, Exxon Mobil Corporation, and Textron Corporation. These companies are major U.S. policyholders with decades of experience in risk management and in the insurance market. They are eager to share their perspectives and insights with the Subgroup as it considers the problem posed by so-called solvent schemes of arrangement.

We have enclosed the following materials to aid the Subgroup in its deliberations: (1) a five-page executive summary on solvent schemes and our reasons for opposing them, (2) a proposed resolution that we encourage the NAIC to adopt, (3) a recently published article on solvent schemes in US bankruptcy courts, and (4) a letter filed last year with the Financial Services Authority in the UK detailing some of the key objections to solvent schemes.

We welcome the opportunity to discuss these issues at the Subgroup's meeting in Orlando on March 28, 2008. We look forward to coordinating our participation with you in the coming week and are ready, should the Subgroup find our input helpful to its deliberations, to make representatives from these companies available in Orlando to present their views.

Sincerely,

Benedict M. Lenhart

cc: Goodrich Corporation
Exxon Mobil Corporation
Textron Corporation

Restructuring Mechanisms for Troubled Companies (E) Subgroup

Response to Call for Comment

March 24, 2008

Executive Summary

Restructuring Mechanisms for Troubled Companies (E) Subgroup

Response by Certain Policyholders to Call for Comment

Submitted by Goodrich Corporation, Exxon Mobil Corporation, and Textron Corporation

Solvent schemes of arrangement in the UK have harmed American policyholders by unilaterally terminating years of valuable insurance coverage while allowing fully solvent carriers to back out of unprofitable insurance contracts. Our experience in the UK has shown that, rather than improving efficiency in the insurance market, solvent schemes are being abused by profitable carriers to extinguish coverage while paying little or no compensation to American policyholders. The reality of solvent schemes in the UK illustrates two important lessons for American regulators – (1) restructuring mechanisms meant for *failing* carriers must not become a tool for *solvent* carriers to transfer value away from policyholders, and (2) solvent schemes imposed by foreign jurisdictions should be opposed by US regulators as unfair to policyholders.

We therefore encourage the NAIC to ***strongly oppose solvent schemes*** *by (1) adopting a resolution objecting to solvent schemes, (2) participating as amicus in future legal challenges to solvents schemes, both in the UK and in US Bankruptcy Court, (3) adopting a white paper that critically assesses solvent schemes and their negative effect on American policyholders, and (4) any other means that the NAIC deems appropriate against solvent schemes.*

What Is a "Solvent Scheme of Arrangement"?

A solvent scheme of arrangement is a procedure whereby solvent and profitable insurance companies doing business in the London Market have used a provision of UK law (known as Section 425 of the Companies Act of 1985) to extinguish years or decades of valuable coverage held by US policyholders while paying little or no compensation in return.

Schemes generally operate like insolvency or restructuring proceedings. First, a carrier proposes a "scheme" to commute coverage under certain policies and notifies affected policyholders, who are invited to vote on whether to approve the scheme. If enough voters approve, a UK court will sanction the scheme. Next, all affected policyholders – regardless of whether they voted for the scheme – are required to submit claims for coverage by a bar date. Finally, the carrier evaluates and pays the claims, and the coverage is extinguished forever. But unlike an insolvency or restructuring in the US, fully *solvent* carriers are making use of these schemes to extinguish liabilities, with virtually no judicial – and no regulatory – oversight to protect policyholders.

How Solvent Schemes Offend Public Policy

- **Schemes undermine the value of insurance contracts.** The fundamental basis of insurance business is a contract where by a policyholder pays to transfer risk to an insurance company. For this contract to have value, regulators and the state must be willing to enforce the contract, even when one side (the carrier) decides it would rather cut its losses by changing the bargain mid-stream. Solvent carriers must not be allowed to back out of policies unilaterally and forcibly transfer risk back onto policyholders.

- **Lost coverage hurts policyholders at the expense of American citizens and the economy.** The policies at issue provide billions of dollars in coverage for long-tail liabilities – such as asbestos and environmental claims – that have proven onerous to American companies, large and small. The prudent American companies that insured against these risks are now seeing their insurance assets steadily eroded by solvent schemes. Preserving these assets helps ensure (1) full compensation of claimants, (2) financial health of American policyholders facing large covered risks, and (3) effective risk management that benefits not only the policyholders, but also their employees, customers, suppliers and shareholders.

- **Schemes pose a formidable collective action problem.** Each individual scheme is often organized against tens of thousands of potential claimants whose claims, on an individual basis, are often relatively small. Frequently, notice to policyholders fails to convey the true extent of the threat posed by the scheme to their insurance coverage. Furthermore, the cost and effort involved in mounting a formal opposition to a solvent scheme is quite high. For these cost/benefit reasons, many policyholders opt not to oppose a scheme, and the scheme goes through unchallenged. In short, solvent schemes pose a classic collective action problem for which regulatory oversight is uniquely suited to prevent industry overreaching.

- **Schemes undermine the reliability of insurance institutions.** Any regime that allows solvent carriers to walk away from their obligations undermines policyholder confidence and, ultimately, undermines the long-term reliability of the insurance market.

Debunking the Purported "Advantages" of Solvent Schemes

Proponents of solvent schemes in the UK often tout the "efficiency gains" from a centralized claims adjudication process. These include the cost saving of consolidating and cutting off future claims and the prospect of accelerated cash payments to policyholders. In our experience, however, the "advantages" flow exclusively to carriers at policyholders' expense.

- **"Efficiency" gains are merely cost savings for insurers at the expense of policyholders.** Insurers are expected to pay their own costs of handling claims as part of the business of selling insurance. Just because it would be less expensive for an insurer if fewer claims were made does not mean that extinguishing coverage – to the great disadvantage to policyholders – is a legitimate way to increase efficiency.

- **"Accelerated payments" for policyholders rarely (if ever) provide full value.** Compensation for incurred but not reported ("IBNR") claims is often inadequate, as policyholders are forced to prove the value of highly contingent claims. And compensation is *non-existent* for the loss of coverage of unknown liabilities. While solvent schemes may accelerate some payments, this "acceleration" does no good for IBNR policyholders who are forced to accept a small fraction of fair value in exchange for termination of their valuable occurrence-based coverage. Getting ten percent or less of the fair value of a claim now – on an "accelerated" basis – is of little comfort when the insured would far prefer to keep the coverage in place so that it would be there to pay claims when they mature. That is, after all, why the policyholders purchased the insurance in the first place.

- **Any "efficiencies" are *already* available through voluntary policy commutation.** Virtually every claimed efficiency or cost-saving benefit of solvent schemes is already

available through freely negotiated, voluntary policy commutation. The only "advantage" from a solvent scheme is that carriers can unilaterally impose commutations that they would otherwise be unable to negotiate if policyholders had equal bargaining power. Commutations regularly happen in the marketplace today – and they happen when both sides deem the deal to be fair.

UK Solvent Schemes in Practice – Specific Harms to American Policyholders

Our experience with solvent schemes ([over 40] in the UK to date) reveals that, in practice, they are fundamentally unfair to policyholders and offend basic notions of due process and fair play.

- **Cram down.** First and foremost, US policyholders are harmed because they have no ability to opt out of a scheme. Once a scheme takes effect, the coverage is lost regardless of whether the policyholder wants to keep the coverage, and regardless of whether fair compensation is paid to the policyholder. One might expect this outcome in an insolvency setting, but not with a highly solvent and profitable insurer.

- **Unequal treatment of policyholders.** In our experience, the unequal treatment of policyholders begins even before a scheme is launched as insurers strike early deals with individual policyholders with the largest claims or that are otherwise deemed more likely to object. In contrast to insolvency or bankruptcy proceedings in the US, where the claims resolution process is transparent and all such settlements must be vetted with stakeholders and ultimately approved by a court, solvent schemes face little or no judicial scrutiny.

- **Inadequate notice to policyholders.** Because the policies at issue were written over period of decades to tens of thousands of policyholders, notice is often deficient, largely due to incomplete or stale contact addresses and a lack of incentives diligently to attempt notice. And when notice is provided, it often fails to convey the full extent of the threat posed. Indeed, experience has shown that scheme proponents will fail to disclose the valuation methodologies that are actually used, both in discounting votes, and in discounting claims.

- **Cherry-picking and overreaching.** Solvent schemes in the UK do not require, as an insolvency or restructuring in the US would, that all of a company's policies be included, or that all policyholders be treated equally. Insurers are free to select which lines of coverage are "schemed." This leads to strategic selection of those policies least likely to attract attention and most likely to maximize value at policyholders' expense. And this is a one-way street – if a proposed scheme ends up attracting too much negative attention or appears likely to involve costly claims, the insurer, at its sole option, may abandon the scheme entirely.

- **Lopsided and unrepresentative voting.** For a scheme to be approved, it must receive both a majority of the total votes cast, and 75% of the votes cast by claim value. However, experience has shown that scheme proponents will often manipulate the vote in two ways.

  - *First*, schemes will define voting classes to combine policyholders with contingent IBNR claims – who stand to lose the most from a solvent scheme – with non-policyholders like reinsurers, arbitrageurs, syndicates, and policyholders holding mature or liquidated claims – all groups much more likely to favor policy commutation.

- *Second*, schemes will arbitrarily alter the *value* of the votes submitted to reduce the impact of negative votes and inflate the value of votes of creditors favoring the scheme. In the WFUM case, the scheme proponents actually *lost* the initial vote, but went on to "win" the vote after the scheme adjusted vote values.

- **Burden shifting to the policyholders.** Throughout the process, the policyholders bear the entire burden of proving claims, including highly contingent liabilities, and valuing hypothetical exposures that may arise in the future. This process involves sorting through complex scheme documents, gathering massive amounts of data, and hiring consultants to prepare, estimate, and provide support for claims – all on an abbreviated timetable and on terms set by the carrier.

- **Long-tail coverage undervalued.** Schemes require policyholders to prove all past, present and future claims at once. This is problematic for policyholders with contingent IBNR claims because, while it is difficult enough to estimate the value of IBNR claims arising from identified risks (like asbestos), it is *impossible* to know what other unknown liabilities might materialize in the future for which coverage would no longer be available under policies schemed out of existence. The result is undervaluation of contingent claims, and zero valuation for lost coverage of unidentified risks.

- **Arbitrary (and downward) adjustment of claims.** After claims are filed, they are discounted by a carrier-selected "independent" adjuster (most of whom do a large amount of repeat business with scheme proponents) who applies estimation and allocation methodologies that are often at odds with applicable US law governing the policies and that consistently draw disputed assumptions in favor the carrier on key coverage and exposure variables. There is no right of appeal, and no judicial review of these private adjudications, which are most often carried out by persons with no training in US coverage law.

UK Solvent Schemes and the US Chapter 15 Process

The unstated – but unquestioned – rationale behind solvent schemes is to cut off US policyholders' coverage for liabilities arising from the US tort system. A crucial aspect of that effort is to gain US court recognition in order to make those schemes binding in the US.

- **US Policyholders and Coverage Targeted.** Experience has shown that solvent schemes single out policies held primarily by US policyholders and that provide coverage for long-tail liabilities primarily emanating from US operations.

- **Abuse of US bankruptcy process.** To cut off US liabilities effectively, scheme proponents seek out US bankruptcy court recognition under Chapter 15 of the US Bankruptcy Code, which was originally designed to facilitate cooperation between US bankruptcy courts and foreign courts presiding over cross-border *insolvency* proceedings. But so far, US courts, hearing no opposition from policyholders, have granted this recognition to solvent schemes.

- **Lack of policyholder opposition.** To date, there has been no meaningful policyholder opposition to solvent schemes in a Chapter 15 recognition process. Nevertheless, there are compelling arguments that solvent schemes are not eligible for Chapter 15's protections.

Few Schemes Face Sustained Policyholder Challenges, But Those That Do Fail

In the few cases where policyholders have mounted serious opposition, objecting policyholders have successfully demonstrated the fundamental unfairness of solvent schemes.

- **The BAIC Case.** The UK High Court rejected the proposed scheme of British Aviation Insurance Company as an unfair forced revocation of policies by a solvent carrier. In rejecting the scheme, Justice Lewiston (UK) explained:

  > *[I]t seems to me to be unfair to require manufacturers who have bought insurance policies designed to cast the risk of exposure to asbestos claims on insurers to have that risk compulsorily retransferred to them.*

- **The WFUM Case.** In a complex scheme involving some fourteen different insurance companies, the UK High Court again sided with policyholders who objected to the scheme's proposed voting class structure, which would have grouped policyholders with IBNR liabilities into a single omnibus class with other policyholders holding mature and liquidated claims – a group with very different interests. The same court later expressed misgivings about the scheme proponents' radical downward adjustments in the values assigned to the claims of creditors who had voted against the scheme. Before that issue could be fully aired, however, WFUM settled with the objecting creditors to take the issue off the table.

The Appropriate US Regulatory Response

We encourage the NAIC to **strongly oppose solvent schemes** and to publicly adopt the following basic policy positions:

- Insurance carriers must honor their policies in the jurisdictions in which they sell insurance.
- Insolvency and restructuring mechanisms meant for *failing* carriers must not become a tool for *solvent* carriers to take coverage away from policyholders.

We encourage the NAIC to **take the following steps** to advance these positions:

- Adopt a resolution objecting to solvent schemes;
- Participate as amicus in future legal challenges to solvents schemes, in the UK and in Chapter 15 proceedings in US bankruptcy courts;
- Adopt a white paper that critically assesses solvent schemes and their negative effect on US policyholders; and
- Take any other steps the NAIC deems appropriate to oppose solvent schemes and defend the rights of US policyholders.

Restructuring Mechanisms for Troubled Companies (E) Subgroup

Response to Call for Comment

March 24, 2008

Proposed NAIC Resolution

PROPOSED RESOLUTION

A RESOLUTION OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS (NAIC) IN OPPOSITION TO SOLVENT SCHEMES OF ARRANGEMENT IN THE INSURANCE MARKET.

WHEREAS, solvent schemes of arrangement are mechanisms whereby solvent insurance companies seek to use provisions of foreign law to extinguish years or decades of highly valuable occurrence-based insurance coverage issued to U.S. policyholders and others.

WHEREAS, solvent schemes of arrangement operate to divest policyholders of vested contractual rights on an involuntary basis.

WHEREAS, solvent schemes of arrangement compulsorily retransfer the risk of future uncertainty to the very policyholders that paid substantial premiums to insurance companies to secure the unlimited prospective protection promised by occurrence-based insurance policies.

WHEREAS, the purpose of such schemes is to allow surplus funds to be returned to insurance companies and their shareholders in preference to satisfying the legitimate claims of policyholders and other creditors.

WHEREAS, solvent schemes of arrangement deprive policyholders of their right of access to the courts, of having their contractual rights determined by an independent and impartial tribunal, and of litigating in the forum in which they are contractually entitled to have disputes determined.

WHEREAS, solvent schemes of arrangement typically fail to provide policyholders with just compensation for the highly valuable and irreplaceable insurance assets they are compelled to forfeit under such schemes.

WHEREAS, solvent schemes of arrangement impose substantial burdens and costs on policyholders.

WHEREAS, solvent schemes of arrangement fail to provide policyholders with the option of opting out of the forced commutation of their insurance assets.

WHEREAS, solvent schemes of arrangement in the insurance market have become increasingly common in the past few years.

NOW, THEREFORE, BE IT AND IT IS HEREBY RESOLVED:

1. That the National Association of Insurance Commissioners (NAIC) forcefully opposes solvent schemes of arrangement that operate to divest policyholders of vested contractual rights on an involuntary basis.

2. The NAIC expresses its support for policyholders opposing solvent schemes of arrangement in Great Britain and other jurisdictions.
3. The NAIC agrees that solvent schemes of arrangement are fundamentally unfair to policyholders that prefer to retain their bargained-for contracts of insurance.
4. The NAIC believes it to be highly improper for solvent insurance companies to exploit schemes of arrangement to achieve the forced commutation of policyholders' insurance assets.
5. The NAIC calls on insurers to include, and regulators to require, broad opt-out provisions as part of every solvent scheme of arrangement, whereby any policyholder or other creditor that does not deem a scheme of arrangement to be in its best interest can choose not to participate.

AIG has reviewed the latest proposal and following are our thoughts or comments set forth by the draft's paragraph numbering scheme.

1. The definition of "Domiciled" seems incorrectly worded. Considering the actual definition shown, we suggest the item be labeled as: "Domiciliary jurisdiction". Then "Domiciled" could be defined as: "The domiciliary jurisdiction where the insurer or company is incorporated or organized."

Under the definition of "National reinsurer", under the current system of state-specific licensing laws, we don't see how this model can universally allow a "home state" as defined in the model to approve a reinsurer "to write reinsurance across the United States".

2. A fundamental question becomes: Can a company domiciled in State A choose to be a national reinsurer with a "Home state" of State B whether or not State A qualifies under the model as a home state? Our reading of the model indicates an answer of "No" to this question. Is that a correct understanding? Additionally, what is the standard for "appropriate regulatory capacity"?

3. In the first line of the paragraph after the phrase "home state supervisor", for clarity, we suggest adding the phrase "for the purpose of establishing national reinsurer status hereunder". At the end of the fifth line "reinsurers" should be "reinsurers'". Relative to the consultative process and as reflected in the comment relative to paragraph 10, the construct of the consultative process described is unclear. Additionally, as to the last sentence of the paragraph, it is unclear how matters not related to financial solvency (e.g., corporate governance, market conduct, etc.) are to be handled.

4. The rationale for not having the 5% direct business allowance apply to essentially Lloyds is not made clear. Presumably, it's because Lloyds also writes directly on a surplus lines basis. However, this seems patently unfair to US assuming companies that may write, for example, 10% of their total business on a direct basis.

5. The first seems unclear and we suggest it be rephrased as: "In order to achieve status as a national reinsurer or a port of entry reinsurer, a reinsurer must have a minimum *surplus* of $250 million." Use of the phrase, "Minimum capital", a defined term in many statutes, would seem to require a company's "capital" account to be $250 million, not, we think, the Proposal's intended standard. Then, the question arises as to what happens if the surplus falls below that amount subsequent to achieving national reinsurer or port of entry reinsurer status? As to Lloyds, does the standard apply to each syndicate or all the syndicates at Lloyds in the aggregate? We would also point out (as we did in our prior comments) that the $250 million requirement is arbitrary in that it bears no relationship to underlying risk. A reinsurer with $50 million of surplus and $25 million of liability is much stronger, all other things being equal, to a reinsurer with $250 million of surplus and $10 billion of liability.

6/7. As to sub-paragraphs a. of each paragraph, how can a host state "be required to grant credit for reinsurance ceded by one of its domestic insurers to a national reinsurer"? That could only happen if the host state adopts changes to its law; it's not dependent on a company achieving national reinsurer or port of entry reinsurer status.

8. The Model appears to be designed to allow a Port of Entry reinsurer, i.e., an alien reinsurer entered through a Port of Entry designated state, to conduct business throughout the United States. As noted relative to the paragraph 1, there is a question as to whether the NAIC model can actually do that. It would seem that could only occur if the various other states pass accommodating legislation.

9. The paragraph does not clarify what it means where it states the model "will apply only on a prospective basis." Does that mean it will apply only to ceded reinsurance contracts effective after some date certain, perhaps the date the law is adopted by the last state adopting the template that makes the template national in scope? We note that the language in paragraph 17 seems clearer on this point; however, the "effective date of this proposal" is, as yet, unclear. Is that when the Model is adopted, when a state adopts the Model or when all states have adopted the Model? Or, some other point?

10. How many RSRD board member states will there be, how will they be selected and for what terms will they be selected? Concerning item b, will the RSRD board also consider collateral increase criteria?

11. There is no reference to confidentiality as to the RSRD. Can such a division of the NAIC have confidentiality grant in a manner similar to a state regulator? Under item b, a key question has to do with reserving requirements, particular with reference to term life cessions. Currently, US reserving requirements are much stronger that other jurisdictions' requirements creating an unlevel playing field. Notwithstanding New York's Regulation 20's mirror imaging reserve requirement for life cessions and noting most other states do not have such a requirement, it is not clear whether this factor is within the ambit of the RSRD's matters to consider under this item. Moreover, we do not know whether as the world moves to IFRS whether the reserves required under any ultimately developed standard within IFRS will be equivalent to US reserves as currently required under GAAP and SAP or as resultant under SAP due to principles-based reserving precepts. Additionally, as to item e. v., what does "(s)ufficient ceded premium volume mean"? Concerning item g., it would seem that what would be required would be adoption by all US jurisdictions in order to achieve uniformity "across the country." As to item g vii 1, It doesn't appear that the designation "1" is necessary since it's the only item shown, the use of the word "Company" (twice in the third and fourth lines) should be replaced by "ceding insurer" (in both cases) and what if the standard shown is not representative of both parties' wishes? As to item g's enumeration of proposed required clauses, item iii, the "Premium clause", should be reworded to state: "the amount of premium under the reinsurance contract and how remittances are to be made." The "method of calculating" premium is usually different as to every contract, a matter of some proprietary consideration and reflects the results of negotiation. We believe that reinsurance contracts should set forth the premium and its determination, but using the phrase "method of calculation" has a different connotation. As to clause v, "Service of Suit Clause", it is noted that what is proposed seems fine as long as it is not requiring an exclusive service of suit jurisdiction. As to clause vii, Credit for Reinsurance Clause", the language used, "financial statement penalty", is generally not applicable to US ceding life insurers. In general, US life ceding companies cannot take credit for reinsurance in certain defined circumstances whereas US property/casualty ceding insurers, in some defined circumstances, take credit for reinsurance in their underwriting liability items but then establish a separate penalty liability for the credit thus taken.

12. The content of this paragraph is dependent on the answer to the question relative to paragraph 2 above being correct as we stated it. Also, as to sub-item g, what is the nature of the fee? Is it concordant with a licensing fee generally levied by states?

13. Item b seems to indicate that if port of entry reinsurer resists even one claim, it then has to post collateral for all of its US liabilities. Is that understanding correct? Then, there is the question as to what happens if said reinsurer doesn't post collateral? Will all host state reinsurers ceding to that reinsurer effectively be penalized? As to item b, we do not see the need to describe a final US judgment as "valid". A final judgment is a final judgment. Using the word "valid" as an additional descriptor seems to broaden the possibilities for challenge.

14. As to item b, it is not clear how "comparable" the information has to be considering the variances in accounting standards. Would the information have to be comparable per SAP or just by its nature?

15. As to item a, some evaluation of the "protection" should be made to ensure appropriate confidentiality levels continue. As to item e (and with reference to item g), it should be noted that except for the larger ceding company enterprises, adequate levels of reinsurer credit risk diversity can probably not be attained. In f, (on the second line), "the reinsurance premium" should read "ceded reinsurance premium".

16. The use of the term NRSRO has been discontinued by the NAIC's Securities Valuation Office and replaced by the term ARO (Approved Rating Organization). Additionally, the model appears to be designed to allow a Port of Entry reinsurer, i.e., an alien reinsurer entered through a Port of Entry designated state, to conduct business throughout the United States. As noted relative to our paragraph 1 comment, there is a question as to whether the NAIC model can actually do that. The references should be changed in this paragraph.

17/18. The SVO also recognizes a fifth specific ARO, DBRS. Although fitting within item 17 e, there does not appear to be a reason not to specify that ARO's ratings groupings. It is not clear how the collateral percentages were determined especially as between levels Secure-3 and Secure-4. Additionally, the proposal does not describe what happens when a split rating situation occurs. For instance, what happens if Best rates an insurer in the Secure 1 category and S&P rates a company as Secure 3?

20. The question arises as to whether standards will be promulgated relative to the items of consideration listed so as to determine whether home state and/or POE supervisors are applying like parameters to arrive at their judgments. As to item a, the standard for determining disputed recoverables is assumed to be that set forth in SAP; however, the SAP definition does not consider the circumstance where a ceding company considers a matter in dispute but receives no confirmation from the assuming company of that circumstance. Thus, an incomplete list may be submitted by the assuming reinsurer. Under items b and c, it is unclear how "reputation" and "compliance" are to be determined. As to item d, it is unclear how business practices determination will be made. Concerning item h (and notwithstanding item i), it is noted that the clean audit opinion will be based on local non-US accounting and audit paradigms. As to item I, it appears that the alien reinsurer applicant has the choice to reconcile to US GAAP or SAP. Is that so? It would seem that the second sentence of item I should be its own individual item, perhaps replacing item h.

21. "Catastrophic occurrences" are not defined and as to the second sentence, is it only for the lines of business delineated that collateral can be deferred in placement? The use of the word "included" in the second sentence makes the issue unclear.

22. It is unclear why the placement of an order rehabilitation, liquidation or conservation against the ceding company should trigger a collateral requirement to the assuming reinsurer especially considering that assuming reinsurer would have met the requirements set forth in paragraph 20.

23. Affiliated transactions should be exempt from collateral requirements because they have been pre-approved, non-disapproved or deemed immaterial by US regulators. In any case, it is unclear whether an affiliate can trade off the rating of the group as a whole or needs its own individual rating. What about pooling agreements?

24. There are no timetables set forth required for the home state or POE state actions contemplated. There is dichotomy of verbiage used as between paragraph 24 ("may suspend the certification of a reinsurer") as opposed to paragraph 25 ("amend or withdraw a reinsurer's rating"). Why?

25. On the last line, it should read: "...lead the reinsurer's home state or POE supervisor to reconsider...".

27. It is unclear as to who deems the reinsurance uncollectible. We recommend that at the end of the paragraph, the phrasing be changed to: "...unless the reinsurance is deemed by the ceding company as uncollectible."

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CEA
Insurers of Europe

The Director General

To: Commissioner Steven M. Goldman
New Jersey Department of Banking and Insurance
20 West State Street
P.O. Box 325
Trenton, NJ 08625-0325

Your reference: -
Our reference: AI 8020 (06/08)

Subject: NAIC Reinsurance Modernisation Framework Proposal (Memorandum of 3 July 2008)

Brussels, 17 July 2008

Dear Commissioner Goldman,

The CEA has commented on previous NAIC reinsurance reform proposals and is pleased to have the opportunity to comment on the NAIC's latest proposal as outlined in the 2008 memorandum on modernizing the U.S. reinsurance regulatory framework (the "Memorandum") of the Reinsurance (E) Task Force's dated 3 July 2008.

The CEA sees merit in various aspects of the current proposal, which would help to develop a more modern and fair system of reinsurance regulation, and we acknowledge the progress the NAIC has made to date. There are however still a number of aspects of the proposal which cause serious concern and which we believe need to be addressed.

Considering the very short time we have had to examine the latest NAIC proposal, the CEA comments are limited to five important aspects of concern.

1. Port of Entry State

In contrast to the current proposals in the Memorandum, we do not see any need or justification for a non-US reinsurer to be subject to the additional oversight of a US Port of Entry State where the reinsurer's non-US jurisdiction is found to be equivalent to the US regulatory system.

