



National Association of Insurance Commissioners

NAIC 2009 Summer National Meeting  
*Minneapolis, MN*

**REINSURANCE (E) TASK FORCE**  
**Saturday, June 13, 2009**  
**3:00 p.m.—5:00 p.m.**  
**Convention Center—101 F-J—Level 1**

Steven M. Goldman, Chair	<i>New Jersey</i>	Glenn Wilson	<i>Minnesota</i>
Nonnie Burns, Vice-Chair	<i>Massachusetts</i>	Mike Chaney	<i>Mississippi</i>
Jim L. Ridling	<i>Alabama</i>	John Huff	<i>Missouri</i>
Christina Urias	<i>Arizona</i>	Ann Frohman	<i>Nebraska</i>
Jay Bradford	<i>Arkansas</i>	Scott J. Kipper	<i>Nevada</i>
Steve Poizner	<i>California</i>	Roger A. Sevigny	<i>New Hampshire</i>
Thomas R. Sullivan	<i>Connecticut</i>	Eric Dinallo	<i>New York</i>
Karen Weldin-Stewart	<i>Delaware</i>	Scott H. Richardson	<i>South Carolina</i>
Thomas E. Hampton	<i>District of Columbia</i>	Kent Michie	<i>Utah</i>
Kevin McCarty	<i>Florida</i>	Paulette Thabault	<i>Vermont</i>
John Oxendine	<i>Georgia</i>	Alfred W. Gross	<i>Virginia</