2. Collateral Requirements

We, and indeed the European Commission, have consistently argued that the US system should remove statutorily required collateral obligations and not discriminate between reinsurers on the basis of the country in which the undertaking is domiciled. To our regret, the NAIC's proposal continues to give preferential treatment to US reinsurers over non-US reinsurers in terms of collateral obligations, even in circumstances where the non-US reinsurers are regulated by an equivalent regime and have the same rating as US reinsurers.

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Such preferential treatment is particularly inacceptable in a framework that is only accessible for those non-US reinsurers that are domiciled in a jurisdiction that has been recognised as "equivalent" by the NAIC Reinsurance Supervision Review Department (RSRD), and thereby making them subject to – in our opinion unjustified – additional oversight by a US Port of Entry State (see also points 1 and 4).

We therefore strongly urge the removal of the unjustified discriminatory treatment of non-US reinsurers.

3. Reinsurance-only Provision

We do not understand the rationale behind the inclusion of a provision limiting the new framework to pure reinsurers only. In our opinion, it is inappropriate to deny the benefits of the proposed regime to entities simply because they also write direct insurance business. Such a restriction is also not prudentially justified.

We therefore recommend the NAIC remove the reinsurance-only restriction.

4. Port of Entry Reporting Requirements

As stated above, we do not believe that there is a need for non-US reinsurers from equivalent jurisdictions to be subject to supervision by a US Port of Entry State. In addition, the current NAIC proposal refers to the possibility of entering into a mutual recognition agreement but does not apply it consistently and appropriately in order to remove duplicative reporting requirements. If, which we hope is not the case, the NAIC retains the Port of Entry concept in the final framework, we believe that the reporting obligations proposed should be reformed as follows.

No need for the filing of quarterly financial information
The Memorandum requires a POE reinsurer to file quarterly "[i]nformation comparable to relevant provisions of the quarterly NAIC financial statement". We believe that such quarterly reporting requirements are overly burdensome for non-US reinsurers who are domiciled in a jurisdiction that has been recognised as equivalent by the RSRD and when the sharing of the relevant information between the relevant authorities is ensured. We would therefore urge the removal of the requirement to file financial information quarterly.

No need for Schedule F statement
Much of the information that can be obtained by requiring a non-US reinsurer to file a report annually in the form of Schedule F (or S) of the NAIC annual statement blank as is required by the Memorandum, can also be obtained from other sources, such as the Schedule Fs filed by U.S. ceding companies. We would thus recommend the removal of this provision.

To accept IFRS statements from non-U.S. reinsurers instead of reconciled U.S. GAAP or SAP statements
Given that the U.S. Securities & Exchange Commission already agreed earlier this year to accept IFRS statements from foreign issuers, which would include non-US (re)insurance companies, we would strongly urge the extension of the requirement so that non-U.S. reinsurers can either file audited IFRS accounting statements or audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles.

5. Implementation Period

In order for the new framework to become operational, a substantial number of steps still need to be taken. We would therefore urge the NAIC to develop and commit to an appropriate implementation period.

In spite of the progress made by the NAIC so far, the CEA is convinced that the framework can and should be further improved in line with the comments made above, to ensure a true level playing field for US and non-US insurance undertakings writing reinsurance in the US.

We would be pleased to respond to any questions or comments you or the other Task Force members might have regarding the contents of this letter.

Yours sincerely,

Michaela Koller
Director General

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NAIC Reinsurance Task Force
Comments on the Reinsurance Regulatory Modernization Proposal
5/16/08 Memo

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
RAA	Definition of Terms	Suggested additions in **bold**: The "Definition of terms" section should be moved up to the top of the document after paragraph 1. This would clarify the use of terms in paragraphs 2-4. The RAA suggests the following revisions to the specific definitions: A. "Home state" means the qualifying state where the national reinsurer is **licensed and** domiciled. B. "National reinsurer" means a reinsurer that is **licensed and** domiciled in a Home State and approved by such state to **transact** assumed business across the United States while submitting **solely** to the regulatory authority of the **Home state** supervisor. C. "Non-U.S. Jurisdiction supervisor" means the **domiciliary** supervisor of a reinsurer from a non-U.S. jurisdiction. D. "Port of Entry reinsurer" **or "certified reinsurer"** means a non-U.S. assuming reinsurer that is **certified in a Port of Entry state and approved by such state to provide creditable reinsurance to the U.S. market.** E. "Port of Entry state" means the state where a non-U.S. assuming reinsurer will become certified in order to **provide creditable reinsurance to the U.S. market.**	A. *"Home State"* definition – **change made**. B. *"National reinsurer"* definition – **change made**. C. *"Non-U.S. Jurisdiction supervisor"* definition – **change made**. D. *"Port of Entry reinsurer"* definition – **changes made except for reference to "certified reinsurer", which was noted and discussed, but was not incorporated due to the desire for consistency of terms throughout the proposal.** E. *"Port of Entry state"* definition – **change made**.
IUA	Paragraph 2, RSRD in general	The proposal contemplates the establishment of the NAIC Reinsurance Supervision Review Department. It also indicates that there would be a "Supervisory Board" for this Department. We are uncertain about the constitution of this Supervisory Board, including how many members it will have, whether the Board will be comprised of just insurance regulators, or also NAIC staff, how the	Comments noted – The Task Force has requested that NAIC staff begin preliminary analysis for the RSRD structure. This will be included as part of the implementation process.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		Board members will be chosen and how long they will serve.	
Interested Parties	3a & b	Paragraph 3(a) and (b): The use of the term "appropriate" is confusing as it is utilized in conjunction with two very different concepts: credit for reinsurance and the determination of whether there is adequate risk transfer. To clarify what we understand the Task Force is trying to accomplish, we suggest that the word "appropriate" be deleted from 3(a) and that 3(b) state: A. "States will be required to grant credit for reinsurance ceded by their domestic insurers to a POE reinsurer authorized by a POE supervisor." B. "The ceding insurer's domiciliary regulator retains the same authority it has under existing law to evaluate the amount of the liabilities ceded and retained in order to determine whether the contract transfers risk."	A & B. **Change made** – paragraphs regarding "appropriate" were deleted.
FSA	3c.	We note that, prior to certification of individual reinsurers for port of entry status, it is proposed that their home jurisdictions should be recognised by the Reinsurance Supervision Review Department (RSRD). We urge the Task Force, when designing the details of this process, to have regard to the principles set out in the IAIS's draft guidance paper on mutual recognition of reinsurance supervision. In particular, we believe that the RSRD should not seek exact equivalence in other supervisors, instead looking for broadly comparable regimes, compliant with international standards, which achieve similar outcomes.	Thank you for your comment. Please note paragraph 11.b. of the 7/3/08 revision. Issues related to mutual recognition and the regulatory authority of the RSRD are currently being reviewed and addressed by the NAIC Legal Division.
Interested Parties	3d.	[or its equivalent] This minimum capital requirement is arbitrary and because it is not risk-weighted, is not very meaningful.	**Change made** – Please see paragraphs 4 & 5 of 7/3/08 revision. Your comment is appreciated, however the Task Force made no related changes. The Task Force

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
			has considered any clarification in the capital structure to be a part of a Purposes & Procedures Manual for the RSRD.
Interested Parties	3d.	Lloyd's has central surplus in excess of this amount but those assets are not technically "capital" within the meaning of this memorandum.	**Change made** – Please see paragraphs 4 & 5 of the 7/3/08 revision.
RAA	3	Paragraph 3 describes aspects of the single regulatory system for POE reinsurers. This paragraph should clarify the extent of the authority of the Port of Entry supervisor under the revised regulatory framework. The RAA urges the Task Force to utilize the Port of Entry supervisor to perform administrative functions (i.e., to function as the entry point for non-U.S. reinsurers from approved jurisdictions and to serve as a liaison with the non-U.S. regulator).	**Change made** - Specific section added to clarify role of POE supervisor.
Interested Parties	3, 3d.	The Port of Entry supervisor should not seek to regulate the non-U.S. reinsurers from approved jurisdictions; as set forth below in our comments to Paragraph 5, the purpose of the mutual recognition process is to vet and approve jurisdictions; once that process is complete, approved jurisdictions should not be subject to additional regulation outside of their domicile, except to the extent agreed in supervisory arrangements. Paragraph 3(d): Paragraph 3 is intended to address other aspects of the single regulatory system for POE reinsurers. Paragraph 3(d) includes a requirement for National reinsurers. Because this is a paragraph about POE reinsurers, the minimum capital requirement of $250 million for National reinsurers should be moved elsewhere. The Task Force should consider including a section about National reinsurers generally making it clear what it is intended for National reinsurers vs. POE reinsurers.]	Role of the POE supervisor was clarified in paragraphs 13 and 14 of the 7/3/08 revision. **Change made** – capital requirement was moved to a separate paragraph under the Purpose and Structure section. National and POE reinsurers are discussed together in the paragraph 5 of the 7/3/08 revision.
Interested Parties	4a & 4b.	a. National Reinsurer - licensed in a **Home** state, having a physical presence in the U.S., available to both U.S. and Non-U.S. reinsurers.	**Change made** – this clarification was added to the definition of a National Reinsurer in the "Definition

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		b. Port of Entry Reinsurer - certified by a POE state, the reinsurer must be from an RSRD recommended non- U.S. jurisdiction, no physical presence in the U.S. is required. **Should a US company be able to be a POE reinsurer? e.g. US branch**	of Terms" section. **Change made** – clarification was made to the definition of a POE reinsurer in the "Definition of Terms" section that a POE reinsurer is not permitted to have a physical presence in the U.S.
RAA	4a. & 4b.	Paragraph 4 (a) and (b): The Summary needs to clarify what "conducting reinsurance business" means for each of the four listed categories – i.e., what are the duties and entitlements with each designation. As regards 4(a) State laws generally require that a company be licensed and subject to U.S. regulation to have a physical presence and conduct certain other activities within a State's borders. This should be clarified for US reinsurers because a single state license will be sufficient for regulating a national reinsurer with no license required in the other 49 states. Similarly, 4(b) states that for POE reinsurer, "no physical presence in the U.S. is required." Is it permitted? What can the POE reinsurer do in the U.S. (can they advertise, adjust claims, execute contracts, etc.)?	Your comment is appreciated. The 7/3/08 revision clarifies that a POE reinsurer is prohibited from having a physical U.S. presence. The Task Force will continue to consider the other issues.
RAA	4c.	Paragraph 4(c): "Limited Accredited Reinsurer" is undefined in the Summary and it is unclear what this term means.	**Change made** – "Limited Accredited Reinsurer" was deleted. The term was initially included as it is defined in some state statutes.
RAA	4d.	Paragraph 4(d) should be clarified to state: "Non-U.S. reinsurers could continue to provide creditable reinsurance to the U.S. market by being unlicensed and posting 100% collateral." This change is intended to address the same concern articulated in #3. Furthermore, it should be clarified that a U.S. reinsurer also has this option if it is domiciled in a non-qualifying State and chooses not to become licensed in all states.	**Change made** – language was clarified.
Interested Parties –	4a-d.	There needs to be clarification as to what "conducting reinsurance business" means	Your comment is appreciated. The 7/3/08

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
General Comments		for each of these categories. State laws generally require that a company be licensed and subject to US regulation in order to have a physical presence and do certain other activities within a State's borders. This will need to be clarified for US reinsurers because a single State would be sufficient for regulating a National Reinsurer and presumably a license would not be required in the other 49 States. This issue will also need to be clarified for the POE Reinsurer which states that no physical presence "is required" but is it permitted? Can the POE Reinsurer advertise, execute contracts, etc. within the US?	revision clarifies that a POE reinsurer is prohibited from having a physical U.S. presence. The Task Force will continue to consider the other issues.
		What is a "Limited Accredited Reinsurer"?	**Change made** – "Limited Accredited Reinsurer" was deleted. The term was initially included as it is defined in some state statutes.
		The fourth category states that non-US reinsurers could continue to access the US market through 100% collateral. Presumably a US reinsurer should have the same option if, for example, it is domiciled in a non-certified State and chooses not to become licensed in all States.	**Change made** – language was clarified to reflect that this is an option to US reinsurers.
Interested Parties – Primary Insurers	4a-d.	Having four methods of conducting reinsurance business in the US would make it difficult for a cedent to choose a proper reinsurer, to determine which method should be chosen and how the reinsurers should be monitored. It would require additional resources for the cedent to perform the monitoring function.	Your comment is appreciated, however the Task Force made no related changes.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
Interested Parties – Reinsurers	4a-d.	It would be beneficial to have a provision which reinforces the concept that merely being a POE reinsurer, a non-US reinsurer would not be subject to suit in the US, outside of enforcement of the reinsurance contract or for compliance with requirements of its POE status as properly raised by the POE supervisor. A provision reinforcing that a non-US POE reinsurer is not doing business in the US for tax purposes would be helpful. There appears to remain a great deal of confusion and misunderstanding about the way in which reinsurers can do business in Europe compared to the US. US p/c reinsurers can assume risk in the EU without providing collateral (cross border) and without being licensed. To the extent they wish to underwrite or have a physical presence in the EU, they must become licensed – similar to the requirements in the US. Therefore, there are less restrictions in the EU on cross border business and similar restrictions for establishment.	Your comment is appreciated, however the Task Force made no related changes. Your comment is appreciated, however the Task Force made no related changes.
Interested Parties	5	How many ratings are required – one or two?	**Change made** – paragraph 16 of the 7/3/08 revision clarifies that failure to obtain or maintain at least two ratings will result in an assignment of a Vulnerable-5 rating.
Interested Parties – Primary Insurers	5	The matrix is too liberal and would fail to safeguard the solvency of the US insurance industry. A-rated reinsurers tend to be perched on a cliff. There should be 100% collateral for A-rated reinsurers. It would not be unreasonable to consider reducing the requirement for Class I companies (Best A++) and perhaps Class 2 companies (Best A+ rated).	Your comment is appreciated, however the Task Force made no related changes.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		There should be an express provision that permits insurers and reinsurers to enter into bilateral collateral agreements notwithstanding the revised credit for reinsurance rules.	The Task Force believes this is implied, however changes may be considered for clarification.
		The recent sub prime mortgage crisis indicates the inherent dangers in placing any confidence on credit agencies to protect the US industry's solvency.	Your comment is appreciated, however the Task Force made no related changes.
		The rating and collateral designations conflict with the past representations that the total amount of collateral would stay approximately the same but would just be rearranged more rationally among all reinsurers.	Your comment is appreciated, however the Task Force made no related changes.
		There are no studies, calculations or other background information provided to support changing the collateral designations so severely from past proposals.	Your comment is appreciated. The Task Force notes that a report will be shared concerning the estimated collateral impact of the proposed changes.
		The domiciliary state regulator of the US ceding insurer should retain ultimate authority on any collateral determination as it is his/her responsibility to protect solvency.	Your comment is appreciated, however the Task Force made no related changes.
		All risks from the proposal fall on US cedents. The proposal needs to include a guaranty fund mechanism or some sort of joint and several liability to adequately protect US cedents.	Your comment is appreciated, however the Task Force made no related changes.
		Lowering or eliminating collateral for unlicensed reinsurers that have no assets	Your comment is appreciated, however the

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		in the US will make enforcement and execution on a judgment exceedingly difficult, time consuming, and costly.	Task Force made no related changes.
		Eliminating or severely reducing collateral amounts will place further pressures on receiverships and on state guaranty funds.	Your comment is appreciated, however the Task Force made no related changes.
		No change is needed to the current collateral system because it works well in protecting payment of reinsurance recoverables, securing solvency and offering foreign reinsurers a choice – to either obtain a license or post collateral.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – Reinsurers	5	The rating and collateral designations are an improvement over past proposals.	Thank you for your comment.
		The requirement that reinsurers list all disputed and overdue recoverables and update this on a quarterly basis is overly burdensome.	Your comment is appreciated, however the Task Force made no related changes.
		Subsection (c) states that compliance with reinsurance contractual terms and obligations should be a factor in considering a reinsurer's rating. Does this mean that if a cedent sues a reinsurer for breach of contract one time too many, there should be a rating downgrade?	Your comment is appreciated. The Task Force notes that such determination will depend upon the judgement of the applicable supervisor.
		The basis for collateral reduction should be through mutual recognition agreements and a certification approach (some refer to this as unilateral recognition) whereby the regulatory jurisdictions choose to recognize and defer to the other on the basis of substantial regulatory equivalency. Recognition should result in trust among regulatory jurisdictions, which would result in an elimination of collateral	Your comment is appreciated, however the Task Force made no related changes. Issues related to mutual recognition are currently being reviewed and addressed by the NAIC Legal Division.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		requirements for reinsurers domiciled in those jurisdictions. Given this approach, there would be no need for a rating mechanism as set forth in Paragraph 5, it would result in the elimination of many of the items set forth in Paragraph 6, there would be no US reinsurer collateral issues in Paragraph 7 (as presumably this would be a matter of license, not collateral, upon which US regulators would act), nor would there be any requirement of "springing collateral" in the event of downgrades as set forth in Paragraphs 8 and 9.	
		Other jurisdictions operate efficiently and well without the protection of collateral that US cedents have become accustomed to. Each insurance and reinsurance entity should bear the credit and other risks which are the consequences of their doing business. These entities are, after all, in the business of identifying and assessing risk.	Your comment is appreciated, however the Task Force made no related changes.
RAA	5	Each supervisory authority should also demonstrate that it: (1) maintains sufficient resources and qualified personnel to implement effectively these standards and requirements; (2) will commit to an exchange of all relevant information necessary for ongoing assessment of the above-listed standards and requirements during the period of recognition; and (3) will provide reciprocal regulatory treatment to licensees of the other jurisdiction.	This is discussed in applicable sections throughout the document.
		Thus, once a jurisdiction is vetted and approved pursuant to this process, i.e., where a U.S. reinsurer is licensed and domiciled in a Home state, or a Port of Entry reinsurer is licensed and domiciled in a recommended jurisdiction, additional requirements to provide creditable reinsurance in the U.S. would be unnecessary (unless, for example, the regulatory authorities have negotiated in their recognition arrangement that there should be	Your comment is appreciated, however the Task Force made no related changes.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		some collateral requirement). This approach gives the appropriate value to being licensed by an approved jurisdiction and reflects true recognition of another supervisory authority. Additionally, the proposal imposes collateral requirements on U.S. reinsurers that are subject to "robust regulation" of the Home state while their competitors domiciled in states that may not meet RSRD standards need not post collateral and therefore may enjoy a competitive advantage. Accordingly, the structure set forth in Paragraph 5 is unnecessary and may discourage use of the modernized approach to reinsurance regulation.	
Interested Parties	6a.	Who provides the list? Presumably the reinsurer but this is not clear. What are they, as of when? If the non-US jurisdiction does not require reporting of these, is it a reason for non-recognition? Inwards reinsurance, outward reinsurance or both? In the case of inwards reinsurance, this is not something that Lloyd's has ever been asked to submit despite 74 licenses around the world and filing 450 returns. No materiality standard on what constitutes a dispute.	**Change made** – language clarifies that reinsurer provides this information, and that it pertains to reinsurance assumed from U.S. domestic ceding insurers.
Interested Parties	6b.	How does one determine the reinsurer's reputation? According to whom? Are these judgments with respect to the reinsurer as a legal entity or with respect to its affiliates as well? Who determines what is a "valid" claim?	The Task Force notes that evaluation of these factors will be based upon the judgement of the applicable home or POE supervisor.
Interested Parties	6c.	How is compliance determined?	The Task Force notes that evaluation of these factors will be based upon the judgement of the applicable home or POE supervisor.
Interested Parties	6d.	Given the status of The Hague Convention, perhaps a signatory and any exceptions should be the determining factor.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties	6e.	What is meant by this? Reinsurance transactions are business to business.	**Change made** – language was changed to clarify that

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			the intent was for the business practices of the reinsurer in dealing with its ceding insurers to be considered. (paragraph 20.d. of the 7/3/08 revision)
Interested Parties	6f.	What period of time does this Schedule F have to cover? Rather than an entire Sch. F, Lloyd's suggests requesting 1) information about the retrocessional program of the reinsurer including reports about the potential for uncollectible retrocessional protection; 2) information that will help document the reinsurance utilization reports received from domestic insurers; and (3) information about the claims payment disputes record with U.S. ceding insurers.	**Change made** – language clarifies that the Sch. F data is required annually. Thank you for your additional comments, however the Task Force made no other related changes.
Interested Parties – Reinsurers	6i.	There should be greater flexibility in accepting financial statements from reinsurers located in multiple jurisdictions around the world. Until the IASB completes its insurance accounting project, it is likely that multiple insurance accounting rules will continue to apply in the world's most important reinsurance regulatory jurisdictions. Recently, European and US securities regulators entered into a mutual recognition agreement accepting financial statements filed under each other's accounting regulations. Insurance regulators should accept existing US GAAP and IFRS.	Your comments are appreciated, however the Task Force made no related changes at this time. This will be given further consideration during the implementation phase.
Interested Parties	6j.	This does not have anything to do with the rating of the reinsurer. It should effect whether the jurisdiction is recognized or not.	**Change made** – moved from rating section to section on role of the POE supervisor.
RAA	6	Paragraph 6 is similarly unnecessary; however, some of these factors could be considered during the evaluation process of the supervisory jurisdictions. Moreover, consideration of these factors in determining the appropriate rating appears to be very vague and subjective. It is also unclear what	Your comment is appreciated. Evaluation related information was moved to applicable sections, rating related information retained.

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		weight will be given to each of these factors – i.e., can these factors positively influence a rating or only negatively influence a rating? Is there an appeal process if a reinsurer does not like its assigned rating?	
		A. How will a regulator evaluate a reinsurer's reputation for prompt payment of valid claims under Paragraph 6(b) or compliance with reinsurance contractual terms under 6(c)? What information will be utilized and who will provide this information? Requiring a list of all disputed and overdue recoverables to be updated on a quarterly basis is overly burdensome.	Your comment is appreciated. This will be addressed during the implementation phase of the proposal and during development of the Purposes & Procedures Manual.
		B. What constitute "market conduct outcomes" for a reinsurer in Paragraph 6(e)? (We would note that reinsurance agreements are transactions between sophisticated entities not subject to market conduct regulation in the U.S.) What information will be utilized to evaluate this factor?	**Change made** – language was changed to clarify that the intent was for consideration to be given to the business practices of the reinsurer in dealing with its ceding insurers. (20d.) The Purposes & Procedures Manual will outline best practices, but the determination will ultimately be up to the POE supervisor.
		C. Paragraph 6(f) requires the filing of Schedule F information; however licensed companies already file this information as part of their Annual Statement. Requiring licensed companies to submit this information again is burdensome and unnecessary.	Your comment is appreciated. The Task Force notes that duplicate filing would not be required.
		D. Information sharing and confidentiality agreements in Paragraph 6(j) are more appropriately considered during the evaluation of the non-U.S. regulatory authority.	**Change made** – moved from rating section to section on role of the POE supervisor.
FSA	6j.	We note the requirement for a Memorandum of Understanding. As you may be aware, we are currently negotiating these with a number of US states, and are prepared to do so with any Port of Entry state, subject to confidentiality obligations under UK and EU law.	Thank you for your comment.

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RAA	7	Paragraph 7's use of the terms "U.S. licensed reinsurer" and "National reinsurer" is confusing and should be revised. Specifically, in the first sentence the term "U.S. licensed reinsurer" should be replaced by "National reinsurer" to make clear that the elimination of collateral for those rated in Secure 3 tier and above applies only to National reinsurers and not to those reinsurers who are not part of the newly revised reinsurance regulatory structure (i.e., those described in Paragraph 4(c) and 4(d)). While the RAA very much appreciates the NAIC's acknowledgment of the value of a U.S. license, the more appropriate way to address this regulatory concern (i.e., potential inability to pay claims) may be through licensing. If a regulatory authority believes that a reinsurer may have difficulty in the future paying claim, the appropriate course may be to restrict its ability to write new business rather than impose collateral requirements.	**Change made** – language has been clarified. (paragraph 19 of 7/3/08 revision)
FSA	7	The intention of this paragraph is not clear in a number of respects. The paragraph appears to maintain to some extent the geographic discrimination which is a feature of the current regime, and which we had understood to be part of the Task Force's objectives to remove. It is surely fair for US-domiciled reinsurers to be subject to the same requirements as POE and National Reinsurers, particularly when they are judged to be in the 'vulnerable category".	Your comment is appreciated, however the Task Force made no related changes.
RAA	8	Paragraph 8 requires the inclusion of a credit for reinsurance clause that requires a reinsurer to provide the necessary amount of collateral to enable the cedent to take "full statutory accounting credit." For the reasons set forth in our comments to Paragraph 5, there should not be any obligation to post collateral for a U.S. reinsurer that is licensed and domiciled in a Home state, or a Port of Entry reinsurer that is licensed and domiciled in a recommended jurisdiction. Further, the RAA objects to statutorily mandated "downgrade" clauses in reinsurance agreements as a matter best left to the parties to negotiate. Mandating inclusion of such a clause does not encourage the proper type of risk management where parties appropriately identify and capitalize risk.	Your comment is appreciated, however the Task Force made no related changes.

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		Notwithstanding the above, current credit for reinsurance laws recognize situations where the cedent may take credit only for the amount of collateral provided (i.e., less than 100%). We suggest that at a minimum this provision be modified to allow this to continue. Furthermore, the term "Obligations" also needs to be defined as it is unclear what is included (i.e., is IBNR included?) Cedents and reinsurers sometimes disagree on the valuation of liabilities. Who decides what the Reinsurer's share of Obligations is? Because of these concerns, IBNR collateral clearly should not be required.	Collateral requirements would be a percentage of gross liabilities, including unearned premium and IBNR reserves.
RAA	9	For the reasons stated above in our comments to the previous Paragraph, Paragraph 9 is not necessary. Notwithstanding the above, the second sentence of Paragraph 9 is unclear. We would suggest that the second sentence be modified to state "The POE or Home State supervisor may suspend **the license or** certification of a reinsurer if it does not meet the requirements in paragraph 8 of this proposal."	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – Primary Insurers	8/9	There is too much reliance on the rating agencies. There may be a time lag between downgrade and securing increased collateral which, of course, would penalize the ceding insurer. The proposal places great burdens on ceding insurers in terms of monitoring their reinsurers in areas of rating downgrades, slow-pay and requesting increased collateral along with the time lag in receiving increased collateral. The burden needs to be borne by the Home State, the Host State and the reinsurer. Host States need to have more supervisory authority over foreign reinsurers to protect the solvency of their ceding insurers, specifically in the area of financial analysis and solvency review.	Thank you for your comments. The Task Force added clarification of the Host state supervisor's role/authority. No other related changes were made.

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		With respect to the cat recovery deferral, it is unnecessary and problematic and would risk US insurer solvency at a time when collateral and prompt payment of recoverables is most needed. The proposed clause will not help protect US ceding insurers. There is no real enforcement mechanism a POE state can use against an unlicensed reinsurer that has no assets in the US if the reinsurer simply refuses to post additional collateral.	
Interested Parties – Reinsurers	8/9	Current credit for reinsurance laws recognize situations where the cedent may take only the amount of credit as collateral provided (less than 100% credit). This provision appears to eliminate those situations. Why? This mandatory provision runs contrary to the concept of mutual recognition. The purpose behind mutual recognition is to place trust in other regulatory authorities. Requiring 100% collateral runs afoul of that concept and prevents domiciliary regulatory authorities from being able to address the financial problems of those over whom they have primary supervision. Many reinsurers have refused to accept these “springing collateral” clauses in their negotiation with ceding insurers. The presence of such clauses can result in the acceleration of financial difficulties for a company and runs counter to modern, sophisticated regulatory fundamentals. As a matter of reality, the widespread use of such clauses throughout the US and abroad could result in an unnecessary insolvency of the reinsurer – a result which was avoidable and benefits no one.	Your comment is appreciated, however the Task Force made no related changes at this time. Your comment is appreciated, however the Task Force made no related changes. Your comment is appreciated, however the Task Force made no related changes.

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		The suggestion that a downgrade should result in a reinsurer increasing the amount of collateral it provides is contrary to the industry and regulatory movement toward enterprise risk management. In this more sophisticated risk environment, cedents take responsibility for their own credit and other risks. Similar to the asset side, when a cedent has a bond that is downgraded, the cedent increases its capital to cover that bond or takes a hit to its surplus. Reinsurance should not be treated any differently. Collateral should not be a substitute for a counter party's diligent risk analysis.	Your comment is appreciated, however the Task Force made no related changes.
		This suggested clause is too broad and uses the provision of collateral as the cure for all problems. For example, it appears to imply that a contract with insufficient risk transfer may require the reinsurer to post full collateral. This is probably not intended, nor does it resolve the risk transfer issue. The paragraph also states that "…to avoid the imposition of the …penalty…in a manner, form and amount acceptable to all applicable insurance regulatory authorities." This requirement is much too broad.	Your comment is appreciated, however the Task Force made no related changes.
		With respect to the delay in cat recoverables provided for in Paragraph 10, the meaning of "catastrophe" should be defined. Some believe the delay should be extended from one to two years given the time it takes such claims to be ripe for payment. Some believe that this delay should be limited to reinsurers rated A- or above. There should also be considered an exception to the delay for cats of a certain magnitude (to account for major second or third events in the same year).	Your comment is appreciated, however the Task Force made no related changes.

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Lloyd's	11	This would provide a disincentive for a strong reinsurer to provide reinsurance support for potentially weak ceding insurer and could aggravate an already troubled situation. A reinsurer rated AAA by S & P would go from zero funding to 100% and would suffer the greatest collateral hit but a reinsurer rated BB+ by S & P would not encounter any increase in funding because it would already be funding at 100%.	Your comment is appreciated, however the Task Force made no related changes.
RAA	11	Paragraph 11 requires all reinsurers to post 100% collateral upon the entry of an order of rehabilitation, liquidation or conservation against the cedent. To the extent that this requires a reinsurer to post collateral for IBNR, the RAA strongly opposes this provision based upon valuation and claims acceleration concerns. In addition, the provision may unfairly penalize a reinsurer for the insolvency of its cedent by forcing the posting of 100% collateral when such posting may not be contractually mandated. In cedent insolvencies, reinsurers are already faced with a torrent of claims. Adding collateral requirements on top of the increased claim payment activity places undue financial burden upon reinsurers.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – Primary Insurers	12	A staggered approach, first addressing affiliated transactions, would be preferable, and one for which there would be uniform support.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – Reinsurers	12	The Interested Persons have, on numerous occasions, presented detailed reasons why affiliated transactions should be treated differently than unaffiliated transactions. Based on that rationale, reinsurers support the elimination of collateral for affiliated transactions where the transactions are between a parent and an affiliate that the applicable rating agencies have designated a core affiliate. In those cases, collateral could be required on a transaction by transaction	Your comment is appreciated, however the Task Force made no related changes.

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		basis, if necessary, under the holding company reviews, but in no event, would the transaction be collateralized to any greater degree than it would be had the transaction been undertaken between unaffiliated entities. Although the Framework is intended to apply on a prospective basis, transactions between affiliates should, be retroactive if the Home State approves such application pursuant to the holding company laws. (See comments re Paragraph 22 for further reaction to the effective date.)	Your comment is appreciated, however the Task Force made no related changes.
RAA	12	Paragraph 12 places affiliated transactions on the same footing as other reinsurance transactions. As we have stated before, affiliate transactions are subject to direct regulatory review under state holding company laws. This review subjects them not only to the typical risk transfer and other requirements imposed on unaffiliated reinsurance transactions but also provides a higher standard of regulatory scrutiny by requiring the transaction be fair and reasonable and to result in surplus that is reasonable to liabilities. The holding company laws also require submission of information about the entire holding company system and the controlling entity. Moreover, the non-U.S. affiliated entity has demonstrated a significant capital to the U.S. Finally, all material affiliate reinsurance contracts must be submitted to the U.S. licensee's domestic regulator for prior approval, which approval can be subject to regulatory conditions including the establishment of security sufficient to satisfy any regulatory concerns. Because these transactions are already vetted through processes imposed under existing holding company act laws, no additional collateral requirements are necessary. In the alternative, the Task Force should consider no collateral requirements where the subsidiary has been designated by the rating agencies as a core subsidiary.	Your comment is appreciated, however the Task Force made no related changes.

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Interested Parties	15	When is it so deemed and by whom? How will cedents be apprised of this? When does the 3 months begin?	Your comment is appreciated. The Task Force notes that this is to be determined by the applicable supervisor.
RAA	13-15	Paragraphs 13 – 15 raise a fundamental problem with the rating system – the realities of the impact of such a system on cedents. Collateral is intended to be a substitute for licensing. A reinsurer's rating may change over time and, under the system proposed in the Summary, would require cedents to monitor and make modifications to their collateral. A drop in a reinsurer's rating from A- to B++ requires the imposition of 55% more collateral on the reinsurer. The reinsurer may have difficulty, or not be able to post, this collateral; if that is the case, this is a licensing issue, not a collateral issue. Moreover, the current credit crisis has demonstrated again the problems with relying on rating agencies' ratings. Not only did the rating agencies fail to predict situations like Enron and Parmalat but more recently they failed to predict the downgrades of several monoline insurers in at least once instance, the downgrade occurred after a recent upgrade). In a supervisory recognition situation as outlined above, this would not be an issue because the safeguards built into the recognition process would provide the certainty to regulators that the domiciliary jurisdictions are taking necessary and appropriate action against such entities. A provision such as this defeats that purpose and interferes with the domiciliary regulator's ability to appropriately deal with the company (similarly, requiring such a topping up of collateral in another jurisdiction of a U.S. company would interfere with the U.S. regulator's ability to address a U.S. reinsurer's issues.) Supervisory recognition is based upon evaluation and reliance upon the other jurisdiction's regulation.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – General Comments	16	Why would this procedure not apply to disputes between a Home State and other States?	**Change made** – language clarified to reflect that procedure applies to both home/national and POE scenarios.

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RAA	16	Paragraph 16 is currently limited to POE reinsurers. This paragraph should also apply to National reinsurers.	**Change made** – language clarified to reflect that procedure applies to both home/national and POE scenarios.
FSA	16	We note that the intention of the POE supervisor's judgement will be binding in respect of its determination of collateral requirements, but during the San Francisco meeting, it was stated that the supervisor of the ceding insurer will have overall discretion in respect of the decision to give credit for reinsurance. Whilst we understand that the cedent's supervisor will wish to take account of matters other than the levels of collateral posted, we feel that it would be useful for a protocol to be developed under which any dispute as to the standing of a reinsurer would not result in credit for reinsurance being disallowed solely on the grounds of the levels of collateral posted.	Your comment is appreciated. Please refer to paragraphs 3, 10.a., 12.e., & 13.f. of the 7/3/08 revision for clarification on authority regarding these decisions.
Interested Parties – Primary Insurers	17-17c.	There is disagreement with the third bullet point under *Reinsurers* below, in that primary insurers have expressed the view that even with a recognition approach, there would be situations of non-paying reinsurers or low-rated reinsurers that should still provide collateral even though domiciled in a jurisdiction that has been recognized as being equivalent. There is a great deal of pressure in the EU to meet the stringent capital requirements of Solvency II. Accordingly, the envelope is being pushed to use solvent schemes and Part VII transfers to cull out discontinued books and assign obligations to lower-rated, less well-capitalized companies. This has the effect of increasing the credit risk to US cedents and negating original contract commitments. US regulators should share this concern and discuss this with HM Treasury.	Your comment is appreciated. Your comment is appreciated.

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		The concept of reciprocity is missing.	Your comment is appreciated, however the Task Force made no related changes.
		The current US collateral system is more open than insurance markets in other countries. A majority of US reinsurance under the collateral system is assumed by foreign reinsurers. In contrast, the EU and other foreign countries require that US insurers become licensed in the EU to take advantage of such options as passporting.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – Reinsurers	17-17c.	To the extent that the RSRD recommends to the Federal government standards for eligibility and which jurisdictions qualify, this provision is Constitutional and appropriate. To the extent that it intends that the RSRD or any individual State or combination of States, be the entitie(s) entering into a mutual recognition agreement, it is inappropriate and unworkable.	Your comment is appreciated, however the Task Force made no related changes. Issues related to mutual recognition and regulatory authority of the RSRD are currently being reviewed and addressed by the NAIC Legal Division.
		Unilateral recognition, by definition, is not an "agreement." To the extent that unilateral recognition is utilized, the RSRD should develop standards for unilateral certification. CEIOPS is currently developing a process for standards for unilateral equivalence under the EU Reinsurance Directive. It would be helpful for the NAIC/RSRD to look at that work in developing its own standards for unilateral certification.	Your comment is appreciated, however the Task Force made no related changes. Issues related to mutual recognition and regulatory authority of the RSRD are currently being reviewed and addressed by the NAIC Legal Division.
		To the extent that recognition is utilized, it should result in the elimination of collateral requirements entirely. This should be clarified in the Framework.	Your comment is appreciated, however the Task Force made no related changes.

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		Mutual recognition should require reciprocity and any certification process should also require reciprocal legal benefits to reinsurers domiciled in the two jurisdictions.	Your comment is appreciated, however the Task Force made no related changes. Issues related to mutual recognition are currently being reviewed and addressed by the NAIC Legal Division.
RAA	17-17e.	Paragraph 17 addresses the functions of the RSRD. There are many important functions that the RSRD can perform, including development of standards and making recommendations, which must then be accepted by the regulator. It is critical to remember that the RSRD is not a governmental body and it cannot perform governmental functions or make governmental decisions. For example, the RSRD can perform the assessment of the jurisdiction and make a recommendation to the regulator that the jurisdiction meets the appropriate standards; the regulator must then accept (or reject) this recommendation for it to have any binding effect on other jurisdictions. The regulatory recognition should then either be embodied in an agreement wherein each supervisory authority identifies those areas where the host jurisdiction will defer to and rely upon the exclusive exercise of the home jurisdiction's supervision, or it may be effected through other lawfully prescribed methods (e.g., regulatory certification, authorization) that provide reciprocal legal benefits for the licensees of each jurisdiction. It is critical that this regulatory recognition be accomplished in a lawful manner (either at the federal level or by an appropriate designation from the federal government to the state(s))i. Paragraph 17(a) should be amended to make it clear that since the RSRD is a non-governmental entity, it will be a repository for non-privileged information. ii. Paragraph 17(b) should make clear that the RSRD can only conduct the evaluation and make a recommendation to the appropriate regulatory authority; it cannot make the	Your comments are appreciated. Issues related to mutual recognition and regulatory authority of the RSRD are currently being reviewed and addressed by the NAIC Legal Division.

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		decision or enter into any supervisory agreements. The Summary (like the IAIS Mutual Recognition paper) references but does not define unilateral recognition. See comment (iii) below. The Summary (again, like the IAIS Mutual Recognition paper) also does not – but must – identify the standard pursuant to which the RSRD will make its recommendation (i.e., it must determine that the other regulatory jurisdiction maintains substantially equivalent regulatory standards and enforcement capabilities to the U.S.). iii. Paragraph 17(b) refers to unilateral or mutual recognition, and paragraph 17(c) states that the RSRD will develop a standard form of unilateral or mutual recognition agreement. First, consideration should be given to the likely need for flexibility in developing agreements with different but substantially equivalent regulatory jurisdictions. Second, and as noted above, a key component of the December 2, 2007 Framework Memorandum is mutual recognition. The IAIS Guidance Paper on Mutual Recognition and the Summary refer to, but do not define, "unilateral recognition," though the subcommittee has indicated that they intend to define the term before the paper is finalized. Nonetheless, we do not yet know what the definition will be. Further, the term does not seem to have a concrete definition in international law. Within the NAIC framework, this term should be defined to ensure that there is a common understanding as to its meaning. It has been suggested that the RTF's use of the term in the context of the Summary may refer to a certification process whereby two jurisdictions have an exchange of, and thorough evaluation of, all relevant information regarding the form and nature of regulation in each jurisdiction and conclude that each system maintains and applies substantially equivalent legal standards and regulatory requirements. This certification process does not involve a written agreement because the certifications or recognitions are done independently. The RAA believes it is critical that any recognition between the U.S. and another regulatory jurisdiction, regardless of its form, provide for reciprocal legal benefits for the licensees of each jurisdiction.	

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		Depending on the definition ultimately decided on by the IAIS, the Task Force might want to consider a different term to reflect the reciprocal nature of the recognition. This could be referred to as a "reciprocal certification process," "parallel recognition" or something similar to more accurately describe the contemplated recognition process. iv. Paragraph 17(d) needs to clearly reflect the appropriate role for a nongovernmental body like the RSRD in accordance with the comments stated herein. Specifically, the RSRD can maintain, revise and update collateral reduction eligibility criteria subject to the approval of the governmental regulator. v. Paragraph 17(e) needs to address who will approve the RSRD standards or criteria that will be utilized in the evaluation process.	
IUA	19	The proposal provides (para. 19) that the Framework "will be available to companies that only write reinsurance." We do not understand that rationale for this provision. Many reinsurers write some insurance as well. We can understand that regulators may want to restrict the Framework's "one state approval" process to reinsurance, but you can achieve this by amending paragraph 19 to read that the Framework only applies to reinsurers that "only write reinsurance or to the reinsurance operations of reinsurers that also write insurance."	**Change made** – criteria changed to companies that "primarily" write reinsurance, limitation of no more than 5% of gross written premium coming from other than assumed reinsurance.
Interested Parties – Primary Insurers	19	The Framework should be available to all reinsurers (including primary insurers that assume some reinsurance risk).	**Change made** – criteria changed to companies that "primarily" write reinsurance, limitation of no more than 5% of gross written premium coming from other than assumed reinsurance.
Interested Parties – Reinsurers	19	As a practical matter, the Framework can only be applied to pure reinsurers. Reinsurance should be defined in a way to permit minimal amounts of high level	**Change made** – criteria changed to companies that "primarily" write reinsurance, limitation of no more than

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		excess business.	5% of gross written premium coming from other than assumed reinsurance.
		This paragraph would seem to indicate that even the single State regulator would apply only prospectively. This seems unworkable. Suggest that only the reduced collateral provisions apply prospectively.	Your comment is appreciated, however the Task Force made no related changes.
		This definition should only apply to unaffiliated business to avoid application to pooling structures and other affiliated transactions.	Your comment is appreciated, however the Task Force made no related changes.
RAA	19	Paragraph 19 states that the reinsurance regulatory modernization framework will be available to companies that write only reinsurance business. First, it should be made clear that this refers to the legal entity (not the group). Second, the RAA agrees with this conceptually and is mindful of the difficulties of making this regulatory framework available to companies that write both types of business. We would note however, that there are certain lines of business written by professional reinsurers (such as high level excess business) that should not, if written in nominal amounts, present any regulatory issues. Appropriate exceptions to the Paragraph 19 rule or a de minimis standard should be considered.	**Change made** – criteria changed to companies that “primarily” write reinsurance, limitation of no more than 5% of gross written premium coming from other than assumed reinsurance.
FSA	19	We note the intention to restrict all of the reinsurance supervision modernisation proposals to entities which transact only reinsurance business. We see no reason for such a restriction in the case of POE reinsurers. If a POE supervisor makes a decision in respect of the acceptability of a certain vehicle for credit for reinsurance purposes, we cannot see how this acceptability would be altered in any way	**Change made** – criteria changed to companies that “primarily” write reinsurance, limitation of no more than 5% of gross written premium coming from other than assumed reinsurance.

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		by direct insurance activities of the reinsurer.	
Interested Parties – Primary Insurers	20	There is no current authority to require diversity of reinsurance risk. For the great majority of US direct writers (in terms of number of entities), there is no practical cost-effective way of gaining diversification.	Your comment is appreciated, however the Task Force made no related changes. Please see paragraphs 15.f. & 15.g. of the 7/3/08 revision for related information.
Interested Parties – Reinsurers	20	Diversification effects apply in a number of ways. For example, large, multinational reinsurers diversify their risks throughout the world, thus creating greater security for primary ceding insurers. These paragraphs fail to recognize these fundamental diversification concepts. Additionally, reinsurers receive no recognition of the positive diversification effects (i.e., group ratings are not accepted, even if the affiliate is a core subsidiary of the group), while on the other hand, the negative effects of diversification (i.e., too much aggregation of risk) is recognized. A modernized system of regulation must recognize all effects, positive and negative, of diversification.	Your comment is appreciated, however the regulators made no related changes. Please see paragraphs 15.f. & 15.g. of the 7/3/08 draft for related information.
RAA	20	Paragraph 20 states that reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements. We would urge the Task Force to utilize a group rating where a rating agency has either enhanced the rating of a subsidiary, or has assigned the parent's rating to the subsidiary. If regulators are going to rely upon ratings and the rating agency has determined that a legal entity is considered a core subsidiary, that decision should be respected. This paragraph also does not address how individual Lloyd's syndicates will be treated (i.e., will Lloyds' as a group receive a rating?	Your comment is appreciated, however the Task Force made no related changes… Please see paragraphs 4 & 5 of 7/3/08 revision.

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		Will the support of the Central Fund be taken into consideration?). This needs to be specifically addressed.	
FSA	20	We note that the current proposal is to apply RSRD ratings on a legal entity basis, but wonder whether there might be scope to apply these on a group basis, especially in cases where groups benefit from a single rating agency rating and other intra-group arrangements which mean that the level of security provided is the same.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties	21	21. The domiciliary state supervisor retains the authority to require diversification of unaffiliated reinsurance risk for ceding insurers as well as the adequacy of risk transfer in a given reinsurance transaction. States (if this limited to the Home or POE supervisor? If cedent fails to do so or does so on an untimely basis, what are the consequences?) may require the ceding insurer to notify their supervisor within 30 days after a recoverable from a single reinsurer exceeds 50% of the ceding insurers policyholder surplus and notify their supervisor within 30 days after ceding to any single reinsurer more than ~~20~~50% of the ceding insurer's gross written premium or if it is likely to exceed this limit. The diversification requirement should not apply to affiliated reinsurance. Changing 20 to 50% tracks the material transactions model.	Your comment is appreciated, however the Task Force made no related changes.
RAA	21	Paragraph 21 provides that the "domiciliary state supervisor" retains the authority to require diversification of reinsurance risk for ceding insurers. First, a domiciliary state supervisor should not be permitted to apply diversification requirements in a manner that discriminates against a reinsurer based on its status as a National reinsurer or a POE reinsurer. Second, the RAA suggests modifying this sentence to require	Your comment is appreciated, however the Task Force made no related changes.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		diversification only for unaffiliated reinsurance risk for ceding insurers. Intra-group (retro)cessions can exceed 50% of the cedent's policyholder surplus; because these transactions are already subject to notification and review under holding company act laws, these transactions should be exempt from this requirement. Third, the notice requirement if the cession to a single reinsurer exceeds 20% of the ceding insurer's gross written premium is too low and should be changed to, at a minimum, 50%. The appropriate degree of diversification in a ceding company's reinsurance program depends on many variables that must be considered by that company's management. Setting a low fixed percentage by rule may encourage imprudent decision-making.	
Interested Parties – Reinsurers	22	Primary insurers seek to be able to market and underwrite their contracts on a nationwide basis. Reinsurers seek a similar result. This is not possible when the various States impose differing contract requirements. Even if extraterritoriality of the laws is eliminated (there is no mention of this in the Framework), a reinsurer will have to comply with the individual contract requirements of every State in which they assume business from a ceding insurer. Previously documents of the Task Force indicated that uniform contract requirements were being contemplated. This paragraph seems to indicate that this concept is no longer being considered. One way to address the lack of uniformity with respect to reinsurance contracts is to eliminate all reinsurance contract requirements in favor of specific legislative mandates. Instead of requiring, for example, that a reinsurance contract contain an insolvency clause, State statutes could simply state that there shall be no diminution upon insolvency, that recoverables shall be payable to the	Your comment is appreciated. The Task Force notes that the proposal is not intended to eliminate uniform contracts. Your comment is appreciated.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		receiver and provide the same protections for reinsurers as are currently contained in the insolvency clauses. This approach could be taken with respect to the commonly required contract clauses (required for credit for reinsurance purposes). This approach would eliminate the issue as to whose State (cedent's or reinsurer's) controls the issue of reinsurance credit, at least with respect to contract requirements. It would reflect a compromise between the competing interests of ceding insurers and reinsurers in this regard.	
Interested Parties	22b.	b. Credit consistent with state law for intercompany pooling arrangements or mandatory reinsurance arrangements unless not allowed by the cedent's domiciliary regulator; and Need to better define these. Will this reduce uniformity where a state decides it wants separate security for a line of business (e.g. workers' comp) from all reinsurers or a certain class of reinsurers?	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties	22c.	c. Transactions entered into before [effective date], to the extent that they qualify for full credit under the standards in effect on that date. This assumes that under existing law full credit is given which is not the case.	Your comment is appreciated, however the Task Force made no related changes.
Interested Parties – Primary Insurers	22c.	It is unclear what is meant by the language that the proposal is retroactive "to the extent that the [reinsurance transactions] qualify for full credit under the standards in effect on that date." This qualifying language continues to remain in the proposal, and corresponding summaries of same, despite several requests from industry groups that it be stricken, revised or clarified. Paragraph 20 clearly seems to indicate the intent to apply the proposal on a prospective basis, thus it may simply be a drafting issue that has not yet been addressed.	**Change made** – proposal applies on a prospective basis only.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
		Some primary insurers believe that the language should simply state that there is no retroactive effect. A staggered approach, first addressing affiliated transactions, would be preferable, and one for which there would be uniform support. Although the Framework is intended to apply on a prospective basis, transactions between affiliates should, be retroactive if the Home State approves such application pursuant to the holding company laws.	
Interested Parties	23b.	b. Information comparable to relevant provisions of the quarterly NAIC financial statement modified as deemed appropriate by the POE supervisor for use by insurance markets; Too nebulous	Your comment is appreciated, however the Task Force made no related changes.
RAA	22-23	The opening sentence of Paragraph 22 is confusing and should be rewritten. Paragraph 22 states that no change is intended to existing regulatory requirements with respect to qualifying reinsurance contracts (insolvency clause, transfer of risk, agent for service of process, choice of U.S. law and court). Reinsurers seek to market and underwrite their contracts on a nationwide basis. This is not possible when various states impose different contract requirements. Even if extraterritoriality of laws is eliminated (and there is no mention of this in the Summary), a reinsurer will still have to comply with individual contract requirements in each state in which they assume business from a cedent. Although prior Task Force documents indicated a desire for uniform contract requirements, this paragraph calls that into question. 22. Paragraphs 22 and 23 utilize the word "certified". The defined terms should be used throughout these paragraphs to make it clear what types of entities are being discussed.	Your comment is appreciated. The Task Force notes that the proposal is not intended to eliminate uniform contracts.

Name	Paragraph/ Section of 5/16/08 memo	Comment	Resolution
RAA	24	Paragraph 24 states POE reinsurers "will submit an application fee to the POE supervisor to defray costs of supervision." This statement should be modified to "defray costs of administration" to reflect the fact that the POE supervisor is not conducting an additional layer of regulatory review.	Your comment is appreciated. Please note that the POE supervisor's role and responsibility is outlined in POE supervisor section.
RAA	25	Paragraph 25 states that the NAIC is preparing a legal opinion on the constitutional issues discussed in the DLA Piper/Swiss Re memorandum on mutual recognition agreements. The RAA would like to also review the NAIC's legal opinion and requests that this document be made available to the Interested Parties.	NAIC Legal memo will be distributed prior to 7/23-7/25 Reinsurance Task Force meeting.

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Victor C. Moses
Senior Vice President
Chief Actuary

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July 17, 2008

The Honorable Steven M. Goldman
Chair, Reinsurance (E) Task Force
National Association of Insurance Commissioners

Dear Commissioner Goldman:

Genworth Financial is a Richmond, Virginia based financial services holding company. Our life insurance entities collectively do business in all 50 states and the District of Columbia. Internationally, we have a strong presence in private mortgage insurance and payment protection insurance and do business in 25 countries. We are strong proponents of a level playing field for all competitors in any given jurisdiction.

We have been closely following the activities of the NAIC's Reinsurance (E) Task Force (along with the proposals put forth by the Departments in New York and Florida) related to the subject of reinsurance modernization. We have previously communicated our position on this topic directly to several of the U.S. Commissioners.

In those communications, we have expressed serious concern about the immediate removal or reduction of collateral requirements for non-U.S. reinsurers and the potential that it may exacerbate an already tilted playing field that favors writers and reinsurers of life insurance who are headquartered outside the U.S. over those headquartered in the U.S.

U.S. regulators have established demanding solvency standards (both reserves and Risk Based Capital) for U.S. life insurance companies. In many cases, these standards are significantly in excess of those required of insurers writing similar coverages in other jurisdictions around the world.

U.S. collateral requirements for reinsurance were implemented primarily to assure collectibility. However, setting that issue aside, they have also served the less public purpose of helping to provide support for a level playing field for both the direct and reinsurance life insurance markets in the U.S.

In the current U.S. life reinsurance market, alien insurers either reinsure business directly or from a U.S. subsidiary to an offshore affiliate. In either form, they have to provide collateral for the ceded reserves (either through funds withheld, trusted assets or a letter of credit), but they avoid U.S. RBC requirements. Business naturally migrates to jurisdictions with the lowest capital requirements and this capital advantage (in many cases coupled with a tax advantage) is why there are few U.S. life reinsurers left today.

In this environment, we believe that use of collateral to maintain a consistent level of the reserves required to back liabilities is both an appropriate and necessary function for regulators. Regulators need to address the reserve standards for U.S. based companies, but however they are set, it is important that all carriers operating in the U.S. market are meeting the same standards.

If U.S. collateral requirements for reinsurance are removed (or eased materially), without corresponding reductions in U.S. reserve requirements, any highly-rated foreign insurer will be able to create or buy a U.S. subsidiary, reinsure the bulk of its business to an off-shore affiliate and have a significant advantage over a U.S headquartered company competing for the same business. If such an advantage is allowed to exist for even a few years, we believe the viability U.S. life direct writers will be materially compromised

We urge the NAIC to coordinate the issue of collateral reduction with its work on principles based reserves and capital, so that collateral requirements are not reduced before "equivalent" reserve and capital standards are in place.

In closing we reiterate our strong support for a level playing field and look forward to the removal of collateral requirements as soon as the reserve and capital redundancies for U.S. carriers have been eliminated.

Sincerely,

Victor C Moses
Senior Vice President and Chief Actuary

THE GENERAL INSURANCE ASSOCIATION OF JAPAN

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July 17, 2008

Comissioner Steven M. Goldman
New Jersey Department of Banking and Insurance
20 West State Street
P.O.Box 325
Trenton, NJ08625-0325

Dear Commissioner Goldman:

GIAJ Comment on the Reinsurance Modernization Framework

As one of the highly interested parties, we are pleased to provide you with our comments regarding the reinsurance regulatory modernization framework developed by the NAIC Reinsurance Task Force circulated on July 3.

1. In general

For an insurer, securing efficient reinsurance cover at an affordable/justifiable price is critically important as a means of managing the risks they underwrite. The importance of reinsurance is further increasing in light of growing catastrophe risks such as natural disasters. In order to further develop the reinsurance market, and given the fact that the reinsurance business is "B to B" transaction between sophisticated and professional parties, our basic position is that any collateral requirement (as well as any other preconditions and prerequisites) should be removed. In that sense, the "Reinsurance Evaluation Office (REO)" proposal which was adopted at the NAIC Winter Meeting in 2006 was a step forward in the right direction. By evaluating reinsurers based on the soundness of their financial condition and not on their state or country of domicile, and the same thing can also be said regarding the proposals to relax reinsurance collateral requirements released by the States of NY and FL in 2007.

However, the latest proposal for reinsurance regulation (as well as the "Draft Proposal to Grant Recognition of Regulatory Equivalence to Non-U.S. Insurance Supervisors" released in September last year) is much more complex, costly, and labor intensive than the REO proposal, especially regarding conditions and approval process to obtain reduced reinsurance collateral. We are extremely concerned that this proposal would hinder sound development of the reinsurance market.

Even if this proposal were implemented, it is difficult to see how this framework would work properly without at least resolving the following issues.

2. Preferential treatment given to reinsurers

According to the latest draft proposal, preferential treatment is only applicable to reinsurers that write at least 95% of their gross premiums by the reinsurance business (paragraph 4). Such discrimination should be removed since there is no rationale to make a difference between "pure-reinsurers" and insurers writing both reinsurance and direct insurance.

Such discrimination can not be found in the principles of the IAIS. The Global Reinsurance Market Report published by the IAIS Reinsurance Transparency Group (RTG), for example, treats re/insurers equally regardless of their reinsurance business ratio out of their total business. In this Report, creditworthiness of reporting entities has never been differentiated because of type of their main business.

3. Preferential treatment given to U.S. insurers

To be certified as a "POE reinsurer", a foreign re/insurer is required to meet stringent requirements based on quite complex procedures; i) a state through which a foreign re/insurer would like to do business in the U.S. must meet a set of standards established by the RSRD in order to be certified as a POE supervisor (paragraph 3), ii) the non-U.S. jurisdiction, in which such foreign re/insurer is domiciled , must be recommended as eligible for recognition by the RSRD (paragraph 7-c), iii) a POE supervisor must enter into a supervisory recognition framework with the Non-U.S. jurisdiction supervisor as well as entering into appropriate regulatory cooperation and/or information sharing arrangements (paragraph 13-a), and iv) a POE supervisor must certify a foreign re/insurer as a POE reinsurer (paragraph 13-b). On the other hand, U.S. licensed reinsurers do not have to comply with such complex procedures and consequently, this leads to unfair treatment against foreign re/insurers.

Furthermore, for example, it is too protective to impose on POE reinsurers to comply with requirements of the AR-1 form. Also, reinsurance contracts usually have arbitration clauses, and therefore, careful cost-benefit analysis should be made before binding POE reinsurers to the laws and regulations of the U.S. by setting a legal agent for the service of process.

POE reinsurers are required to file quite a few reports with the POE supervisor quarterly (paragraph 14). This will cause a duplication of regulations of the U.S. and Non-U.S. jurisdiction, thus significantly decreasing benefits of the proposal. In addition, some requirements in the latest proposal (e.g. “Any other information that the POE supervisor may reasonably require”) is too discretionary.

While the U.S. reinsurers categorized as "Secure-3" or above in the table would be exempted from posting any collateral (paragraph 19), this exemption is not applicable for POE reinsurers. This is apparently aimed at favorable treatment of the U.S. reinsurers.

4. Requirement of financial statements

POE reinsurers are required to file their financial statements reconciled to U.S. GAAP or Statutory Accounting Principles (paragraph 20-i). It is virtually impossible for POE reinsurers to meet these requirements when they do not prepare U.S. GAAP based financial statements locally. It is also quite burdensome for POE reinsurers to file a report in the form of Schedule F. annually (paragraph 20.f).

5. Other issues

To become certified as a National reinsurer and a POE reinsurer, foreign reinsurers must have a minimum capital of 250 million dollars (paragraph 5). It is far from rational treatment to require such an additional burden. It is unnecessary additional layer over reinsurers already evaluated by rating.

The legal authority of RSRD over each state regulator has not been clarified in the latest proposal, and this will lead to a vulnerable regulatory framework. Therefore it is doubtful that this regulatory framework would actually bring an intended effect.

Proposed scheme where annual fee is paid by POE reinsurers to a POE supervisor should be reviewed carefully so as to avoid conflicts of interest and other potential legal issues. There is no such case in other countries.

It is unclear what kind of specific situation paragraph 11-g-vii is designed to address and clarification is thus needed. The current clause seems excessively preferential for ceding insurers.

In paragraph 18, we can not find any reasonable necessity to have the class "Vulnerable-5" so the sliding scale should be reviewed and revised accordingly. In other words, as long as reinsurers categorized as this class are required to post 100% collateral (which they already do under the existing regime without the various compliance requirements of the POE scheme), they should be automatically placed out of this POE framework.

Thank you for your consideration of these comments.

Sincerely,

Katsuo Matsushita
General Manager
General Insurance Association of Japan

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FROM THE CHIEF EXECUTIVE

INTERNATIONAL UNDERWRITING ASSOCIATION

17 July 2008

Commissioner Steven M. Goldman
New Jersey Department of Banking and Insurance
20 West State Street
P.O. Box 325
Trenton, NJ 08625-0325

Dear Commissioner Goldman,

Re: Reinsurance Modernisation Framework

We have received the Reinsurance (E) Task Force's July 3, 2008 memorandum on modernizing the U.S. reinsurance regulatory framework (the "Memorandum"). We believe that the Reinsurance Task Force has made substantial progress on the framework, but wish to address a few areas of concern that remain for a number of our members.

THE WORLD OF INSURANCE

The International Underwriting Association of London (the "IUA") is a trade association representing 40 international companies who operate through the London insurance market (see www.iua.co.uk). Our members write considerable amounts of reinsurance premium either from London or other global offices. Some write reinsurance only. Most write insurance and reinsurance. They have long supported the U.S. insurance market. The IUA has participated in the NAIC's efforts to reform reinsurance regulation from the beginning of this debate. We appreciate the Task Force's consideration of our comments.

For our members the remaining issues include:

1. The requirement of a POE regulator for non-U.S. reinsurers. We believe additional regulation of reinsurers by a U.S. regulator will be redundant and unnecessary where the non-U.S. reinsurer is domiciled in an approved jurisdiction.

2. The U.S. style reporting requirements that are proposed for non-U.S. reinsurers. We believe that these requirements undermine your goal of recognizing equivalent jurisdictions and avoiding duplication of regulation.

3. Restricting the framework to those who only write reinsurance (the "reinsurance only" provision). This provision will unduly and unreasonably restrict the benefits of the new framework to a subset of the global reinsurers.

4. The different collateral requirements for U.S. and non-U.S. reinsurers. These conflict with one of the fundamental goals of U.S. reinsurance regulatory reform, i.e., treating all well regulated reinsurers the same.

International Underwriting Association of London

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5. Mandatory contract clauses. These should be restricted to a very few and should be standardised.

These comments are developed more fully below.

1. **POE Regulator**

The Memorandum requires a non-U.S. reinsurer domiciled in a recognized jurisdiction to also apply for approval by a POE regulator. We believe that a more efficient system would be to have the RSRD determine what jurisdictions should be recognized and then permit reinsurers domiciled in those countries to reinsure U.S. ceding companies, provided they comply with the other requirements of the Memorandum (including the collateral requirements). This would be consistent with how most countries including EU countries regulate reinsurance – indeed most countries grant even more liberal access to their markets. It would also be consistent with the efforts of the IAIS to move towards a system of mutual or unilateral recognition of qualified jurisdiction. This approach has much to recommend it and has broad international support.

Alternatively, we urge you to make the POE state more a point of "registration" rather than "regulation". We believe this is what is contemplated by the Memorandum, but clarification of this point would be important.

2. **Reporting Requirements**

As part of our concerns that the POE state will become a redundant level of regulation, we note that non-U.S. reinsurers will have to meet numerous U.S. based reporting requirements. These will increase significantly the cost of providing reinsurance capacity to the U.S. market. More specifically we are concerned about the following provisions.

A. Filing of Schedule F data

Paragraph 20(f) of the Memorandum requires a POE reinsurer to file annually a report in the form of Schedule F (or S) of the NAIC annual statement blank. The filing of complete Schedule F's will be a substantial administrative burden and cost for non-U.S. reinsurers. Non-U.S. reinsurers do not capture the same data in the same form. We also believe that U.S. regulators can obtain much of the information they require from other sources. In particular, information concerning U.S. business assumed by non-U.S. reinsurers can be obtained by the Schedule Fs filed by U.S. ceding companies. Accordingly, we would urge you not to require the assumed reinsurance portion of Schedule F.

We would recommend that the POE regulator should only require non-U.S. reinsurer to file material information, for example, the aggregate amount of retrocession protection they have, and the identity of material reinsurers, perhaps the identity of their top five reinsurers.

B. Filing of quarterly financial information

Paragraph 14(b) of the Memorandum requires a POE reinsurer to file quarterly "information comparable to relevant provisions of the quarterly NAIC financial statement". We are not certain what is contemplated by this phrase. We believe that it should not be necessary to have quarterly filings from

reinsurers who are domiciled in countries which you have recognised as an equivalent reinsurance regulator. We urge you to delete this requirement.

C. Filing of U.S. GAAP or SAP statements

Paragraph 20(i) of the Memorandum provides that non-U.S. reinsurers must file with their port of entry ("POE") state audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles. We urge you to amend this provision to accept IFRS accounting statements as well, in light of the clear movement towards such a format.

Reconciling foreign financial statements to U.S. GAAP or SAP involves a considerable expense. We have been advised that for reinsurers of any significant size the accounting and auditing fees alone could be around $1million. In addition, GAAP or SAP reconciliation requires substantial IT and administrative burdens for the reinsurer. We do not believe that the benefits of this reconciliation will outweigh the substantial costs. Moreover, many regulators worldwide are moving to require or accept IFRS statements, including EU Member States. As you know, the U.S. Securities Exchange Commission, earlier this year, agreed to accept IFRS statements from foreign issuers. They are currently considering accepting them from U.S. issuers. This accommodation is being done in the context of promoting retail sales of securities to U.S. consumers. In the context of the reinsurance regulatory framework, IFRS will only be used in a business to business transaction. In light of clear movement towards the acceptance of IFRS, we would urge you to accept such statements from non-U.S. reinsurers.

D. Lists of disputed and overdue claims

Paragraph 14(c) and 20 (a) require the filing of a list of all disputed and overdue reinsurance claims on a quarterly basis (14(c)) and as part of the initial POE review (20(a)).

We agree that some information regarding disputes and overdue claims can be relevant to the review of the financial integrity of a reinsurer. We would recommend that instead only disputes in excess of a certain amount be reported. Finally, we would note that there should be some definition of what is a disputed claim. Presumably claims would be in dispute where a notice of intent to commence arbitration has been served or complaint has been filed in a court of competent jurisdiction.

With regard to overdue claims this is another area where the data is readily accessible from the financial statements filed by ceding insurers. We recommend that the POE regulator obtain this information from the NAIC database. If this information raises questions, the POE regulator should be free to request additional information from the reinsurer.

3. <u>"Reinsurance Only" Provision</u>

Paragraph 4 of the Memorandum provides that the new framework will only be available for companies that "write primarily reinsurance business with no more than 5% of their gross premiums written other than assumed reinsurance". Our members who write insurance and reinsurance are particularly concerned about this provision. We confess that we do not see any rationale for this provision and we see a number of practical problems in enforcing it.

International
Underwriting Association

In considering this provision, we note that we are not certain why it has been added. Some have suggested it was added in an effort to be consistent with the EU Reinsurance Directive, which applies to those who write reinsurance only. If this is true, we respectfully note that it is a misdirected attempt at consistency. The Reinsurance Directive was made applicable to those who only write reinsurance because it was targeted at the one sector of the EU insurance industry that was not yet covered by the EU insurance directives. The Reinsurance Directive was adopted in order to put pure reinsurers in the same position in terms of solvency regulation, passporting rights and other regulatory requirements as mixed insurers. It was not done to create special rules for reinsurers. It was adopted for exactly the opposite reason.

Beyond the precedents set by the EU Reinsurance Directive, we would note that creating separate rules for those who write reinsurance only is not sound as a commercial or regulatory matter. Many companies write both insurance and reinsurance. This diversification is recognized as a positive factor by rating agencies and regulators. We believe that it is proper to restrict the application of the framework only to the reinsurance operations of an insurer/reinsurer. For example a U.S. company that writes insurance and reinsurance would be able to transact reinsurance business throughout the U.S. based on its domestic state licence. To write insurance, however, it would need to obtain appropriate state licences. This rule would easily be enforced.

The wisdom of reinsurers writing insurance and reinsurance is evidenced by the exceptions provided to the reinsurance only provision. The provision has been amended to provide an exception for Underwriters at Lloyd's, London. Lloyd's writes a substantial amount of insurance and reinsurance and it is appropriate to permit the Lloyd's market to operate under the framework. The same argument is equally valid for every carrier who, for good commercial reasons, elects to write both insurance and reinsurance.

We also note that for any reinsurer, there is a 5% of gross written premiums exception to the reinsurance only requirement. We wonder why it would be permissible for a reinsurer which writes 5% of its business as insurance to conduct its reinsurance operations under the framework but not a reinsurer for which 10%, 20%, even 50% of its premium volume is insurance?

We also wonder how the 5% exception will work in practice. When do you apply the 5% test, daily, quarterly, yearly? What if a reinsurer had direct premiums equal to 4.5% of its business for the first two quarters of the year and then its insurance premiums increase to 6.5% of its business. What happens? We also suggest that there will be contracts – particularly some facultative reinsurance agreements – where it will be very difficult to distinguish between what is insurance and reinsurance.

The reinsurance only provision will impose dramatically different regulatory requirements on various reinsurers. It will create undesirable market distortions. This provision should be dropped.

4. **U.S. v. non-U.S. funding requirements**

Paragraph 18 of the Memorandum provides the requisite collateral requirements for rated reinsurers. Paragraph 19 provides that U.S. licensed reinsurers rated Secure-3 or above will be exempt from any collateral requirements.

INTERNATIONAL
UNDERWRITING ASSOCIATION

This disparity in treatment between U.S. and non-U.S. reinsurers is hard to understand. Only non-U.S. reinsurers who are subject to a level of regulation that is recognised by the RSRD will be able to apply to be rated. These reinsurers will then also have to apply to be listed and approved by a POE regulator. We do not believe it is justified to then provide more onerous collateral requirements on these reinsurers. Under the proposed system, a non-U.S. reinsurer that is, by definition, well regulated by its domestic regulator, reviewed and approved by a POE regulator in the U.S. and rated AA+ (S&P) must post 10% collateral. At the same time, a U.S. reinsurer, licensed in one State (let's assume it is the same which is used as the POE state by the AA+ non-U.S. reinsurer) and rated A- posts 0% collateral. This discriminatory treatment strikes at the heart of what the Reinsurance Task Force has said it wants to do – treat all well regarded reinsurers the same, regardless of its state or country of domicile. We believe strongly, that you should delete paragraph 19.

Even with equivalent collateral requirements, it is important to note that there will still be significant value in having a U.S. licence, as opposed to reinsuring on a cross-border basis. U.S. licensed reinsurers will be able to operate from offices in the United States. This proximity to cedents is a big commercial advantage.

5. **Mandatory Contract Clauses**

Paragraph 11(g) of the Memorandum provides that the RSRD will develop mandatory contract clauses. Throughout the global markets, insurance regulators have recognized that ceding insurers and reinsurers, as sophisticated commercial parties, should have the freedom to draft contracts as they want. In the US, regulators have mandated contract clauses in only a few areas: insolvency, intermediary obligations, service of suit and submission to jurisdiction. Although each of these have been imposed for sound reasons, there have been problems when different states impose specific and at times inconsistent contract language. We would urge you to limit the number of mandatory clauses and to ensure that there are not state by state variations in form or substance regarding these clauses.

We believe that the changes suggested above will increase the efficiency and effectiveness of the proposed reinsurance regulatory framework. We would be pleased to respond to any questions or comments you or the other Task Force members have concerning these suggested changes, either now or at the Interim Meeting in New York. We appreciate your consideration of our comments.

Yours sincerely,

Dave Matcham
Chief Executive

IUA OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION

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POE Regulator

The Memorandum requires a non-U.S. reinsurer domiciled in a recognized jurisdiction to also apply for approval by a POE regulator. We believe that a more efficient system would be to have the RSRD determine what jurisdictions should be recognized and then permit reinsurers domiciled in those countries to reinsure U.S. ceding companies, provided they comply with the other requirements of the Memorandum (including the collateral requirements). This would be consistent with how most countries including EU countries regulate reinsurance – indeed most countries grant even more liberal access to their markets. It would also be consistent with the efforts of the IAIS to move toward a system of mutual or unilateral recognition of qualified jurisdiction. This approach has much to recommend it and has broad international support.

Alternatively, we urge you to make the POE state more a point of "registration rather than regulation". We believe this is what is contemplated by the Memorandum, but clarification of this point would be important.

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A. Filing of Schedule F data

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We would recommend that the POE regulator should only require non-U.S. reinsurer to file material information, for example the aggregate amount of retrocession protection they have, and the identity of the material reinsurers, perhaps the identity of their top five reinsurers.

B. Filing of quarterly financial information

Paragraph 14(b0 of the Memorandum requires a POE reinsurer to file quarterly "information comparable to relevant provision of the quarterly NAIC financial statement". We are not certain what is contemplated by this phrase. We believe that is should not be

necessary to have quarterly filings from reinsurers who are domiciled in countries which you have recognized as an equivalent reinsurance regulator. We urge you to delete this requirement.

C. Filing of U.S. GAAP or SAP statements

Paragraph 20(i) of the Memorandum provides that non-U.S. reinsurers must file with their port of entry ("POE") state audited financial statements reconciled to U.S. GAAP or Statutory Accounting Principles. We urge you to amend this provision to accept IFRS accounting statements as well, in light of a clear movement towards such a format.

Reconciling foreign financial statement to U.S. GAAP or SAP involves a considerable expense. We have been advised that for reinsurers of any significant size the accounting and auditing fees alone could be around $1 million. In addition, GAAP or SAP reconciliation requires substantial IT and administrative burdens for the reinsurer. We do not believe that the benefits of this reconciliation will outweigh the substantial costs. Moreover, many regulators worldwide are moving to require or accept IFRS statements, including EU Member States. As you know the U.S. Securities Exchange Commission, earlier this year, agreed to accept IFRS statements from foreign issuers. They are currently considering accepting them form U.S. issuers. This accommodation is being done in the context of promoting retail sales of securities to U.S. consumers. In the context of the reinsurance regulatory framework, IFRS will only be used in a business to business transaction. In light of clear movement toward the acceptance of IFSR, we would urge you to accept such statements from non-U.S. reinsurers.

D. Lists of disputed and overdue claims

Paragraph 14 (c) and 20(a) require the filing of a list of all disputed and overdue reinsurance claim on a quarterly basis (14(c)) and as part of the initial POE review (20(a)).

We agree that some information regarding disputes and overdue claims can be relevant to the review of the financial integrity or a reinsurer. We would recommend that the instead only disputes in excess of a certain amount be reported. Finally, we would not that there should be some definition of what is a disputed claim. Presumably claims would be in dispute where a notice of intent to commence arbitration has been served or complaint has been filed in a court of competent jurisdiction.

With regard to overdue claims this is another area where the data is readily accessible from the financial statements filed by ceding insurers. We recommend that the POE regulator obtain this information form the NAIC database. If this information raises questions the POE regulator should be free to request additional information from the insurer.

3. <u>"Reinsurance Only" Provision</u>

Paragraph 4 of the Memorandum provides that the new framework will only be available for companies that “write primarily reinsurance business with no more than 5% of their gross premiums written other than assumed reinsurance”. Our members who write insurance and reinsurance are particularly concerned about this provision. We confess that we do not see any rationale for this provision and we see a number of practical problems in enforcing it.

In considering this provision, we note that we are not certain why it has been added. Some have suggest it was added in an effort to be consistent with the EU Reinsurance Directive, which applies to those who write reinsurance only. If this is true, we respectfully note that it is a misdirected attempt at consistency. The Reinsurance Directive was made applicable to those who only write reinsurance because it was targeted at the one sector of the EU insurance industry that was not yet covered by the EU insurance directives. The Reinsurance Directive was adopted in order to put pure reinsurers in the same position in terms of solvency regulation, passporting rights and other regulatory requirements as mixed insurers. It was not done to create special rules for reinsurers. It was adopted for exactly the opposite reason.

Beyond the precedents set by the EU Reinsurance Directive, we would note that creating separate rules for those who write reinsurance only is not sound as a commercial or regulatory matter. Many companies write both insurance and reinsurance. This diversification is recognized as a positive factor by rating agencies and regulators. We believe that it is proper to restrict the application of the framework only to the reinsurance operations of an insurer/reinsurer. For example a U.S. company that writes insurance and reinsurance would be able to transact reinsurance business thoughout the U.S. based on its domestic state license. To write insurance, however, it would need to obtain appropriate state licenses. This rule would easily be enforced.

The wisdom of reinsureres writing insurance and reinsurance is evidenced by the exceptions provided to the reinsurance only provision. The provision has been amended to provide and exception to Underwriters at Lloyd’s, London. Lloyds writes a substantial amount of insurance and reinsurance and it is appropriate to permit the Lloyds market to operate under the framework. The same argument is equally valid for every carrier who, for good commercial reasons, elects to write both insurance and reinsurance.

We also note that for any reinsurere, there is a 5% of gross written premiums exception to the reinsurance only requirement. We wonder why it would be permissible for a reinsurer which write 5% of its business as insurance to conduct its reinsurance operations under the framework but not a reinsurer for which 10%, 20%, even 50% of its premium volume is insurance?

We also wonder how the 5% exception will work in practice. When do you apply the 5% test, daily, quarterly, yearly? What is a reinsurer had direct premiums equal to 4.5% of its business for the first two quarters of the year and then its insurance premiums increase to 6.5% of its business. What happens? We also suggest that there will be contracts – particularly some facultative reinsurance agreements – where it will be very difficult to distinguish between what is insurance and reinsurance.

The reinsurance only provision will impose dramatically different regulatory requirements on various reinsurers. It will create undesirable market distortions. This provision should be dropped.

4. U.S. v. non-U.S. funding requirements

Paragraph 18 of the Memorandum provides the requisite collateral requirements for rated reinsurers. Paragraph 19 provides that U.S. licensed reinsurers rated Secure-3 or above will be exempt from any collateral requirements.

The disparity in treatment between U.S. and non-U.S. reinsurers is hard to understand. Only non-U.S. reinsurers who are subject to a level of regulation that is recognized by the RSRD will be able to apply to be rated. These reinsurers will then also have to apply to be listed and approved by a POE regulator. We do not believe it is justified to then provide more onerous collateral requirements on these reinsurers. Under the proposed system, a non-U.S. reinsurer that is, by definition, well regulated by its domestic regulator, reviewed and approved by a POE regulator in the U.S. and rated AA+ (S&P) must post 10% collateral. At the same time, a U.S. reinsurer, licensed in one State (let's assume it is the same which is used as the POE state by the AA+ non-U.S. reinsurance) and rated A- posts 0% collateral. This discriminatory treatment strikes at the heart of what the Reinsurance Task Force has said it wants to do. – treat all well regarded reinsurers the same, regardless of its state or country of domicile. We believe strongly, that you should delete paragraph 19.

Even with equivalent collateral requirements, it is important to note that there will still be significant value in having a U.S. license, as opposed to reinsurance on a cross-border basis. U.S. licenses reinsurers will be able to operate from offices in the United States. This proximity to cedents is big commercial advantage.

5. Mandatory Contract Clauses

Paragraph 11(g) of the Memorandum provides that the RSRD will develop mandatory contract clauses. Throughout the global markets, insurance regulators have recognized that ceding insurers and reinsurers, as sophisticated commercial parties, should have the freedom to draft contracts as they want. In the U.S., regulators have mandated contract clauses in only a few areas: insolvency, intermediary obligations, service of suit and submission to jurisdiction. Although each of these have been imposed for sound reasons, there have been problems when different states impose specific and at times inconsistent contract language. We would urge you to limit the number of mandatory clauses and to ensure that there are not state by state variations in form of substance regarding these clauses.

JOSEPH P GUNSET
General Counsel

LLOYD'S

July 17, 2008

Hon. Steven M. Goldman
Commissioner of Banking and Insurance
New Jersey Department of Banking and Insurance
20 West State Street
P.O. Box 325
Trenton, NJ 08625

Re: NAIC Reinsurance Modernization Framework Proposal
(Memorandum of July 3, 2008)

Dear Commissioner Goldman:

We are writing to offer our comments on the July 3, 2008 memorandum circulated by the NAIC Reinsurance Task Force (RTF).

Preliminarily, we would like to acknowledge the hard work regulators have done on this important issue. It is clear to us that the Task Force has listened carefully to industry's comments on its drafts. We would like thank the RTF for its careful consideration of the points raised in our letter dated May 28, 2008 and for its acknowledgment of Lloyd's role as an important participant in the United States reinsurance, surplus lines and direct insurance markets[1].

We would also like to recognize the substantial progress that has been made towards enhancing and modernizing the U.S. reinsurance regulatory regime. Clearly, the July 3 memorandum represents a very substantial improvement over the current system.

We feel that we should record our view, however, that there are some principles that are not incorporated into the current proposal which we believe should be included in any new long term regulatory approach to these issues. We continue to believe that these principles need to be included in a modernized regulatory structure to maximize the ability of U.S. insurance regulators to coordinate their efforts on a fully cooperative basis with their colleagues in this country's major trading partners. We present these comments as an organization that has demonstrated an established commitment to the future health of the U.S. market and which has been a long-standing participant in NAIC deliberations on these issues.

[1] We note the clarification in the memorandum that only U.S. domestic reinsurers may qualify as national reinsurers and that reinsurers domiciled outside the U.S., such as Lloyd's Underwriters, would qualify as P.O.E. reinsurers. We also note that P.O.E. reinsurers would not be permitted to have a "physical presence in the U.S.". It is our understanding that this language is intended to prohibit P.O.E. reinsurers from establishing underwriting offices in the U.S. and is not intended to prohibit such things as liaison offices that do not engage in underwriting activity. If we are correct in our understanding, we would ask for a revision to make this distinction clear.

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Lloyd's is authorised under the Financial Services and Markets Act 2000

As Lloyd's has commented before, we suggest that where the RSRD has recognized another jurisdiction as having a system of regulation that is equivalent to that in place in the United States and as otherwise meeting the standards set forth in the memorandum, the regulator in that jurisdiction should be treated as being an equal of its U.S. colleagues. Thus, we would respectfully submit that it is duplicative for a reinsurer from that jurisdiction and subject to that regulator's supervision to also be subject to the additional oversight of a U.S. Port of Entry State. We believe the ultimate goal must be full mu tual recognition among effective regulators in t he global reinsurance market, both here and abroad.

We certainly recognize the strength of the U.S. insurance regulatory system but we believe that regulatory systems in certain other jurisdictions are equally as strong. As a result, we do not feel that different collateral requirements to those required of US reinsurers are justified for strong, well-regulated non-US reinsurers from a jurisdiction that the RSRD has found to impose a regulatory regime that is equivalent in its effectiveness to that in the U.S.. We continue to believe that the framework should treat a strong well-regulated non-U.S. reinsurer the same as its equivalent in the U.S.

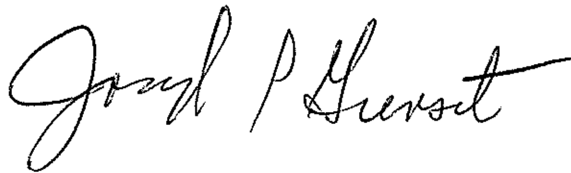
We are grateful for the specific provisions added to the memorandum to address and resolve issues arising from the structure of the Lloyd's market. While these provisions address Lloyd's specific issues, we feel a commitment to the RTF to assist it in making the framework as good as it can be for the market as a whole. In this spirit, we believe the ideal approach would be to broaden the scope of the framework to cover all those entities writing reinsurance, provided they meet the regulatory jurisdiction standard and financial criteria. We understand that a number of international "mixed insurers" have strong views that this distinction between those reinsurers that do and do not write direct insurance should be removed from the framework. Like them, we are unsure of the rationale for restricting the proposal in this way. We believe it should be possible to clarify that direct business written by mixed insurers is outside the scope of the framework and would continue to be fully subject to all applicable U.S. regulatory requirements for direct insurance activity.

Finally, the U.S. has for a number of years conditioned balance-sheet credit for reinsurance upon the reinsurance agreement containing a few mandatory contract provisions, such as the standard insolvency and service of suit clauses. We note that paragraph 11(g) in the July 3 memorandum goes further and mandates several additional clauses that we do not believe have heretofore been mandated. We believe that, while the imposition of some contractual requirements may be appropriate, the global reinsurance market benefits from allowing ceding insurers and their reinsurers to freely negotiate the terms and conditions of their agreements. For this reason, we believe that mandatory clauses should be kept to the minimum necessary to promote sound regulation and that any mandatory clauses that are imposed should be made uniform across the country.

We thank the RTF for making significant progress in the last few months towards modernization of the current US credit for reinsurance rules. Our comments are offered in an effort to be constructive and supportive of the RTF in its endeavours to deliver a reinsurance regulatory modernization framework that will ensure the security of insurers and to be responsive to the challenges of a global industry. Once again, we are grateful for the acknowledgement of the importance of Lloyd's in the U.S. marketplace and the acceptance of the need to accommodate Lloyd's market structure as part of the regulatory modernization framework. We support the goal of maintaining a secure and healthy U.S. insurance and reinsurance market and will continue to work towards that end.

Please do not hesitate to contact us if we can offer further assistance or information.

Respectfully,



cc: Robert B. Kasinow,
Chief Insurance Examiner- NJDOBI
Bryan Fuller, NAIC

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July 17, 2008
Mr. Steven M. Goldman, Chair, and Members
NAIC Reinsurance Task Force
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, MO 64108
Attn.: Mr. Bryan Fuller and Mr. Ryan Couch, Committee Liaison

Dear Chairman Goldman and Members:

Introduction
NAMIC is a trade association representing approximately 1,400 mutual property and casualty insurers in the United States and Canada. Members domiciled in the United States write over 40 per cent of the property-casualty premium in this country. NAMIC, which regularly participates in deliberations on regulatory matters before the NAIC, notes that its members have a direct interest in the proposal now pending before this Task Force.

Our comments herein for the occasion of the Task Force's meeting in New York, July 23 through July 25, address the Reinsurance Task Force's "Reinsurance Modernization Framework Proposal" that intends comprehensive change in reinsurance regulation, especially in licensure of reinsurers and in the collateral regime for reinsurers without conventional domicile in the United States. Our perspective is, understandably, one that originates in the interests of primary insurers that manage risk by use of reinsurance, and we emphasize that our members' services to policyholders depend on a highly secure system for cession of risk.

Consistent with those interests and with our comments made to the Task Force on a number of previous occasions about proposals to alter the current, full-collateral regime, in this letter we first briefly reiterate our reservations about changes in collateral that is now used for credit for reinsurance. Additionally, understanding the strength of the Task Force's resolution to impose changed reinsurance regulation, we make observations, criticisms, and suggestions on the Framework Proposal.

Continuing reservations
The facts of the marketplace in the United States demonstrate that alien reinsurers are dominant and, for reason of that dominance, we believe it is difficult for anyone to assert that any restriction on international trade has been imposed by any design or connivance. Legislation that may be premised on any supposed disadvantage to aliens who wish to

enter the reinsurance market in this country may cause the Task Force to believe it must act, yet there is every reason for the Task Force to reject any such premise and to consider the weight, or lack of it, to be accorded such legislation.

Credit for reinsurance based on full collateral has served well for many years. It can be argued that what is now proposed in the framework results in more efficient use of reinsurers' capital, diminishing the friction costs of collateral. It may simultaneously be argued, however, that insolvency costs to be borne by primary insurers in the United States and its territories will inevitably rise. In other words, when an alien reinsurer does not meet its obligations to a cedent in this country and collateral is not otherwise available, the guaranty-fund system will assess other insurers domiciled in this country. Primary companies, via reduction of collateral, are caused to assume a greater increment of the risk of failure of reinsurers.

With respect to a level playing field—taxation already favors alien reinsurers—as may exist between the market in this country and in the EU countries, we have not seen in the Task Force's materials any country-by-country itemization of collateral regimes that forces the conclusion that state regulation in this country discriminates against EU domiciled reinsurers. EU countries may or may not, to the extent of our knowledge, recognize full credit for reinsurance where collateral is less than 100 per cent. A strong argument based on reciprocal reduction of collateral is not, in other words, visible.

In summary, the substance of the framework document—and we do not take issue with the entirety of its content—would appear to accommodate alien reinsurers with respect to a) consequences of their non-payment and b) consolidation of state licensure. These accommodations, however, provide no assurance that alien reinsurers will be more willing to assume catastrophe risk but do give us caution with respect to solvency.

Observations, criticisms, and suggestions

In this section we provide more specific comment on content of the July 3, 2008, memorandum that articulates the framework. Our comments presuppose that very substantial further drafting must occur for creation of a model statute or regulation and that, presumably, all states would have to embed such model law or regulation in their respective insurance codes:

- The section labeled Definition of Terms should include at least identification and brief description of what is a new regulatory entity, the "Reinsurance Supervision Review Department," or RSRD. This entity is at the very nexus of operation of this proposal, and, although later explained, would seem appropriate for identification in "Terms."

- Further, with respect to entries in the Definition of Terms, "National Reinsurer" is described as submitting "solely to the regulatory authority of the home state …," but certain actions, particularly those related to rating of financial strength, appear, in fact, very closely tied to actions of the RSRD.

- With respect to Paragraph 11., "functions of the RSRD," it would appear to be necessary to include some means of administrative process to treat disputes as to rating of a reinsurer and, further, for de-certifation of an insurer or de-certification of a jurisdiction. It may be suggested these are functions wholly to be performed by the state or states of the cedents, yet this may not be a practical expectation. A "purposes and procedures" manual is contemplated for enforcement actions, yet the source of sanction seems ambivalent as between states and the RSRD—which would not appear to have any official power. The SVO may stand as the model analytic office here, yet it would seem some explication is warranted of the source for authority of sanctions—changes in ratings or removals of certifications—that occur at the RSRD level. It is understood that paragraph 12. leaves state regulators in charge of related actions at the state level, yet it would appear that many of such state-level actions would begin at the RSRD level as specified at 12. f.

- Paragraph 15. g. seems to except "affiliated transactions," and we assume the intent is to exclude intra-group transactions. We believe it is better that the framework and any model made on it, state affirmatively that intra-group cessions between or among insurers domiciled in the United States are not affected by content of this framework or rule. Similarly, the framework and any model based on it should affirmatively exclude pools among insurers domiciled in the United States.

- Paragraph 16. vests the home-state regulator with responsibility to assign a financial strength rating to a reinsurer. Will, in fact, the home-state regulator be conducting this crucial function, or will the RSRD have the dominant role, given its responsibilities under paragraph 10.? Provision a. under paragraph 10. presumably gives the RSRD a powerful role in settling disputes in this context. The broader function of the RSRD further includes standard-setting and creation of contract forms and constraints. All of these suggest it will be the site of much decision-making nominally placed with home-state regulators.

- A larger and crucial question to be posed about the RSRD is its governance: Is a "supervisory board" of state regulators fully empowered to manage the RSRD, or is power to manage personnel and crucial functions vested at NAIC headquarters. We believe that industry, both representatives of primary insurers and reinsurers, should be part of RSRD governance and, further, that an oversight committee be established within the NAIC structure.

- With respect to paragraph 16 and subsequent part of the section on Collateral Proposals …, it may be appropriate to note that ceding and assuming insurers are free to adjust collateral to higher levels.

- Are conventions of the reinsurance business business so strongly embedded that one year must be specified for posting collateral for post-catastrophe recoverables, as is done in paragraph 21. for a number of lines?

- Paragraph 26. treats what may be one of the most problematic scenarios possible under a new framework of calibrated collateral: Additional collateral will be required in the case of a downgrade of financial strength ratings. We read the requirement as prescribing this for all business, both old and new. We assume that the three months of paragraph 27. is the pratical time limit of such posting of additional collateral.

- Our reading of the proposal shows means for states to support their role, if chosen, as regulators of national or port-of-entry reinsurers. Yet provison of revenue for expenses of the RSRD seems not to be included. What is contemplated with respect to establishment and support of the RSRD?

Respectfully yours,

/s/ William D. Boyd

William D. Boyd
Financial Regulation Manager

Property Casualty Insurers
Association of America

Shaping the Future of American Insurance

July 17, 2008

RE: PCI Comments to the NAIC Reinsurance Taskforce: July 3, 2008 Reinsurance Regulatory Modernization Proposal

PCI appreciates the opportunity to comment to the July 3, 2008 proposal. We are aware of the great deal of time and effort by members of the Reinsurance Task Force and others in developing this proposal.

By way of overview, PCI continues to oppose collateral reduction for alien reinsurers. We still do not understand nor see the need for making a change to collateral rules here in the United States. We do see potential harm to solvency regulation and the guaranty association system in the U.S. Nothing prevents an alien reinsurer from doing business in the U.S. Nor is an alien reinsurer subject to more onerous requirements than a U.S. reinsurer. Collateral is an *additional* (emphasis added) way that an alien reinsurer may do business in the U.S. The collateral requirement is part of accreditation of states, a system by which the states determined what was necessary for good solvency regulation. The proposal seeks to force the states to accept reduced or zero collateral under an optionally free of collateral (OFC) system in addition to the existing ways of doing business in the U.S.

While we reiterate many of our comments submitted in the past, it is appropriate for PCI to comment to the proposed OFC system. Our comments are geared toward improving the proposal. They should not be taken as conditions under which PCI would no longer oppose the proposal. For that, the proposal would have to give the ceding companies the same level of security that collateral does.

PCI remains very concerned that the proposals place very onerous burdens on the ceding insurers. These are burdens that should be placed upon the reinsurers, the home, POE and host states, but not on ceding companies. These should be clear in contractual provisions.

Under this proposal, ceding insurers will have to closely monitor rating downgrades of their, often numerous, reinsurers. Slow-paying reinsurers will have to be monitored closely by the relevant regulator. Even if that occurs, the proposal lacks sufficient penalty for overdue reinsurance recoverables. We are concerned not only with the time lag related to requesting increased collateral but also the time lag to receive collateral, if at all. Here is one example of the time lags built into the proposal. Should the home or POE state seek to downgrade a reinsurer, there presumably would be an administrative procedure (and related appeals) to the downgrade. Meanwhile, the ceding company could have a reinsurer balking for months, perhaps years at funding the increase in collateral requirement. By the time the reinsurer is finally downgraded under the proposal, its ceding companies may have been downgraded by their rating agencies for a failure to obtain collateral. It may be then too late to obtain increased collateral.

The use of rating agencies in the proposal appears excessive. We reference the subprime crisis in the broadest sense. Looking at the timeline of the proposal, an entity is downgraded, then there must be notice of the existence of the downgrade, then additional collateral must be requested and

finally collateral must actually be increased. There is one entity affected should this go wrong: the ceding company.

At the spring NAIC meeting, there was a paper released regarding the constitutionality of rating the regulation of a foreign country. PCI remains concerned in this area.

We are concerned that full solvency regulation by a host state over its domestic ceding insurers no longer exists with this proposal.

PCI has continuously raised the issues of Schemes of Arrangement and Part VII Transfers and must do so here. Run-offs need further examination prior to any proposal. Where a scheme of arrangement or Part VII transfer is used, existing collateral provision should apply. Any impact of the proposal for collateral reduction and collateral reduction as related to run-offs should be, as with the proposal itself, prospective only. Yet there is no mention of these in the proposal. We also believe that no jurisdiction offering schemes of arrangement or Part VII transfers should be certified for reduced collateral for its reinsurers of U.S. cedents. An alternative might be that for any group in which any affiliate that has ever applied for or applies for a scheme of arrangement, Part VII transfer or similar mechanism, all entities in the group or if a single reinsurer that reinsurer, must post 100% collateral.

There is a great deal of pressure in the EU to meet the stringent capital requirements of Solvency II. Accordingly, the envelope is being pushed to use solvent schemes of arrangement and Part VII transfers to cull out discontinued books and assign obligations to lower-rated, less well-capitalized companies. This has the effect of increasing the credit risk to U.S. cedents and negating original contract commitments. PCI notes that HM Treasury in the U.K. has a document entitled "Consultation on Amendments to Part 7 FSMA." We urge the NAIC and/or the Reinsurance Task Force to participate with HM Treasury to express U.S. regulator and ceding company concerns with such transfers. We believe a constructive "dialogue" is critical in relation to Part VII transfers and potential impact on U.S. ceding companies.

Specific Comments:

Purpose and Structure:

Item 3. There is discussion of a consultative process, but in the end, "the decision by the home state or POE …will be final." It is unrealistic to conclude that there will be uniformity in reinsurance regulation, given the broad discretionary factors that come into play for the home state or POE to evaluate the reinsurer (see #20 in the proposal). One home or POE state may consider 100 day overdue recoverables unacceptable, another may allow explanations as to recoverables, and another may not consider 100 day over due recoverables material. There is no objective assignment of rating, nor objective value given to each factor listed in #20.

Item 4. The 5% limitation of gross premium written other than assumed reinsurance seems on its face to be an acceptable standard for defining a primary reinsurer. However, PCI can envision intercompany pooling arrangements or intercompany reinsurance agreements where one of the entities might not meet this qualification. From other sections of the proposal, it appears that the affiliate might have to meet these requirements for reduced collateral. There needs to be clarification as to how all intercompany pooling or reinsurance agreements would be handled.

Items 6&7, (a). This crams down reduced collateral upon the ceding company and prevents the host state regulator from any review of the credit quality of its domiciled insurer's reinsurance, effectively telling the domicile to regulate for solvency, but be powerless over one aspect of perhaps the largest balance sheet item, reinsurance.

Item 8. This is a clear statement of the optional nature of the proposal and the fact that reinsures will now have two new ways, items (a) and (b) to do business along with the existing structure, items (c) and (d). Current collateral requirements (item d) are merely an additional way in the U.S. a company can be a reinsurer (the other way being item c). Stated differently, item 8 says that there is no discrimination by the U.S. against alien reinsurers. PCI does not see the need for this proposal.

Item 9. PCI appreciates the comment that the proposal would operate only on a prospective basis. However, as the proposal is "fleshed out," it is important to maintain clear prospective application as the standard and avoid any provisions that may indicate otherwise. Therefore, we would seek a clear statement to this effect.

__**Role and Structure of the RSRD**__

Item 10: While the goals of this item are laudatory, we do not believe the reality of the proposal would effectuate these goals. For example, in (a) the RSRD is to facilitate dispute resolution. Yet elsewhere it appears that the decisions of the home or POE state are final, preempting regulation of reinsurance by the host state of a ceding company. Thus, should a host state be extremely concerned about the slow payment of a reinsurer to a domestic insurer, the rating of the reinsurer might not change because the home or POE state refuses to do so. Interestingly, should the host state be able to argue that it needs a rating downgrade of a reinsurer to seek additional collateral, should that reinsurer not post the additional collateral, it is the host state's domestic that would take the surplus hit. If significant enough, it is the host state with an insolvent insurer based on the decision of the home or POE state.

In (b) the RSRD is to maintain, revise and update collateral reduction eligibility criteria. One concern here is that the RSRD becomes a legislator. It appears the RSRD at best is an administrative entity, empowered to enforce laws the states enact. PCI is not certain exactly what the status of the RSRD is. We do not see how a legislature can delegate its legislative duty to the RSRD to create law. The "collateral reduction criteria" must be set by statute, with the RSRD perhaps the entity to enforce those statutes.

This raises another concern relating to part (a). If the RSRD is to enforce, not create the statutes, then it should not, and constitutionally should not, judicially interpret the provisions. Yet it appears the RSRD seeks to be the legislative, executive and judicial branch in relation to collateral reduction.

Part (c) raise related concerns, some very practical. To the extent the RSRD establishes uniform standards, only in the event each host state accepts each home or POE state determination will the proposal work. Another practical issue, mentioned earlier, how would the RSRD establish the uniform standards, especially relate to item #20, so that each state uniformly interprets and applies those standards? There could be as many different applications of the #20 standards as there are home and POE states. In fact, a state which might be both a home state and POE state might apply those standards differently in the home and POE context, since, for example, home states would be working with SAP accounting and POE states with, at best, reconciled SAP accounting. Or home states need not consider enforceability of judgments by other states, but POE states must consider enforceability of judgments of foreign countries.

Item 11 (a). PCI is very concerned with the RSRD as the "repository for relevant data concerning reinsurers and the reinsurance markets." This is vague and raises a number of concerns. It is not clear what "relevant" data are. Confidentiality of data held by the RSRD is another issue. Still another is what financial (and other) information about reinsurers, U.S. and alien, required by this

process will be publicly available? Since the RSRD proposal preempts host state solvency regulation as to collateral, transparency becomes an issue, not only for host state regulators, but for ceding insurers. Ceding insurers must have full access to as much RSRD data as possible on reinsurers in order to make informed decisions as to reinsurers.

Item 11(b). The RSRD is to determine the appropriate supervisory recognition approach for non-U.S. jurisdictions and create a list of eligible jurisdictions. PCI continues to believe there is no constitutional authority for the RSRD to "vet" foreign countries. We do not recall seeing a system under which such could constitutionally occur absent an act of Congress.

Item 11(c). We do not understand the concept of "unilateral" recognition. This seems to confirm the "one-way" nature of the concept of collateral reduction as a benefit to non-U.S. companies with no mutuality.

Item 11(e). These are mandatory criteria for qualifying home and POE states. Other criteria may exist. Part (ii) requires accreditation of the state. Currently, that would exclude New York from being either a home or POE state. It is not clear what would happen in the event a home or POE state loses its accreditation. Parts (iii-v) discriminate against smaller states. Assuming that a small state might have expertise and staff size, part (v) is a simple exclusion for states without "sufficient (undefined) ceded premium volume." Part (v) excludes a small state regardless of how otherwise qualified it might be to be a home or POE state.

Item 11(g). The mandatory contractual provisions are an intrusion into what is properly the role of the legislature. Assuming for the sake of argument that the RSRD should establish mandatory provisions, there will not be uniformity as the proposal allows any reinsurer to operate under the current credit for reinsurance system; including posting collateral to avoid disfavored RSRD mandated contractual provisions. Should it be maintained that these mandated provisions occur only under an optionally free of collateral (OFC) system, then this option confirms that alien reinsurers can operate in the U.S. under the current system and the RSRD is an additional option, not elimination of discriminatory collateral requirements.

Role of Home State Supervisor

Item 12(c). Also as applied to the POE states, absent a host state statutorily accepting the evaluation of a home or POE state, it may not be constitutional for the home or POE state to impose its determination on a host state. Uniformity is clearly not met under this section as the home state is to be responsible for establishing the "appropriate" rating of national reinsurers and adjusting that rating. A reinsurer seeking to be a national reinsurer might seek out the home state that, given all else equal, grants the reinsurer the highest rating. There is an element of the "race to the bottom" here.

Item 12(e). It is unclear as to what is meant by this item. Elsewhere, it seems the determination of the home state is final, unless the home state decides to change its position.

<u>Role of the Port of Entry Supervisor</u>

Item 13: PCI continues to have concerns regarding the POE provisions and the constitutionality of states in dealing with foreign countries.

Item 13(b): Twice here the term "valid" judgment appears. This word should be deleted if there is to be certainty (and to some degree, mutuality since it is our understanding the U.S. honors foreign judgments) of outcomes. Otherwise, a perfectly valid judgment within the U.S. can be considered as not being "valid" by the foreign country. The refusal to accept an AR-1 from any reinsurer in a

jurisdiction that does not promptly and fully enforce final U.S. judgments is confusing. Any such jurisdiction should not be certified in the first place. Failure to enforce a final U.S. judgment should result in removal of certification of that jurisdiction. PCI is concerned as there does not seem to be a "decertification" process in the proposal. Decertification is problematic to all U.S. ceding companies of any such reinsurer(s) who now lose annual statement credit if collateral is not posted at 100% within three months.

Item 13(c). Same comment as with 12(c).

Item 14. These quarterly reports are material to any ceding company within the U.S. and must be available to any potential ceding insurer.

Item 14(c). PCI still does not understand why disputed and overdue reinsurance claims are only material to the process (and the U.S. ceding insurers) if the information relates to reinsurance assumed from U.S. domestic ceding companies. A reinsurer's disputed and overdue reinsurance claims information is relevant whether the business is reinsurer/U.S. cedent or reinsurer/any cedent. Not paying is not paying. The U.S. ceding insurer language should be stricken.

Role of Host State Supervisors

Item 15. There could be an unintentional limitation of the powers of host state supervisors to the enumerated items and no others. This should read, "*In addition to the normal regulatory duties* the host state supervisor shall:"

This provision creates a "catch-22" for the host state. The host state is, by its own statutes, required to regulate its domiciliary insurer for solvency. The proposal would remove host state regulation as to collateral for reinsurance. Major insolvencies have shown that reinsurance is often the largest single part of an insurer's financial statement.

Item 15(a). We are not sure how this would work in reality. The host state might receive information about the reinsurer that could seriously jeopardize the solvency, or for that matter the financial position of the host state insurer. Host state insurers, too, should have access to that information.

We believe the end of the first phrase should read, "…home *or POE* state."

Item 15(b). This should not be limited to emergencies, the phrase, "…due to an emergency" should be removed. And in the event the home (also should read, "…home *or POE* state…") state does not within a reasonable time commence such an examination, the host state should be empowered to do so (similar wording exists in relation to risk retention groups and non-domicile's ability to perform examinations).

Item 18. Reinsurers with an S&P or A.M. Best rating below A- have an extremely difficult time securing future reinsurance business. U.S. cedents are substantially penalized where there reinsurers are in the B range. The S&P capital model penalty for uncollateralized cessions to all BBB rated companies is twice that of A-rated companies. Best's Impairment Rate and Rating Transition Study of U.S. P&C companies indicates reinsurers rated B++/B+ are more than twice as likely to become impaired after a 5 year period than companies rated A/A-.

A-rated reinsurers tend to be perched on a cliff and/or in the early years of rating analysis. PCI recommends requiring 100% for A- rated. It would not be unreasonable to consider reducing the requirement for Class 1 companies (Best A++) and perhaps Class 2 companies (Best A+ rated).

Item 19. For a long time, the proposals for collateral reduction have spoken of “geographically agnostic.” This item and the table show that it is not the case with the proposal at hand. With claims of discrimination against alien insurers as the basis for having a proposal, this is confusing. The current system at least treats the aliens as any other insurer as evidenced by the divisions within item #8, see above.

We must mention that U.S. reinsurers’ level of regulatory oversight is well known. In addition, the timeliness and level of disclosure of financial results is very good in comparison to many non-U.S. companies. Accordingly, there should be some level of benefit accorded to U.S. reinsurers.

Item 20. There is no specificity, hence no uniformity, as to the amount of “downgrade” that could occur in the event that a reinsurer fails any one or more of these criteria and to differing extents. A prudent ceding company will have to look at its potential reinsurer in light of each of these factors, "guesstimate" how the home or POE state might or might not consider these relevant and if so how relevant, and then determine if it should run the risk of losing credit for reinsurance to one degree or another. This is another problem with the proposal: It does not give business level certainty to the ceding insurers, yet the ceding insurer must anticipate how a home or POE state will treat the reinsurer.

These items will do the opposite of creating uniformity as states apply some or all of the criteria to one degree or another.

In order for the criteria in #20 to be truly useful, it seems the criteria should be at least the same as if the reinsurer became licensed.

Item 20(a). Under this item “all” disputed or overdue recoverables are to be considered, yet under the reporting section, only those related to U.S. ceding companies are to be considered. “All” is the preferable choice as any disputed or overdue recoverable is relevant to a ceding company.

Item 20(e) and (f). There will have to be major changes to the schedule F (and related document for alien reinsurers). This is not just a change to the schedule F of national reinsurers or a schedule F-like document for the POE reinsurers. Ceding companies would have to list reinsurers at varying collateral amounts. Some reinsurers may be certified while some not. Some reinsurers may have lowered or increased ratings. Some reinsurers may have changed ratings would have to indicate for which periods and contracts. Other information may be needed on the schedule F. This is another burden the proposal places on ceding companies.

Item 21. The presumption that short tail business can have collateral deferred is appropriate only if such reinsurers never become troubled within a year after a catastrophe. PCI believes that there may be reinsurers with heavily weighted catastrophe books of business that are in reality more likely to be troubled immediately after a catastrophe. Additionally, there is no provision in this item for a circumstance where there is short tail business and the reinsurer is downgraded within that year. This is but another instance where the ceding company will have to wait for the collateral. Meanwhile, as with other instances where the ceding company has a downgraded reinsurer, the ceding company itself may be downgraded while waiting for collateral that would, had it existed, prevented a downgrade to the ceding company in the first place.

This concept, if in the proposal at all, should require a showing by the reinsurer why it should be exempt from collateral requirements. The current proposal simply grants the exemption.

Item 23. While the “no more than 5% of gross premium written on a primary basis” is used to define entities able to avail themselves of the proposal, PCI believes there should be clarity how the

proposal applies or not to intercompany pooling arrangements or intercompany reinsurance agreements.

Item 24. The suspension of a certification of a reinsurer, or worse, reinsurer(s) jurisdiction causes a number of concerns. One is timing. PCI believes there would be an administrative process to challenge the suspension and after that, judicial review. This delay poses problems for ceding insurers. Their own ratings may be downgraded because the collateral is not increased while this process goes on. They may not receive any collateral until completion of an administrative hearing. Or they may not receive any collateral until after judicial review of the administrative hearing.

Item 25. This item mentions that financial or operating results could be a cause for suspension. Significant delay in payment should be another reason.

Item 26. The proposal should be modified so that where the rating declines, the reinsurer must immediately meet collateral requirements applicable to its new rating. Thus, for reinsurers posting collateral at any reduced rate, they must regularly monitor loss reserves of their ceding companies in order to immediately effectuate any collateral posting and indicate to the home or POE state the amount of collateral they would need to post to be fully collateralized for all their U.S. ceded business. The time to inquire as to ceding insures' loss reserves should not start when additional collateral is required. The home or POE state should be required to analyze that amount to see if the reinsurer can in fact post such collateral and if not, the rating must be adjusted downward.

Item 27. There is nothing in this item as to what recourse the ceding company would have after the three months, or earlier, if the required collateral is not posted. PCI believes that is not addressed as the answer is none. The hit to surplus is a burden to be borne by the ceding companies.

Summary

Regulators should consider the impact to U.S. cedents of process changes (e.g. possible penalties on a revised Schedule F, realistic view of whether or not additional collateral can be secured when a reinsurer's rating changes). There are benefits to be gained if there are more timely payments of obligations from slow pay reinsurers, if foreign reinsurers are required to disclose financials on a more timely/transparent basis at the risk bearer level (versus group level), and if there is real consideration change made to tools such as schemes/transfers which often puts U.S. cedents at greater credit risk. For example, transfer of obligations to a small unrated company but with a general parental guarantee still disadvantages the cedent in the eyes of rating agencies and the cedent.

In conclusion, collateral requirements have been a proven benefit to U.S. cedents. We must realistically understand the impact change would have on the cedent and reinsurer. Any burdens of any change must be placed upon the reinsurer, not the ceding company.

Sincerely,

Michael G. Koziol
Assistant Vice President and Counsel

MGK:sk

Proposed amendment to NAIC Model Credit for Reinsurance Law

D. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution, as defined in Section4B, for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. To enable the commissioner to determine the sufficiency of the trust fund, the assuming insurer shall report annually to the commissioner information substantially the same as that required to be reported on the NAIC Annual Statement form by licensed insurers. The assuming insurer shall submit to examination of its books and records by the commissioner and bear the expense of examination.

(2) (a) Credit for reinsurance shall not be granted under this subsection unless the form of the trust and any amendments to the trust have been approved by:

(i) The commissioner of the state where the trust is domiciled; or

(ii) The commissioner of another state who, pursuant to the terms of the trust instrument, has accepted principal regulatory oversight of the trust.

(b) The form of the trust and any trust amendments also shall be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the United States. The trust shall vest legal title to its assets in its trustees for the benefit of the assuming insurer's U.S. ceding insurers, their assigns and successors in interest. The trust and the assuming insurer shall be subject to examination as determined by the commissioner.

(c) The trust shall remain in effect for as long as the assuming insurer has outstanding obligations due under the reinsurance agreements subject to the trust. No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing the balance of the trust and listing the trust's investments at the preceding year-end and shall certify the date of termination of the trust, if so planned, or certify that the trust will not expire prior to the following December 31.

(3) The following requirements apply to the following categories of assuming insurer:

(a) The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers, and, in addition, the assuming insurer shall maintain a trusteed surplus of not less than $20,000,000. <u>**However, in the case of a non U.S. assuming insurer that has discontinued underwriting new business, hereinafter referred to as a "non-U.S. run-off assuming insurer", the domiciliary commissioner may determine, in his sole discretion, that a lower minimum trusteed surplus is acceptable. In making such determination, the domiciliary commissioner may consider such factors as the effect that the $20,000,000 minimum has on the solvency or liquidity of such non U.S. run-off assuming insurer and the protection of U.S. cedants and policyholders.**</u>

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July 17, 2008

Via E-mail

Commissioner Steven M. Goldman
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Re: RAA Comments to July 3 Reinsurance (E) Task Force Activities Memorandum – Reinsurance Regulatory Modernization Framework Proposal ("July 3 Memorandum" or "the Proposal")

Dear Commissioner Goldman:

The RAA appreciates the opportunity to comment on the reinsurance regulatory modernization framework proposal outlined in the July 3 Memorandum. We appreciate your continued leadership efforts to pursue comprehensive reinsurance regulatory reform at the NAIC and look forward to the continued dialogue on this issue.

The RAA is a national trade association representing property and casualty companies that specialize in reinsurance. RAA membership is diverse, including large and small direct writers and brokers in the U.S. and subsidiaries of foreign companies. We have two general comments and several more specific comments to the July 3 memorandum.

General Comments

First, the RAA is very concerned that the current draft of the Framework Proposal is missing one of the three core components - the mutual recognition component - which was an essential element in the Framework Proposal draft that the NAIC plenary passed in March 2008. A key element in the original November 8, 2007 Framework Memorandum (which was repeated in the December 2, 2007 Framework Memorandum that was passed by the RTF, E Committee and Plenary) was "assessing regulatory effectiveness through an 'outcomes-oriented' approach" to "determine which non-US jurisdictions are entitled to enter into mutual recognition agreements." The Framework Proposal identified several "Outstanding Issues" to be addressed including "determination of how mutual recognition agreements should be negotiated, enforced and terminated". The Framework Proposal also identified several potential areas where mutual recognition parties would determine that their counterparts apply appropriate legal standards and regulatory requirements. This key component has virtually disappeared in the July 3 Memorandum.

This is surprising for many reasons, including the fact that the NAIC's April 5, 2008 letter to Senator Jack Reid asking the Senate to not consider the reinsurance section of H.R. 1065, the Nonadmitted and Reinsurance Reform Act of 2007, is based upon the fact that the NAIC RTF had adopted a framework for the reinsurance modernization initiative that "included 3 critical components: (1) mutual recognition of different regulatory regimes (both within and outside the US) and a process to attain mutual recognition; (2) the concept of a single US regulator for reinsurers within the US; and (3) the concept of a single state regulator for non-US reinsurers through which non-US reinsurers could access the US marketplace." Three months after this representation to Congress, however, the first critical component appears to have disappeared without explanation and with it the ability to implement the objectives of the 3rd point – the equivalent treatment of non-U.S. reinsurers pursuant to a process which assures the appropriate protection to the U.S. insurance market through assessment of non-U.S. jurisdictions to determine if they employ substantially equivalent legal standards and regulatory requirements.

The RAA would also caution the Task Force that the IAIS Guidance Paper on Mutual Recognition has changed significantly from the draft referenced and relied upon in earlier versions of the RTF framework proposals. It now is, in fact, much broader than the title would suggest as it addresses all the possible options for recognition of other supervisory authorities (unilateral, bilateral and multilateral). During drafting sessions of this paper at IAIS meetings, international regulators were clear that they wanted the paper to address all of these options but that individual countries could and would do what they deemed appropriate. It is noteworthy that, with the broadening of the IAIS paper to include additional forms of supervisory recognition, the "Benefits of mutual recognition" section set forth in the July 18, 2007 IAIS draft has been revised. Several important benefits of mutual recognition to the insurance industry, its regulators and the public have been deleted, presumably because they may not be realized under some of the forms of supervisory recognition now encompassed in the IAIS draft. We urge this Task Force to again include "mutual recognition" of other supervisory regimes in its proposal.

Inherent in this concept of "mutual recognition" is the idea that U.S. reinsurers would get the same benefits and access to non-U.S. jurisdictions that non-U.S. reinsurers from recognized jurisdictions would receive in the U.S. The U.S. is the largest consumer of property/casualty reinsurance in the world. There is no doubt that the U.S. needs the global reinsurance marketplace to meet its demands. At the same time, however, U.S. regulators should also seek to preserve the domestic reinsurance market by not only streamlining the regulatory process within the U.S. but also by assuring similar treatment of its companies abroad. The method for accomplishing this will be addressed in the implementation phase.

<u>Second</u>, and as set forth in more detail below, the RAA is very concerned about the July 3 Memorandum's requirement of numerous mandatory contract terms in reinsurance agreements. Reinsurance transactions are between sophisticated business entities with relatively equivalent bargaining power. There is no need to dictate explicit clause language to ceding and assuming insurers and doing so would be inconsistent with current NAIC and international regulatory practice. Such a move is in the opposite direction of principles-based regulation, which the NAIC is exploring. Finally, the specific referenced clauses go beyond what is necessary to ensure an entity's solvency.

Addressing these two critical issues is of the utmost importance as the Task Force moves forward in both the design and implementation phases of its reinsurance regulatory modernization framework.

Section-by-Section Comments

The RAA has the following comments to specific sections of the July 3 Memorandum:

1. The RAA suggests the following revisions to the definitions:

   A. "National reinsurer" means a reinsurer that is licensed and domiciled in a home state and approved by such state to ~~write reinsurance~~ <u>transact</u> assumed <u>reinsurance</u> business across the United States while submitting solely to the regulatory authority of the home state supervisor for purposes of its reinsurance business.

The amendment more accurately reflects standard reinsurance terminology.

2. <u>Paragraph 3</u>: The RAA is concerned about the NAIC through the RSRD, which is not a governmental body and which is not accountable to any governmental body, having responsibility for establishing and implementing the certification mechanism for evaluating and determining which states should be single state regulators. As we have previously suggested, consideration should be given to the appropriate federal role and/or "federal tools" that may be necessary to enable effective implementation of the certification aspect of the Proposal.

3. <u>Paragraph 4:</u> For purposes of calculating "assumed reinsurance" in determining a company's eligibility under the Framework, when a reinsurer writes surety reinsurance and has related co-surety arrangements, the fact that the reinsurer may face potential direct liability should not change the classification of the surety reinsurance business. Such business should properly be classified as "assumed reinsurance."

4. <u>Paragraphs 6(b) and 7(b):</u> leave the determination of risk transfer to the ceding company's domiciliary regulator. The RAA is concerned that a regulator could use this authority to require additional contract terms and conditions in order for a contract to qualify as transferring risk. The Proposal should explicitly state that risk transfer should be determined in a consistent manner in accordance with statutory accounting rules and that the ceding company's domiciliary regulator has no authority to require additional contract terms or conditions.

5. <u>Paragraph 7(c)'s</u>: second sentence should be amended as follows so that the terminology is in accord with the Definitions section:

   Once the non-U.S. jurisdiction has been recommended as eligible by the RSRD, and so long as it maintains that status, the reinsurer could then be

certified by the POE state to ~~access~~ provide creditable reinsurance to the U.S. market through the POE state.

6. As noted above, Paragraph 7(c) states that in order to be certified as a POE reinsurer, a company/reinsurer "must be organized and licensed by a non-US jurisdiction recommended as eligible for recognition by the RSRD." Requiring reciprocity and/or entering into a mutual recognition arrangement, which was a cornerstone of the Framework Proposal passed by Plenary, is absent and should be re-inserted here to make clear that is a significant component of the Proposal that needs to be addressed in the implementation phase.

7. Paragraph 8: fails to refer to the "substantially similar" category of authorization in the NAIC model credit for reinsurance law. Additionally, Paragraph 8(d) references 100% collateral as the current status quo, however, this is not always the case with respect to individual funding mechanisms. The amount of collateral required under the current system must be equal to the amount of credit taken, which is not necessarily 100% in all cases. This point should be clarified.

8. Paragraph 10(b): provides that the RSRD will maintain, revise and update collateral reduction eligibility criteria. As explained more fully elsewhere in our comments, the RAA believes a system of collateral criteria is unnecessary in a regulatory regime with meaningful recognition standards that ensure all reinsurers transacting assumed business or providing creditable reinsurance in the U.S. are subject to substantially equivalent regulatory standards and enforcement. If such a recognition system is in place, neither a national reinsurer nor a POE reinsurer from an eligible, recognized jurisdiction should be required to post collateral except as expressly provided for under the recognition arrangement with the non-U.S. jurisdiction.

9. Paragraph 11: addresses the functions of the RSRD. There are many important functions that the RSRD can perform, including participating in the development of standards and making recommendations, which must then be accepted by the regulator. It is critical to remember that the RSRD is not a governmental body and it cannot perform governmental functions or make governmental decisions. For example, the RSRD can perform the assessment of the jurisdiction and make a recommendation to the regulator that the jurisdiction meets the appropriate standards; the regulator must then accept (or reject) this recommendation for it to have any legally binding effect.

The regulatory recognition should then either be embodied in an agreement wherein each supervisory authority identifies those areas where the host jurisdiction will defer to and rely upon the exclusive exercise of the home jurisdiction's supervision, or it may be effected through other lawfully prescribed methods (e.g., regulatory certification, authorization) that provide reciprocal legal benefits for the licensees of each jurisdiction. It is critical that this regulatory recognition be accomplished in a lawful manner (either at the federal level or by an appropriate authorization from the federal government to the state(s)).

This supervisory recognition should be founded upon a mutual determination by the supervisory authorities that each maintains substantially equivalent regulatory standards and enforcement capabilities. The recognition process (whether by supervisory agreement, regulatory certification, authorization, bilateral agreement or as otherwise prescribed by local law and regulation) should be preceded by an exchange of, and thorough evaluation of, all relevant information regarding the form and nature of regulation in each jurisdiction, and a conclusion that each system maintains and applies substantially equivalent legal standards and regulatory requirements for:

A. Licensing, including an assessment of the quality and competence of licensee ownership and management;

B. Financial condition, including capitalization, risk based capital, solvency, investment and reserving requirements;

C. Periodic examination of the financial condition and operating practices of licensees;

D. Financial accounting and reporting;

E. Regulating insurance holding company systems;

F. Procedures for the prompt enforcement of final judgments and arbitration awards rendered in the other jurisdiction.

Each supervisory authority should also demonstrate that it: (1) maintains sufficient resources and qualified personnel to implement effectively these standards and requirements; (2) will commit to an exchange of all relevant information necessary for ongoing assessment of the above-listed standards and requirements during the period of recognition; and (3) will provide reciprocal regulatory treatment to licensees of the other jurisdiction.

Thus, once a jurisdiction is vetted and approved pursuant to this process, i.e., where a U.S. reinsurer is licensed and domiciled in a Home state, or a Port of Entry reinsurer is licensed and domiciled in an approved jurisdiction, additional requirements to provide creditable reinsurance in the U.S. would be unnecessary (unless, for example, the regulatory authorities have negotiated in their recognition arrangement that there should be some collateral requirement). This approach gives the appropriate value to being licensed by an approved jurisdiction and reflects true recognition of another supervisory authority.

This critical element of "mutual recognition" as part of a modernized, uniform system of reinsurance regulation has disappeared from the Task Force's proposal. The concern first arises in Paragraph 7(c). If the eligibility requirements of the RSRD included a process for recognition of jurisdictions that maintain a substantially equivalent level of reinsurance regulation and which provide for reciprocal legal benefits for the licensees of

each jurisdiction, the spirit of the original Framework Memorandum would remain. However, that is not the case under the current draft of the Proposal. Paragraph 11(b) merely states that "the RSRD will determine the appropriate supervisory recognition approach for non-U.S. jurisdictions." Paragraph 11(c) goes further in stating the RSRD will develop a protocol for unilateral recognition – a term which is undefined in the Proposal. The Proposal notes that the IAIS Guidance Paper on Mutual Recognition should serve as a reference document, yet that paper is based upon recognition of "acceptable" regimes. A standard of "acceptability" likely will not give Host states comfort that reinsurers from that "acceptable" jurisdiction are regulated on an equally strong basis as reinsurers in the U.S. At best, the current proposal is unclear as to the standard that will be applied by the RSRD in recommending recognition.

Additionally, the Proposal imposes collateral requirements on U.S. reinsurers that are subject to robust regulation in their Home state while their competitors that remain in the 50-state system (i.e. that are not passporting) need not post collateral. This disadvantages the similarly heavily regulated U.S. entities that are passporting vis-à-vis their competitors who remain in the current system.

Other comments on this Paragraph include:

i. Paragraph 11(a) should be amended to make it clear that since the RSRD is a non-governmental entity, it will be a repository for non-privileged information.

ii. Paragraph 11(b) should make clear that the RSRD can only conduct the evaluation and make a recommendation to the appropriate regulatory authority; it cannot make the decision or enter into any supervisory agreements. Moreover, the requirement of reciprocal legal/regulatory treatment from the non-US jurisdiction and/or entering into mutual recognition arrangements with that jurisdiction is missing from this provision and should be included for the reasons set forth above.

iii. Paragraph 11(c) states that the RSRD will develop a standard supervisory recognition agreement and a protocol for unilateral recognition. We would note that the RSRD does not have authority to enter into supervisory recognition agreements. Furthermore, the RTF (unlike the IAIS Guidance Paper) should define "unilateral recognition" to clearly include a requirement that each jurisdiction provide reciprocal legal benefits to the licensees of the other jurisdiction and maintain substantially equivalent regulatory standards and enforcement capabilities.

iv. Paragraph 11(e)(ii) requires accredited status however we would urge the addition of the following language at the end of the sentence: "or financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation."

v. Paragraph 11(g) empowers state regulators to mandate numerous reinsurance contract terms and to make those contract terms uniform, meaning that specific language will be required. This is a departure from the current NAIC model laws and accounting guidance, which require only a few specific contract clauses and do not dictate specific language. International regulatory practice follows the same approach. The departure from this custom puts the Proposal at odds with the way reinsurance is commonly transacted on a national and global basis. Reinsurance involves contracts between sophisticated entities and therefore the terms and conditions of reinsurance agreements should be left to the marketplace. RAA policy strongly supports freedom to contract in a competitive market with respect to terms and conditions, other than those uniformly required by SSAP 62.

Insolvency Clause: The insolvency clause is a clause properly mandated in reinsurance agreements. An appropriate insolvency clause must recognize a balancing of interests—that the reinsurer must pay even though the estate cannot first pay the claim—but that the reinsurer also has the ability to protect itself from improper payment by participating in the adjudication of the underlying claim. To the extent the Task Force believes that specific insolvency clause language is necessary, the RAA suggests the following language:

> (1) No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance, unless the reinsurance contract provides, in substance, that in the event of the insolvency of the ceding insurer, the reinsurance shall be payable under a contract(s) reinsured by the assuming insurer on the basis of reported claims allowed by the liquidation court, without diminution because of the insolvency of the ceding insurer. Such payments shall be made directly to the ceding insurer or to its domiciliary liquidator except: (a) where the contract or other written agreement specifically provides another payee of such reinsurance in the event of the insolvency of the ceding insurer, or (b) where the assuming insurer, with the consent of the direct insured(s), has assumed such policy obligations of the ceding insurer as direct obligations of the assuming insurer to the payees under such policies and in substitution for the obligations of the ceding insurer to such payees.
>
> (2) The reinsurance agreement may provide that the domiciliary liquidator of an insolvent ceding insurer shall give written notice to the assuming insurer of the pendency of a claim against such ceding insurer on the contract

> reinsured within a reasonable time after such claim is filed in the liquidation proceeding. During the pendency of such claim, any assuming insurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defenses which it deems available to the ceding insurer, or its liquidator. Such expense may be filed as a claim against the insolvent ceding insurer to the extent of a proportionate share of the benefit which may accrue to the ceding insurer solely as a result of the defense undertaken by the assuming insurer. Where two or more assuming insurers are involved in the same claim and a majority in interest elect to interpose a defense(s) to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance agreement as though such expense had been incurred by the ceding insurer.

Intermediary Clause: The proposal should not mandate inclusion of an intermediary clause. Whether to include this type of clause is better left to the negotiation between the parties. It long has been established as a matter of law that the typical activities of a reinsurance intermediary create an agency relationship between the intermediary and the ceding company. (*See In the Matter of Pritchard & Baird, Inc.*, 8 B.R. 265 (D.N.Y. 1980)) This principal-agent relationship between the ceding company and its intermediary broker is underscored by the NAIC Model Intermediary Act's definition of an intermediary broker and the requirements that the cedent and the broker enter into a written contract. Dictating a specific intermediary clause attempts to alter fundamental principal-agent law that payments made to an agent constitute payments to principal. Instead, the mandated clause attempts to shift credit risk to a third party (the reinsurer) with whom there is no contractual relationship or control over the intermediary broker. While commercial parties can (and, in the context of reinsurance transactions, often do) negotiate contract terms that shift credit risk, the RSRD has no authority to change fundamental agency law principles to require a third party to bear the credit risk for payments made to a principal's agent.

Credit for Reinsurance Clause: Furthermore, we strongly object to the inclusion of the new "downgrade" credit for reinsurance clause that requires a reinsurer to provide the necessary amount of collateral to enable the cedent to take "full statutory accounting credit." For the reasons set forth elsewhere in our comments (#14), there should not be any obligation to post collateral for a U.S. reinsurer that is licensed and domiciled in a Home state. Further, the RAA strongly objects to statutorily mandated "downgrade" clauses in reinsurance agreements as a matter that should be left to the parties to negotiate. Mandating inclusion of such a clause does

not encourage the proper type of risk management where parties appropriately identify and capitalize risk. Notwithstanding the above, current credit for reinsurance laws recognize situations where the cedent may take credit only for the amount of collateral provided (i.e., less than 100%). We suggest that at a minimum this provision be modified to allow this to continue.

The term "Obligations" needs to be defined as it is unclear what is included (i.e., is IBNR included? Cedents and reinsurers sometimes disagree on the valuation of liabilities. Under the proposal who decides what the Reinsurer's share of Obligations will be? Because of these concerns, collateral for IBNR clearly should not be required.)

Finally, we would note that the RSRD could properly consider, in evaluating regulatory regimes, whether the supervisory system makes adequate provision for evaluating reinsurance agreements in a manner similar to that set forth in SSAP 62. In this way, the RSRD can ensure that non-U.S. reinsurance regulatory systems adequately address credit risk allocation, insolvency obligations and other key provisions without dictating specific clause language.

10. Paragraph 13: does not address the situation where multiple states serve as POE supervisors to several different reinsurers in a single jurisdiction. Does the Proposal contemplate that each POE state will need to enter into an agreement with the non-U.S. jurisdiction?

11. Paragraph 14: The provisions are ambiguous as to what would be required and leave too much discretion to the POE supervisory authority. Many of the items are more properly the subject of any applicable recognition arrangement. Paragraph 14(c) provides that POE reinsurers must file quarterly reports with their POE supervisor listing all disputed and overdue reinsurance. The information sought by the report is currently available from ceding insurers. Only a change in information materially relevant to a reinsurer's individual financial situation should be required by the POE supervisor. At a minimum, there should be a materiality standard for this reporting requirement.

12. Paragraph 15: provides that the "domiciliary state supervisor" retains the authority to require diversification of reinsurance risk for ceding insurers. First, a domiciliary state supervisor should not be permitted to apply diversification requirements in a manner that discriminates against a reinsurer based on its status as a National Reinsurer or a POE reinsurer. Second, the RAA suggests modifying this sentence to require diversification only for unaffiliated reinsurance risk for ceding insurers. Intra-group (retro)cessions can exceed 50% of the cedent's policyholder surplus; because these transactions are already subject to notification and review under holding company act laws, these transactions should be exempt from this requirement. Third, the notice requirement if the cession to a single reinsurer exceeds 20% of the ceding insurer's gross written premium is too low and should be changed to, at a minimum, 50%. The appropriate degree of diversification

in a ceding company's reinsurance program depends on many variables that must be considered by that company's management. Setting a low fixed percentage by rule may encourage imprudent decision-making. Ceding companies should be free to manage their credit risk and reinsurance purchases without regulatory interference so long as they meet RBC levels and overall enterprise risk management requirements.

13. Paragraph 16: states that reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements. We would urge the Task Force to utilize a group rating where a rating agency has either enhanced the rating of a subsidiary, or has assigned the parent's rating to the subsidiary. If regulators are going to rely upon ratings and the rating agency has determined that a legal entity is considered a core subsidiary, that decision should be respected.

This paragraph also does not address how individual Lloyd's syndicates will be treated (i.e., will Lloyds' as a group receive a rating? Will the support of the Central Fund be taken into consideration?). This should be specifically addressed.

14. Paragraphs 16 – 18: also raise a fundamental problem with the rating system – the realities of the impact of such a system on cedents. Importantly, collateral has historically been utilized as a substitute for licensing. A reinsurer's rating may change over time and, under the system outlined in the Proposal, would require cedents to continuously monitor and modify their collateral. A drop in a reinsurer's rating from A- to B++ requires the imposition of 55% more collateral on the reinsurer. The reinsurer may have difficulty, or not be able to post, this unnecessary collateral; if that is the case, this should be a licensing issue, not a collateral issue.

Moreover, the current credit crisis has demonstrated again the problems with relying on rating agencies' ratings. Not only did the rating agencies fail to predict situations like Enron and Parmalat but more recently they failed to predict the downgrades of several monoline insurers (in at least once instance, the downgrade occurred after a recent upgrade). In a supervisory recognition situation as outlined above in comment # 9, this would not be an issue because the safeguards built into the recognition process would provide the certainty to regulators that the domiciliary jurisdictions are taking necessary and appropriate action against such entities. A provision such as this defeats that purpose and interferes with the domiciliary regulator's ability to appropriately deal with the company (similarly, requiring such a topping up of collateral in another jurisdiction of a U.S. company would interfere with the U.S. regulator's ability to address a U.S. reinsurer's issues.) True supervisory recognition should be based upon evaluation and reliance upon the other jurisdiction's regulation.

Further, home state and POE supervisors have additional discretion to assign reinsurer ratings based on a list of factors in Paragraph 20. The RAA is concerned that this additional discretion is based on subjective evaluations which will be difficult for reinsurers to predict and could be subject to misuse and abuse.

15. Paragraph 19: The RAA very much appreciates the NAIC's acknowledgment of the value of a U.S. license and believes that National Reinsurers should not have to post collateral (U.S. domiciled reinsurers have been subject for many years to a broad array of regulatory rules developed by the States through the NAIC Model Law process). However, the more appropriate way to address the regulatory concern regarding potential inability to pay claims may be through licensing/certification. If a regulatory authority believes that a reinsurer may have difficulty in the future paying claim, the appropriate course may be to restrict its ability to write new business rather than impose additional collateral requirements.

16. Paragraph 20: is unnecessary for the same reasons the collateral system should be unnecessary in a truly modernized regulatory regime based upon meaningful, enforceable supervisory recognition with reciprocal obligations. A better alternative would be to consider some of these factors during the evaluation process of the non-U.S. jurisdiction. Moreover, consideration of these factors in determining the appropriate rating appears to be very vague and subjective. It is also unclear what weight will be given to each of these factors – i.e., can these factors positively influence a rating or only negatively influence a rating? Is there an appeal process if a reinsurer believes that its assigned rating is not justified?

- Requiring a list of all disputed and overdue recoverables to be updated on a quarterly basis is overly burdensome.

- How will a regulator evaluate a reinsurer's reputation for prompt payment of valid claims under Paragraph 20(b) or compliance with reinsurance contractual terms under 20(c)? What information will be utilized and who will provide this information?

- It is unclear what is meant by "business practices" in Paragraph 20(d). This term is nebulous and should be defined.

This Paragraph, along with Paragraph 25, gives unfettered discretion to regulators to assign reinsurer ratings and thereby trigger collateral requirements regardless of financial security. Regulators have other tools available to address concerns over claims paying or market practices without the threat of an arbitrary collateral requirement.

17. The RAA strongly objects to Paragraph 22 which requires all reinsurers to post 100% collateral upon the entry of an order of rehabilitation, liquidation or conservation against the cedent. To the extent that this requires a reinsurer to post collateral for IBNR, the RAA strongly opposes this provision based upon valuation and claims acceleration concerns. These unknown liabilities (IBNR) are actuarial estimates that insurers and reinsurers use for accounting purposes in order to ensure that sufficient funds will be available to pay for any claims which, in the future, may be reported, adjudicated and paid. Reinsurers are not required to pay, under their reinsurance contracts, on the basis of unknown potential losses in the form of IBNR. They are obligated to pay only known claims that have been fully identified, for which liability has been established and value

has been determined. IBNR does not meet any of these requirements. Because reinsurance if often the largest asset of an insolvent estate, placing collateralized funds within reach of a receiver presents opportunities for mischief in the face of pressure to maximize estate values.

In addition, the provision unfairly penalizes a reinsurer for the insolvency of its cedent by forcing the posting of 100% collateral when such posting may not be contractually mandated. A.M. Best's special report on insolvency (*Best's Insolvency Study, Property/Casualty U.S. Insurers*, 1969-2002) indicates that reinsurance failures are rarely the cause of ceding company insolvencies. Thus, there is no justification, from a solvency perspective, to require a reinsurer to post collateral when a cedent is in financial difficulty. Cedent insolvencies usually arise from poor management of risk or poor underwriting results, and lead to significant claims which are ceded to reinsurers. To require collateral is to compound the problem for reinsurers.

Additionally, the reinsurers in this situation would be subject to either Home or POE state regulation either directly or through recognition arrangements. Where these reinsurers are timely meeting payment obligations, they should not be required to bear the additional costs of collateral and other associated risks. Where they are not, the Home or POE regulator has regulatory options to deal with the situation.

18. Paragraph 23: places affiliate transactions on the same footing as other reinsurance transactions. As we have stated before, affiliate transactions are subject to direct regulatory review under state holding company laws. This review subjects them not only to the typical risk transfer and other requirements imposed on unaffiliated reinsurance transactions but also provides a higher standard of regulatory scrutiny by requiring the transaction be fair and reasonable and to result in surplus that is reasonable to liabilities. The holding company laws also require submission of information about the entire holding company system and the controlling entity. Moreover, the non-U.S. affiliated entity has demonstrated a significant capital commitment to the U.S. Finally, all material affiliate reinsurance contracts must be submitted to the U.S. licensee's domestic regulator for prior approval, which approval can be subject to regulatory conditions including the establishment of security sufficient to satisfy any regulatory concerns. Reduced collateral for these transactions is warranted. In the alternative, the Task Force should consider no collateral requirements where the subsidiary has been designated by the rating agencies as a core subsidiary.

Thank you for the opportunity to comment on the current draft of the Proposal. We continue to review the Proposal and consider its implications. We look forward to working with you to implement the core components of the December 2, 2007 framework in the new regulatory modernization proposal. We are available if you have any questions or would like to discuss these comments further.

Sincerely yours,

Tracey Laws

cc: Bryan Fuller
Bob Kasinow

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MEMORANDUM

To: Reinsurance (E) Task Force

From: NAIC Legal Division

Date: July 15, 2008

Re: NAIC Reinsurance Regulatory Modernization Framework Proposal

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A. Executive Summary

The NAIC's Reinsurance (E) Task Force received a *Discussion Draft Only* Memorandum addressed to Swiss Re America Holding Corporation and prepared by the law firm of DLA Piper ("Draft Memorandum") dated November 6, 2007. The Draft Memorandum discussed legal issues relating to the NAIC Reinsurance Supervision Review Department Draft Proposal to Grant Recognition of Regulatory Equivalence to Non-U.S. Insurance Supervisors ("RSRD Proposal"), which the Reinsurance Collateral Study Group of the Task Force had released for comments on September 7, 2007. Specifically, the Draft Memorandum identified three areas of concern with respect to the RSRD Proposal regarding reinsurance collateral requirements: (1) traditional equivalence principles would require that unequal treatment and other burdens on companies should not be imposed simply based on their nationality; (2) the RSRD's mutual recognition framework is unconstitutional because the states cannot enter into mutual recognition agreements with a foreign power; and (3) the RSRD Proposal is impracticable because it will not be adopted unanimously by the states, which is necessary in order for the proposal to work.

The Task Force charged the NAIC Legal Division to evaluate the legal issues discussed in the Draft Memorandum, specifically with respect to the constitutionality of states entering into mutual recognition agreements with non-U.S. jurisdictions. After thorough review, and with the assistance of Sidley Austin, LLP the Legal Division has prepared the following memorandum and reached the following conclusions:

- The RSRD Proposal has been substantially revised by the Task Force since the Draft Memorandum was first issued, thereby bringing into question the findings and conclusions of the Draft Memorandum;

- The current version of the RSRD Proposal is unlikely to violate the United States' Most Favored Nation obligation under GATS;

- While the different reinsurance collateral requirements for U.S.-national reinsurers and non-U.S. port of entry reinsurers might be found to violate the National Treatment obligation under GATS, this disparate treatment could be found to be permissible if there are identifiable and meaningful differences between U.S. regulatory schemes and those non-U.S. regulatory schemes that are deemed to be "effective" by the RSRD;

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- The certification of non-U.S. jurisdictions by the RSRD through mutual recognition agreements is likely to be found constitutionally permissible under the Compact Clause, even in the absence of Congressional consent;

- To the extent that mutual recognition under the current version of the RSRD Proposal would involve states (or the RSRD) negotiating with foreign countries to achieve reciprocal recognition by facilitating the entry of U.S. companies into foreign markets, it calls into question whether the mutual recognition framework may be invalid under the Compact Clause, in the absence of Congressional consent;

- The RSRD's evaluation function of non-U.S. jurisdictions is not contrary to Foreign Affairs preemption;

- The RSRD Proposal satisfies the Dormant Foreign Commerce Clause.

These conclusions are based on the following facts and legal analysis:

B. History of Reinsurance Collateral Requirements in the United States ("U.S.")

The NAIC's Credit for Reinsurance Model Law (Model # 785) was first enacted in 1984, and has been adopted by all NAIC member jurisdictions. Under Section 2 of the Model Law, credit for reinsurance is allowed to a domestic ceding insurer on account of reinsurance ceded to an assuming insurer that is licensed to transact insurance or reinsurance business in the state ("U.S. reinsurer"). However, under Section 3 of the Model Law, credit for reinsurance ceded by a domestic insurer to a reinsurer not meeting the requirements of Section 2 ("non-U.S. licensed reinsurer") shall be allowed only to the extent that security is held in the United States subject to withdrawal and under the exclusive control of the ceding insurer ("collateral"). This collateral is generally in the form of a letter of credit, but can also be held in cash, securities, trust, or any form acceptable to the commissioner

The collateral requirements for non-U.S. licensed reinsurers have been a frequent subject of debate within the NAIC's Reinsurance (E) Task Force. In 2005 the Task Force published the U.S. Reinsurance Collateral White Paper (adopted by the NAIC membership in January 2006), which provided a balanced synopsis of the historical arguments in favor of and against amending U.S. reinsurance collateral requirements. On September 27, 2005, the Reinsurance Collateralization Roundtable (an ad hoc group consisting of insurance regulators and industry representatives) issued its Report of the Co-Chairs to the Task Force, in which it informally recommended that (1) the current U.S. system of requiring 100% collateral should be changed; and (2) any new U.S. rules should be "geographically agnostic" (i.e., they should apply to all reinsurers operating in the U.S. regardless of the country of domicile). During the Joint Meeting of the NAIC Executive Committee/Plenary on March 5, 2006, the following charge to the Task Force was adopted:

> "The Reinsurance (E) Task Force is directed to develop alternatives to the current reinsurance regulatory framework, including the use of collateral within the U.S. and abroad. Consider approaches that account for a reinsurer's financial strength regardless of domicile, i.e., state or country. Identify and consider variations in state law and regulation relative to reinsurance contracts, financial reporting, etc. As part of its deliberations, the Task Force should consult with international regulators in addition to all other interested parties. The Task Force shall present the proposal to the membership by the December 2006 national meeting."

On December 4, 2006, the Task Force adopted the NAIC Reinsurance Evaluation Office Proposal to Grant Credit for Ceded Reinsurance ("REO Proposal"), which would have created an organization called the Reinsurance Evaluation Office ("REO") to rate the financial strength of reinsurers doing business in the U.S., irrespective of the reinsurer's country of domicile. The Task Force later determined that there was further interest by regulators in re-evaluating the regulatory framework for reinsurance beyond the REO Proposal. On September 7, 2007, the Reinsurance Collateral Study Group of the Task Force released for comments the NAIC Reinsurance Supervision Review Department Draft Proposal to Grant Recognition of Regulatory Equivalence to Non-U.S. Insurance Supervisors, and the accompanying Port Of Entry State Criteria For Reinsurers Supervised in Jurisdictions Approved by the NAIC Reinsurance Supervision Review Department and U.S. Licensed Reinsurers (collectively referred to as the "RSRD Proposal'). As part of amending the U.S. reinsurance regulatory framework, the RSRD Proposal would develop a system which would allow for the following:

> **Mutual Recognition Framework.** Allows supervisors to recognize the quality of regulation and supervision in other jurisdictions and consequently to remove or greatly mitigate additional regulatory/supervisory burdens to reinsurers in those same jurisdictions. Reinsurance Supervision Review Department ("RSRD") would determine which non-U.S. jurisdictions are eligible under mutual recognition framework. Unilateral recognition, although it is by definition not "mutual," can also be an option if a host supervisor unilaterally chooses to place reliance on the work of another.
>
> **Single State U.S. Regulator – U.S. Reinsurers.** Domestic reinsurers would submit to one jurisdiction in order to access the U.S. market (minimum criteria established to qualify for single state regulatory approach).
>
> **Port of Entry – Non-U.S. Reinsurers.** Non-U.S. reinsurers from approved jurisdictions would be certified to access the U.S. market through one jurisdiction that has met certain criteria.

The Draft Memorandum is based on the version of the RSRD Proposal dated September 7, 2007. However, this version has never been adopted by either the NAIC Plenary or the Task Force, and the proposal has undergone significant modifications since the Draft Memorandum was written. The Reinsurance Regulatory Modernization Framework Memorandum ("Framework Memorandum") dated December 2, 2007, was approved by the Task Force and its parent Financial Condition (E) Committee in December 2007, and by the full NAIC Plenary in 2008. The Framework Memorandum was intended to convey the basic understanding of what the NAIC had agreed upon with respect to the RSRD Proposal, and what issues were still necessary to be developed. Interim meetings of the Task Force were held in March, May and June of 2008 to discuss the outstanding issues of the reinsurance regulatory modernization framework. The memorandum on Reinsurance (E) Task Force Activities dated July 3, 2008, reflects the current status of the RSRD Proposal, although to date the only matter that has been formally approved by either the Task Force or the NAIC is the Framework Memorandum. Additional meetings of the Task Force are anticipated to be held in 2008 to further refine the RSRD proposal.

C. Current Reinsurance Regulatory Modernization Framework Proposal

While still a work in progress, the current status of the NAIC's reinsurance regulatory modernization framework proposal ("Proposal" or "Current Proposal") as reflected in the Framework Memorandum and subsequent work by the Task Force can be summarized as follows: under the Proposal, the current 0% collateral requirements would continue in place for U.S.-licensed reinsurers under Section 2 of the Credit for Reinsurance Model Law. However, the Proposal would essentially provide an option for single-state regulation for both U.S. reinsurers and non-U.S. reinsurers. In the case of a "national reinsurer," a U.S. reinsurer that is licensed and domiciled in a home state and approved by that regulator (based on uniform

minimum standards yet to be established by NAIC) would be able to sell reinsurance in all other U.S. jurisdictions that had adopted the anticipated revisions to the Model Law while submitting solely to the regulatory authority of the home state supervisor for purposes of its reinsurance business. Note that federal legislation may eliminate the need for state action.

In the case of a "port of entry reinsurer," a non-U.S. reinsurer would be certified by a port of entry ("POE") state regulator to sell reinsurance in all other states. The Current Proposal consists of two main components with respect to port of entry reinsurers. First, through "mutual recognition" the RSRD would assess whether the regulatory regimes of foreign jurisdictions achieve adequate "regulatory effectiveness" determined through an "outcomes-oriented" approach. Those non-U.S. jurisdictions that are found to achieve "regulatory effectiveness" by the RSRD would be entitled to enter into mutual recognition agreements ("MRAs") with a state. The Framework Memorandum identifies mutual recognition as an outstanding issue left to be considered by the Task Force (the RSRD Proposal itself discussed a mutual recognition framework, and the Draft Memorandum analyzed this concept extensively, but this issue has not been formally addressed by the Task Force at this time). The four methods of conducting reinsurance business in the U.S. under the Proposal include the following:

1. National Reinsurer - licensed in an approved state, having a physical presence in the U.S., available to both U.S. and Non-U.S. reinsurers.

2. Port of Entry Reinsurer - certified by a POE state, the reinsurer must be from an RSRD recommended non- U.S. jurisdiction, no physical presence in the U.S. is permitted.

3. Licensed or Accredited Reinsurer under the current NAIC Credit for Reinsurance Model Law.

4. Non-U.S. reinsurers could continue to access the U.S. market by being unlicensed and posting 100% collateral.

Under the Current Proposal, the amount of collateral required for both national reinsurers and POE reinsurers will depend on the ratings assigned to such reinsurers by the applicable state regulator (Home State Supervisor for national reinsurers and port of entry state for POE reinsurers). That rating will be based on the reinsurer's ratings from nationally recognized statistical rating organizations, as well as other designated criteria that the state may take into account under RSRD guidelines. However, the collateral requirements appear to differ for U.S. reinsurers and non-U.S. reinsurers in some cases, even where they have the same rating. For example, under the Current Proposal a POE reinsurer rated Secure-3 would be required to post 20% collateral, while a similarly-rated national reinsurer would not be required to post any collateral. However, a national reinsurer that is downgraded to a tier-4 or 5 status would also be required to post collateral under the proposal.

D. Legal Analysis

In analyzing the RSRD Proposal, the Draft Memorandum identified the following alleged shortcomings:

- Deviates from the central purpose of equivalence by imposing additional burdens on foreign reinsurers, creating substantial uncertainties, and permitting significant variations among states;

- The proposal's mutual recognition framework is likely unconstitutional based on:

    - Federal Trade Power
    - Compact Clause
    - Foreign Affairs Doctrine; and

- Is impractical due to the requirement of adoption by 50 states.

The charge to the Legal Division was specifically to review the issues raised in the Draft Memorandum. However, the Draft Memorandum is based on the RSRD Proposal, which has been significantly modified under the Current Proposal. Therefore, we will not only attempt to address the federal trade issues and constitutional questions raised under the Current Proposal, but also address the issues raised in the Draft Memorandum where appropriate.

It is the opinion of the Legal Division that the Proposal implicates four constitutional provisions or doctrines: federal preemption, the Compact Clause, foreign affairs preemption and the dormant Commerce Clause. The Proposal must satisfy all four of these requirements to be constitutionally valid.

1. Federal Preemption: The General Agreement on Trade in Services ("GATS").

If the Proposal conflicts with existing federal law, either by way of a statute, regulation, treaty, or executive agreement, then it is invalid by virtue of the Supremacy Clause of the Constitution (U.S. Const., art. VI) and is preempted from enforcement. That Clause provides that where state and federal law conflict, federal law prevails.

We are currently aware of only one existing federal law, the World Trade Organization ("WTO") General Agreement on Trade in Services (the "GATS"), that potentially conflicts with the Proposal. In particular, the Proposal implicates two GATS requirements: the most favored nation ("MFN") obligation in Article II of GATS and the "national treatment" obligation under Article XVII of GATS. The MFN obligation prohibits the United States, at either the federal or state level, from treating the services or service suppliers of one WTO Member less favorably than it treats "like" services or service suppliers of any other WTO Member, which would include reinsurance and retrocession-related financial services. The national treatment obligation requires that the United States not favor its own service suppliers over foreign suppliers.

Most Favored Nation Obligation. This obligation prohibits the United States, at either the federal or state level, from treating the services or service suppliers of one WTO Member less favorably than it treats similar services or service suppliers of any other WTO Member. Under the Current Proposal, only those non-U.S. reinsurers from RSRD-approved jurisdictions would be eligible to be certified as POE Reinsurers. Reinsurers from other WTO Member countries would not be eligible. Whether this disparate treatment of reinsurers from different countries violates the MFN obligation in Article II of the GATS turns on whether non-U.S. reinsurers from RSRD-approved jurisdictions are considered "like," or not sufficiently "like," non-U.S. reinsurers from jurisdictions that failed to obtain RSRD approval.

In our opinion it is unlikely that this aspect of the Proposal would be found to violate the MFN obligation of GATS. A determination by the RSRD that two non-U.S. reinsurers operate under functionally different regulatory regimes, one of which provides "regulatory effectiveness" as determined by the RSRD, while the other jurisdiction does not, strongly suggests that the service suppliers from the two jurisdictions are not "like" service suppliers as defined under Article II. Accordingly, we think it is likely that non-U.S. reinsurers operating under functionally different regulatory regimes would not be considered "like" service suppliers within the meaning of the GATS.

Alternatively, the disparate treatment of non-U.S. reinsurers operating under functionally different regulatory regimes as determined by the RSRD would likely be permitted under the GATS "prudential carve-out," which provides an exception to the MFN obligation for prudential actions taken to protect policyholders or to ensure the integrity and stability of the financial system. Specifically, in the case of

financial services (including reinsurance- and retrocession-related services), WTO Members "shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system," even when those measures would otherwise be in violation of a Member's obligations under GATS, including the MFN obligation. GATS Annex on Financial Services at ¶ 2(a).

The prudential carve-out provides a strong argument that disparate treatment of non-U.S. reinsurers from RSRD-approved jurisdictions and non-U.S. reinsurers from non-RSRD-approved jurisdictions does not violate the United States' MFN obligation under GATS because such treatment falls within the scope of the prudential exception to that obligation. The prudential carve-out has also been cited in the past as permitting the NAIC's 100% collateral requirements for non-U.S. reinsurers under Section 3 of the Credit for Reinsurance Model Law. For both of these reasons, we think it is unlikely that the Current Proposal would be deemed to violate the United States' MFN obligation under Article II of the GATS.

National Treatment Obligation. Whether the Proposal complies with the GATS' national treatment requirement is a more difficult question. Each WTO Member makes binding and enforceable legal commitments with respect to specific service sectors and/or sub-sectors that it identifies in its "Schedule of Commitments." In turn, Article XVII of GATS requires a WTO Member to accord to services and services suppliers of other WTO Members "treatment no less favourable than what it accords to its own like services and service suppliers" (known as "national treatment") in those sectors and/or sub-sectors specifically identified in a Member's Schedule of Commitments. The United States has made a national treatment commitment in the reinsurance- and retrocession-related services sub-sector and, therefore, is obligated to accord to foreign reinsurance suppliers and their services treatment no less favorable than that which it accords to its domestic reinsurance companies. *See* General Agreement on Trade in Services at Annex on Financial Serves § 5(a)(2).

Under the Proposal, it appears that non-U.S. reinsurers certified as POE Reinsurers, including those regulated by a non-U.S. jurisdiction the RSRD has deemed "effective," may be subject to higher collateral requirements than U.S. reinsurers that have been certified as National Insurers. This disparate treatment between POE reinsurers and national reinsurers is permissible if there are identifiable and meaningful differences between U.S. regulatory schemes and those non-U.S. regulatory schemes that are deemed to be "effective" by the RSRD. Specifically, the July 3rd memorandum provides, as follows:

> Because of the prudential U.S. reinsurance regulatory requirements designed to protect policyholders and to ensure the integrity and stability of the U.S. financial system, national reinsurers would not have to post any collateral for those rated by their home state supervisors in the Secure - 3 tier or above. For those national reinsurers rated in the Secure - 4 tier, 75% collateral would be required and for those in the Vulnerable – 5 tier, 100% collateral would be required. The basis for this determination is that U.S. domiciled reinsurers have been subject for many years to a broad array of regulatory rules developed by the states through the NAIC's Model Law process.

U.S. domiciled reinsurers are currently subject to a number of regulatory rules developed by the states through the NAIC's Model Law process, all of which have been deemed necessary to adequately regulate and monitor the financial condition of reinsurers. These include on-site financial examinations, analysis of financial statements, application of the NAIC's Insurance Regulatory Information System, limitations on dividends, review of inter-company transactions, investment diversification and limitation rules, risk based capital requirements, annual audited statutory financial statements, and many other regulatory rules. If, for example, a non-U.S. jurisdiction is deemed "effective" even though it does not require or rely on independent verification (such as an independent actuarial opinion) or comply with statutory accounting

requirements, then such differences could justify different collateral requirements. On the other hand, if the foreign regime is deemed "effective" because it achieves the same regulatory outcomes through different means, then merely pointing to inconsequential procedural differences between the two systems may not be sufficient to justify different collateral requirements. The different collateral requirements may also be justified by differences in the enforceability of judgments obtained against non-U.S. reinsurers versus those obtained against U.S. reinsurers. It may be possible to show, for example, that neither U.S. regulatory regimes nor their functionally equivalent foreign counterparts eliminate all risk of default by reinsurers. If so, and if it can be demonstrated that, notwithstanding a finding of regulatory effectiveness, it is more difficult to satisfy judgments against non-U.S. reinsurers whose assets are in a non-U.S. jurisdiction, this could also justify disparate collateral requirements under the prudential carve-out.

The Framework Memorandum identifies mutual recognition as an outstanding issue left to be considered by the Task Force, under which the RSRD would assess whether the regulatory regimes of foreign jurisdictions achieve adequate "regulatory effectiveness" determined through an "outcomes-oriented" approach. When developing the mutual recognition framework under the Current Proposal, the Task Force should take care to identify the key and meaningful differences between U.S. regulatory schemes and those non-U.S. regulatory schemes that are deemed to be "effective" by the RSRD.

2. The Compact Clause.

Article I, section 10 of the Constitution provides that "No State shall, without the Consent of Congress … enter into any Agreement or Compact with another State, or with a foreign Power." Read literally, the Compact Clause appears to bar any cooperative endeavor between one state and another, or between a state and a foreign nation, unless Congress agrees to it. The Compact Clause, however, has not been so interpreted. In *Virginia v. Tennessee*, 148 U.S. 503 (1892), the Supreme Court expressly rejected the view that the words "compact" and "agreement" should be read in their most literal sense and instead concluded that agreements between states are permissible, even in the absence of congressional consent, as long as they do not "tend to increase and build up the political influence of the contracting States, so as to encroach upon or impair the supremacy of the United States." *Id.* at 517-18.

Virtually all of the cases addressing Compact Clause challenges have involved agreements between states, not agreements between states and foreign nations. In 1917, the North Dakota Supreme Court held that the *Virginia v. Tennessee* standard also applied to agreements between states and foreign powers. *McHenry County v. Brady*, 163 N.W. 540, 544 (N.D. 1917) (applying interstate compact standard to review agreement between North Dakota and Canada). However, the U.S. Supreme Court has not reviewed the question since its decision in *Virginia v. Tennessee*.

With respect to the Current Proposal, the Compact Clause raises two issues: (1) would the mutual recognition agreements (MRAs) required under the Framework Memorandum be considered to be agreements between states and foreign powers of the type that requires Congressional approval; and (2) do any federal laws currently provide Congressional consent to such mutual recognition agreements. When reviewing these issues, the following 4-step analysis of the Compact Clause is useful:

> **1. Are MRAs "Agreements" under the Compact Clause?** A reviewing court would initially consider whether the mutual recognition agreements constitute "agreements" between states and foreign nations that trigger analysis under the Compact Clause. We conclude that the MRAs would amount to such "agreements."
>
> In *Virginia v. Tennessee*, the Supreme Court viewed reciprocal recognition as constituting an agreement for purposes of the clause. 148 U.S. at 520. The RSRD Proposal (which has been

superseded by the Current Proposal) contains elements of reciprocity by providing that recognition should not be granted by the RSRD if the non-U.S. jurisdiction has not granted recognition to the U.S. regulatory system. However, as previously noted, the Task Force has still not addressed the issue of mutual recognition fully in the Current Proposal, and no final determination has been made as to whether reciprocity will be an element of mutual recognition. The RSRD proposal also referred to "cooperation agreements" between U.S. states and foreign nations; if the final proposal employs such cooperation agreements, these would also be "agreements" for purposes of the Compact Clause.

2. Does an MRA require Congressional Consent? A reviewing court would then consider whether the agreements require Congressional consent. This inquiry comprises a number of subsidiary questions. First, are agreements between states and foreign nations subject to the *Virginia v. Tennessee* standard for determining when Congressional consent is required? While there is little case law on this topic, there is academic consensus that the *Virginia v. Tennessee* standard does apply to agreements between states and foreign governments, and the text and the history of the Compact Clause support this view. *See e.g.* Restatement (Third) of the Foreign Relations Law of the United States, §302f (1986). For these reasons, we conclude that the courts would apply this standard to the agreements contemplated by the Proposal.

Second, does the preeminence of the federal government in the area of foreign affairs render virtually all agreements between states and foreign nations *per se* invalid encroachments on federal sovereignty in the absence of Congressional consent? The Restatement on Foreign Affairs now indicates that "[i]n general, agreements involving local transborder issues, such as agreements to curb a source of pollution, to coordinate police or sewage services, or to share an energy source, have been considered not to require Congressional consent." Restatement § 302f. And Louis Henkin, perhaps the leading commentator in the foreign affairs arena, states that "Congressional consent to an agreement between a state and a foreign government [ ] is required only if the agreement tends to give the state elements of international sovereignty, interferes with the full and free exercise of federal authority, or deals locally with a matter on which there is or might be national policy."[1] Thus, while neither the Supreme Court nor any lower federal court has upheld a state agreement with a foreign nation, we believe the courts would not conclude that, in the absence of Congressional consent, a mutual recognition agreement contemplated by the Proposal would be a *per se* invalid encroachment on the federal government's preeminent authority in the field of foreign affairs.

3. Does an MRA Enlarge State Power & Encroach on Federal Sovereignty? Do the mutual recognition agreements enlarge state power and, if so, do they encroach unduly on the federal government's sovereignty in foreign affairs? The Current Proposal's requirement for mutual recognition implicates the Compact Clause's enlargement/encroachment standard in two potential ways. First, in making a determination on "regulatory effectiveness," the RSRD could be said to be passing judgment on another nation's regulatory systems, which could further be characterized as an attempt to coerce those nations to alter their regulatory schemes in order to obtain RSRD approval. Second, if the RSRD Proposal's concept of reciprocal recognition is ultimately incorporated into the Current Proposal by the Task Force, this might be viewed as the states' attempt to leverage their economic power to compel foreign nations to recognize U.S. state regulatory schemes and permit U.S. reinsurers access to those foreign markets.

[1] Henkin at 155. For Supreme Court citations to Henkin's treatise, *see, e.g.*, *Medellin v. Dretke*, 544 U.S. 660, 686 (2005) (O'Connor, J., dissenting); *United States v. Lara*, 541 U.S. 193, 201 (2004); *American Ins. Ass'n v. Garamendi*, 539 U.S. 396, 415 (2003).

It is our opinion that the first aspect of the mutual recognition framework (i.e., certification of non-U.S. jurisdictions by the RSRD through mutual recognition agreements) is likely to be found constitutionally permissible, even in the absence of Congressional consent. To be sure, by sitting in judgment on other nations' regulatory schemes, the states (or their agent, the RSRD) could affect the foreign relations of the United States as a whole, and thus the RSRD evaluation process could potentially be viewed as enlarging state authority or encroaching on federal sovereignty. Nevertheless, we believe this certification activity is sufficiently tied to the states' traditional role in regulating the insurance industry that it is constitutionally sound. Moreover, in our opinion the courts would likely view the McCarran-Ferguson Act, together with GATS (which sets ground rules for state regulation of foreign reinsurers), as embodying a Congressional judgment that the federal government's sovereignty in the area of foreign affairs is not impaired by state regulatory activities that, like the RSRD approval process, are tied to protecting consumers in the domestic insurance market, provided those regulatory activities do not run afoul of GATS requirements (see previous discussion on GATS preemption).

However, to the extent that mutual recognition under the Current Proposal involves states (or the RSRD) negotiating with foreign countries to achieve reciprocal recognition by facilitating the entry of U.S. companies into foreign markets, it calls into question whether the mutual recognition framework may be invalid under the Compact Clause in the absence of Congressional consent. Courts are likely to view this "market opening" activity as a traditional function of the federal government in foreign affairs, and not as a traditional function of state regulation of the business of insurance.

Ultimately, in the absence of Congressional consent, the permissibility of mutual recognition agreements turns on whether such agreements address and ameliorate concrete effects that would otherwise arise in the domestic market if states unilaterally reduced regulatory entry barriers for non-U.S. reinsurers and foreign regulators failed to reciprocate. Because the "market opening" function of mutual recognition agreements would be seen as the traditional province of the federal government, the NAIC would have to make a very strong showing of significant domestic effects from permitting non-U.S. reinsurers greater access to U.S. markets on a non-reciprocal basis. If the NAIC can show that a unilateral reduction in the regulatory barriers to entry for non-U.S. reinsurers confers an unfair competitive advantage on those reinsurers, and that this unfair advantage does have such significant effects within the domestic market, it may be able to demonstrate that a demand for reciprocity falls within the ambit of the states' traditional authority to regulate insurance. In the absence of such a showing, however, courts are likely to view mutual recognition agreements as falling outside the states' traditional authority to regulate insurance, and instead as attempts by states to exercise a traditional federal power in the field of foreign trade.

A comparison to a unilateral recognition framework might be considered by the Task Force. Under a unilateral recognition framework, the RSRD could deem another country's regulatory scheme to be "effective" and could permit companies from that country to offer services without regard to any reciprocal treatment of U.S. reinsurers. Such a policy would still have power to influence another jurisdiction to attain "regulatory effectiveness" in order to obtain access for its nationals to U.S. reinsurance markets. Unilateral recognition does not amount to an agreement, and thus faces no difficulty under the Compact Clause. *See* Restatement § 301c ("A unilateral statement is not an agreement"). Mutual recognition agreements or MOUs could still be used to confirm RSRD approval and to act as cooperation agreements with respect to the sharing of information and other regulatory functions, but reciprocal recognition would not be an element in these agreements. Eliminating reciprocal recognition, so that states, through the RSRD, merely determine which non-U.S. reinsurers are regulated through an "effective" system in their home

nation, would focus the scheme much more closely on the traditional state function of monitoring insurance companies for consumer protection purposes, and render it much less related to federal foreign affairs.

4. Is there Implied Congressional Consent? Finally, if a reviewing court finds that the mutual recognition agreements require Congressional consent, the next question is whether any existing statute implies such consent. We think the strongest candidate is the McCarran-Ferguson Act, but the Supreme Court has cast doubt on the idea that the McCarran-Ferguson Act was intended to play a significant role in foreign affairs: "As the text itself makes clear, the point of McCarran-Ferguson's legislative choice of leaving insurance regulation generally to the States was to limit congressional preemption under the commerce power, whether dormant or exercised. . . . [A] federal statute directed to implied preemption by domestic commerce legislation cannot sensibly be construed to address preemption by executive conduct in foreign affairs." *American Ins. Ass'n v. Garamendi,* 539 U.S. 396, 428 (2003).

It is our opinion that courts are likely to conclude that McCarran-Ferguson embodies Congressional consent to mutual recognition agreements only insofar as MRAs are used to assess non-U.S. regulatory schemes and effectively compel or induce non-U.S. regulators to alter their schemes. To the extent MRAs cannot be shown to address domestic market imperfections arising from a lack of parity in access to U.S. and non-U.S. reinsurance markets, it is unlikely courts would view McCarran-Ferguson as implicit Congressional consent to state negotiations with other nations to reduce regulatory barriers to entry by U.S. reinsurers into foreign markets.

In conclusion, it is our opinion that the Compact Clause would cause constitutional concerns with respect to any mutual recognition framework that would require reciprocal recognition as an element of the RSRD approval and mutual recognition agreement process. It is our recommendation that the Task Force consider a unilateral recognition framework that would utilize cooperation and information sharing agreements to address issues which do not impact the Compact Clause and that more closely fall within the traditional authority of states to regulate insurance.

3. Foreign Affairs Preemption.

By virtue of the Supremacy Clause, federal law in the form of treaty or executive agreement unquestionably preempts any state law that is in direct conflict with it. *See Garamendi*, 539 U.S. at 413. But preemption in the field of foreign affairs has been found to be significantly broader than merely direct preemption. Courts have invalidated state laws that infringe not only actual federal foreign affairs activity (including treaties and executive agreements), but also potentia*l* federal foreign affairs activity. Courts have not based foreign affairs preemption on any specific constitutional provision, but rather on the Constitution's structure.

Under the most expansive view of foreign affairs preemption, state action with more than incidental effect on foreign affairs is preempted even absent any affirmative federal activity in the subject area of the state law, and hence without any showing of conflict. This strong view is reflected in the Court's decision in *Zschernig v. Miller*, 389 U.S. 429 (1968), in which the Court struck down a state inheritance law that limited which foreign heirs could inherit an Oregon estate, despite an absence of conflicting federal law, and despite statements by the representatives of the federal government that the law posed no problem for the United States' foreign policy interests. *Zschernig*, however, represents the high-water mark in the doctrine of dormant foreign affairs preemption. Later cases have not overruled *Zschernig*, but they have limited its applicability. No Supreme Court case since *Zschernig* has adopted such an expansive view of dormant foreign affairs preemption.

One of the most prominent of post-*Zschernig* cases is *Garamendi*, which like *Zschernig* invalidated a state law because of foreign affairs preemption, but on strikingly different facts. In *Garamendi*, the Court struck down a California law requiring extensive disclosures from any insurer that had been operating in Europe between 1920 and 1945 in an attempt to identify policies that had belonged to Holocaust victims. *Id.* at 401. Like *Zschernig*, *Garamendi* invalidated the state law even though it was not expressly preempted by any federal agreement or treaty. *Id.* at 416-17. But unlike *Zschernig*, *Garamendi* relied on substantial federal activity to find preemption. The federal government had expended significant effort and resources to establish a voluntary claims-settling process, which the Court found to be threatened by California's statute. The Court specified that, even though no federal law expressly preempted California's statute, there was "evidence of clear conflict between the policies adopted by the two," *id.* at 421: "Whereas the President's authority to provide for settling claims in winding up international hostilities requires flexibility in wielding 'the coercive power of the national economy' as a tool of diplomacy, [the California law] denies this, by making exclusion from a large sector of the American insurance market the automatic sanction for noncompliance with the State's own policies on disclosure," *id.* at 424.

Two key criteria can be distilled from these cases. First, *Zschernig*'s status (the strongest form of dormant foreign affairs preemption) is questionable in light of heavy criticism and *Garamendi*'s lukewarm endorsement. If anything, *Zschernig* now stands for the principle that states cannot enter into the realm of foreign affairs in order to denigrate a foreign nation's policies. Second, *Garamendi* makes clear that extensive federal activity in a particular area throws into doubt any state foreign affairs activity in that area. As *Garamendi* holds, express preemption is not necessary to invalidate state law if there is conflict in underlying foreign affairs policy. This doctrine also precludes states from leveraging traditional state activities, including the regulation of the insurance business, to effect political changes in foreign nations.

It is our opinion that the RSRD's evaluation function of non-U.S. jurisdictions is not contrary to foreign affairs preemption. The federal government has delegated the field of insurance regulation to the states, and the Proposal does not interfere with or undermine any foreign affairs activities or initiatives of the federal government. Even if the RSRD's judgments of regulatory effectiveness entail implicit criticisms of those nations that do not meet the effectiveness requirements and prompts diplomatic complaints from some, this activity is closely enough tied to traditional state activity to avoid preemption in the absence of a conflict with any affirmative federal initiatives or negotiations with foreign governments.

The reciprocal recognition aspect of the RSRD Proposal, however, raises greater concerns. Opening foreign markets to U.S. business does not closely resemble traditional state activity. Nevertheless, we believe that courts are most likely to read the relevant Supreme Court precedents in this area as limiting foreign affairs preemption to situations in which non-traditional state activities conflict in some manner with affirmative federal initiatives or negotiations with foreign governments. Accordingly, because the "market opening" aspect of the RSRD Proposal would involve no such conflict, we conclude that foreign affairs preemption is unlikely if the Task Force would incorporate this concept into the final Proposal.

4. Dormant Foreign Commerce Clause.

The so-called "dormant" foreign Commerce Clause under Article I, § 8 requires that U.S. states to not discriminate against foreign commerce in favor of their own citizens, avoid imposing multiple taxation, and avoid impinging the federal government's ability to speak with "one voice" in the field of commerce with foreign nations. It is considered "dormant" because it serves to invalidate state laws even if the federal government has remained silent with regard to a particular form of commerce.

A dormant foreign Commerce Clause challenge to the NAIC Proposal is unlikely to succeed. First and foremost, the McCarran-Ferguson Act precludes a dormant Commerce Clause challenge. As the Supreme Court has said, "The McCarran-Ferguson Act exempts the insurance industry from Commerce Clause restrictions." *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 880 (1985). The McCarran-Ferguson Act amounts to Congress's assignment of its constitutional authority to regulate interstate and foreign insurance-related commerce to the states. Congress expressly declared that the states, not the federal government, should speak to the business of insurance. Even if, as *Garamendi* warned, the effect of the McCarran-Ferguson Act in foreign affairs should not be overstated, the statute clearly answers the question of whether Congress has granted to the states the ability to regulate insurance matters. Nothing in the McCarran-Ferguson Act distinguishes states' ability to regulate U.S. insurers from their ability to regulate non-U.S. insurers; instead, the statute is a blanket grant of authority.

It is our opinion that the Proposal satisfies the dormant foreign Commerce Clause because Congress has made clear that states, not the federal government, are the stewards of the insurance industry. In this way, the federal government has not remained silent: it has spoken, and it has delegated its authority to the states.

E. Conclusion and Recommendations

The NAIC's Reinsurance Regulatory Modernization Framework Proposal, while still a work in progress, has built substantially on the previous REO and RSRD Proposals prepared by the Task Force. In our opinion (1) the Current Proposal does not violate the United States' Most Favored Nation obligation under GATS; (2) the certification of non-U.S. jurisdictions by the RSRD through mutual recognition agreements is constitutionally permissible under the Compact Clause; (3) the RSRD's evaluation function of non-U.S. jurisdictions is not contrary to Foreign Affairs preemption; and (4) the Current Proposal satisfies the Dormant Foreign Commerce Clause.

However, this does not mean that the Current Proposal does not raise any constitutional issues. The different reinsurance collateral requirements for U.S.-national reinsurers and non-U.S. port of entry reinsurers might be found to violate the National Treatment obligation under GATS. However, this disparate treatment will be found to be permissible if there are identifiable and meaningful differences between U.S. regulatory schemes and those non-U.S. regulatory schemes that are deemed to be "effective" by the RSRD. Of more concern is the extent that mutual recognition under the Current Proposal would involve states (or the RSRD) negotiating with foreign countries to achieve reciprocal recognition by facilitating the entry of U.S. companies into foreign markets, which calls into question whether the mutual recognition framework would be invalid under the Compact Clause. When completing its work on the Current Proposal, the Task Force should carefully consider the alternatives raised by these issues, and should specifically decline to include reciprocal recognition as a key principle in the mutual recognition framework.

From: Stewart.Keir@tawa.net [mailto:Stewart.Keir@tawa.net]
Sent: Wednesday, July 16, 2008 5:36 AM
To: commissioner@dobi.state.nj.us
Cc: Fuller, Bryan J.
Subject: NAIC - Reinsurance Regulatory Reform

Honorable Stephen M. Goldman, Commissioner
New Jersey Banking and Insurance Department

Dear Commissioner Goldman:

I am writing you on behalf of Tawa Management in your capacity as Chair of the NAIC Reinsurance Task Force ("Task Force") and in connection the Task Force's deliberations regarding reinsurance regulatory reform. We respectfully ask that you consider a change to the current NAIC Model Credit for Reinsurance Law pertaining non US reinsurers in run-off that qualify for cedants to take credit for reinsurance in reliance of the reinsurer's multi-beneficiary trust ("MBT") established in accordance with NAIC requirments.

Tawa Management is an Insurance Services Company providing Acquisition, Operational and Change Management capability to the non-life run-off insurance market. It is an operating subsidiary of Tawa plc, a company listed on the London Stock Exchange.

Tawa Management is authorized and regulated by the UK Financial Services Authority. Tawa Management is dedicated to creating value for its counterparties and clients by providing the highest quality services, delivered by highly skilled and experienced people, leading edge thinking and state of the art systems and methodologies. Its claims-focused, accelerated run-off strategy is a key strength and is designed to respect the rights of policyholders. Attached is a copy of a recent article about Tawa Management.

In 2002, Tawa UK, acquired CX Reinsurance Company Ltd. (formerly known as CNA Reinsurance UK) from CNA US. CX Reinsurance Company Ltd. ("CX Re") operated in the US as an accredited reinsurer and as a surplus lines insurer listed with the NAIC International Insurers Department ("IID"). When its former owners placed CX Re into run-off, the company voluntarily withdrew from the IID list. CX Re continues to be an accredited or approved reinsurer in 46 jurisdictions through the maintainance of its MBT located in New York. CX RE also wrote business in non-US jurisdictions.

At the time of it acquisition, CX Re was the second largest run-off company in the UK, second only to Equitas. Over the last six years, the liabilities of CX Re have been reduced from over $2 billion to about $300 million. At the same time, assets in the MBT have been reduced from nearly $750 million to about $87 million.

We do not believe that the authors of the NAIC Model Credit for Reinsurance Law gave much, if any, consideration to winding-up a MBT when a reinsurer discontinues active underwriting. When a reinsurer goes into run-off, liquidity is one of the key areas of responsible risk management. As the run-off reinsurer's US liabilites are reduced, the disproportionate amount of assets including the $20 million minimum surplus requirement for MBT's dedicated to US exposures in relation to non-US exposure makes it increasingly more difficult to manage liquidy.

We therefore ask that the Task Force consider a change to the current NAIC Model Credit for Reinsurance Law to permit the domiciliary commissioner discretion to allow a surplus of less than $20 million for run-off reinsurers under controlled circumstances.

Attached please find suggested language (underlined) for amending the current NAIC Model Credit for Reinsurance Law. We are happy to answer any questions that you may have and meet with you to discuss this issue further. Thank you in advance for your consideration.

Stewart Keir, CPCU, CFE, CIE
Consultant to Tawa Management
516 942-2633

cc: Brian Fuller
NAIC, Senior Reinsurance Manager

Please note that Tawa have now moved to their new offices at The Isis Building193 Marsh Wall London E14 9SG Tel: 020 7068 8000. E-Mail addresses will remain unchanged. Our website www.Tawa.net provides a full list of individual's new telephone numbers.

Changing the landscape of the insurance market

Summary of Primary Comments on 7/3/08 Framework Revision

- Current US collateral system has been successful and should be maintained. Requirements are not discriminatory. No rationale is provided for rating / collateral % matrix. Matrix does not reflect reality of financial ratings.
- Collateral and POE supervision should not be required when RSRD recognizes regulatory equivalence in a foreign jurisdiction, as long as reinsurer meets other requirements.
- 5% direct business limitation – provision is unfair; lacks practicality in application; no rationale is provided for this limitation. Framework should scope out direct business and be applicable to "mixed" insurers' reinsurance business only. EU Directive is not a template to follow.
- Mutual recognition concept is missing from the framework. No mutual recognition benefit for US companies. IAIS Guidance Paper on Mutual Recognition has changed significantly from the draft referenced in earlier versions of the RTF framework proposals.
- Role, function, authority, details of RSRD; clarification needed that it is an evaluation and recommendation body only, non-governmental; clarification needed on evaluation process; great deal of concern over inclusion of numerous mandatory contract clauses.
- Concern over POE reinsurer reporting and evaluation requirements – too much subjectivity in rating; need to accept foreign basis financials (IFRS or domiciliary); quarterly reporting is not necessary; reporting of overdue & disputed recoverables needs materiality level: much of the required information is available in ceding companies' NAIC statements.
- Comprehensive life reinsurance regulation reform is needed. Collateral requirements should not be removed prior to addressing statutory reserving requirements for life companies.

Summary of Primary Comments – by Company Type

Top Comments – Ceding Companies

- Current collateral system has worked and should be maintained. Current system is not discriminatory. No rationale is provided for rating / collateral % matrix. Matrix does not reflect reality of financial ratings.
- Current proposal results in diminished role for domiciliary regulator – violates fundamental insurance regulation principle that domiciliary regulator evaluates and administers financial health of its insurers.
- Current proposal relies too heavily on rating agencies. Questionable credibility due to credit market & subprime crisis.
- No mutual recognition benefit for US companies.
- Onerous burdens placed on ceding companies to continuously monitor assuming companies. All benefit within proposal is to assuming companies.
- Concern over what appear to be new diversification requirements.
- Concern over permitted delay in posting collateral requirements for catastrophe recoverables.

Life specific comments

- Comprehensive life reinsurance regulation reform is needed.
- Serious concern exists over removal of collateral requirements before statutory reserving standards are addressed.
- Changes should be coordinated with PBR project.
- NAIC needs congressional assistance.

Top Comments – Assuming Companies

- Mutual recognition concept is missing from the framework
- Collateral requirements and POE supervision should be removed completely when RSRD recognizes regulatory equivalence in a foreign jurisdiction.
- Concern over constitutional authority of RSRD and POE state to negotiate with foreign jurisdictions.
- 5% direct business limitation – unfair, practicality, rationale? Framework should apply to "mixed" reinsurers.
- Concern over numerous mandatory contract clauses. No need to dictate specific contract language.
- Role, function, authority, details of RSRD; clarification needed that it is an evaluation and recommendation body only, non-governmental; clarification needed on evaluation process.
- Concern over POE reinsurer reporting and evaluation requirements – too much subjectivity in rating; need to accept foreign basis financials (IFRS or domiciliary); quarterly reporting is not necessary; reporting of overdue & disputed recoverables needs materiality level: much of the required information is available in ceding companies' NAIC statements.
- Proposed framework relies too heavily on rating agencies.
- Affiliated transactions – collateral requirements should be removed as these have been approved; direct business limitation should be clarified for intercompany pools and other transactions.

Summary of Primary Comments – by Section

Paragraph 4 – 5% Direct Business Limitation

- Rationale unclear, seems unfair.
- Need clarification as to how all intercompany pooling or reinsurance agreements would be handled under this limitation.
- Clarification needed for application to co-surety arrangements in which the carrier has direct exposure.
- Rationale for the 5% direct business limitation is not understood, or is not clear
- Limitation on direct business is not appropriate and should be dropped
- Direct business should be scoped out
- Reinsurers should not receive preferential treatment.
- Such discrimination is not found in the IAIS.
- Misdirected attempt at consistency with EU Directive
- Diversification between direct and assumed business is recognized as a positive factor by rating agencies and regulators.
- Lloyds' exception is appropriate, and should be extended to other commercial writers that diversify between direct and assumed.
- How will the limitation work in practice, as the % fluctuates?
- The reinsurance only provision will impose dramatically different regulatory requirements on various reinsurers. It will create undesirable market distortions. This provision should be dropped.

Paragraph 11 (specifically 11g) Mandatory Contract Clauses

- Ceding insurers and reinsurers are sophisticated commercial parties and should have the freedom to draft contracts as they want.
- New proposal mandates new and additional contract clauses.
- This is a departure from current NAIC model laws and accounting guidance.
- Premium clause should be reworded.
- Whether to include the intermediary clause is a decision better left to the parties of the contract.
- Insolvency clause is appropriate, but should be reworded. An appropriate clause must recognize a balancing of interests.
- Provides broad new powers for state regulators.
- Credit for reinsurance clause may be ineffective in practice.
- Foreign countries may refuse to enforce the contractual term.
- The language "financial statement penalty" may not be applicable to life insurers.
- The mandatory contract provisions are an intrusion into what is properly the role of the legislature.
- Mandatory inclusion of such clauses does not encourage the proper type of risk management where parties identify and capitalize risk.
- The term "Obligations" should be defined.
- RSRD could properly evaluate whether or not non-US reinsurance regulatory regimes adequately address credit risk allocation, insolvency obligations, and other key provisions without dictating specific contract language.

Paragraphs 16-18 – Ratings and Collateral Requirements:

Ceding:

- Will home state regulator or RSRD have dominant role in assigning ratings?
- Current system works with no known problems. Collateral protects ceding insurers.
- Reducing collateral may lessen US primary capacity.
- Security deposits are required by licensed US insurers.
- Collateral reduction is too severe, levels need revision to better correspond to rating level reality.
- Problems arise when reinsurer ceases writing in US.
- Security fund must be created.
- Statistical rating organizations are often too late in rating downgrades.

- Collateral requirements are not an unfair trade issue.
- Not clear how collateral percentages were determined, especially between Secure 3 & 4.
- Reinsurers with a rating below A- have extreme difficulty securing reinsurance business. Collateral requirements should be revised to correspond better to ratings.
- Have not seen a country by country comparison of collateral requirements to prove that US collateral requirements discriminate against any EU domiciled reinsurers.
- Ceding companies will be forced to closely monitor the ratings of numerous insurers.
- Concern over postponement of collateral requirements for catastrophe recoverables.

Assuming:

- Collateral requirements should be dropped.
- Group ratings should be utilized where rating agency has enhanced the rating of a subsidiary, or assigned the parent's rating to the subsidiary.
- Cedents will have to continuously monitor reinsurer ratings and adjust collateral requirements.
- A reinsurer may have difficulty posting additional capital when rating drops. This is a licensing issue not a collateral issue.
- Too much reliance on rating agencies – see subprime crisis.
- Reinsurers will be at the discretion of subjective evaluations that will be difficult to predict.
- Consistent international arguments to remove statutory collateral requirements.
- No reason to have Vulnerable 5 category, a reinsurer in this class should not be POE eligible.
- Collateral requirements should be removed for strong, well regulated non US reinsurers from RSRD approved jurisdictions.

<u>Paragraphs 20-20i - Evaluation and Reporting Requirements for POE Reinsurers</u>

- POE state not necessary for reinsurers from approved jurisdictions. Reinsurer in equivalent jurisdiction should not be subject to additional layer of regulation.
- RSRD should approve jurisdictions and allow reinsurers from those jurisdictions to reinsure US companies. This is consistent with the efforts of the IAIS to move toward a system of mutual or unilateral recognition.
- POE state should be one of registration rather than regulation.
- Concern over POE states dealing with foreign countries.
- Quarterly reporting requirement for POE reinsurers is unnecessary.
- IFRS or foreign basis (domiciliary) financial statements should be acceptable for reinsurers domiciled in approved jurisdictions. Reconciliation to US GAAP or SAP is difficult if not impossible for some foreign reinsurers.
- Materiality threshold needed for overdue & disputed recoverables. Much of the information required of reinsurers is available within ceding companies' NAIC statements.
- All overdue and disputed recoverables should be considered, not just those pertaining to US ceding companies.
- Term "valid" should be removed from all references to foreign recognition of US judgments.
- Framework needs to prevent forum shopping for most favorable POE state.

<u>RSRD</u>

- Numerous questions related to RSRD role, authority, makeup, ability to negotiate with foreign countries, etc.
- Mutual recognition concept is missing. No mutual recognition benefit for US companies.
- No clear standards specified for eligible foreign jurisdictions.
- Need mutual recognition rather than unilateral.
- Concern over confidentiality of data maintained by the RSRD.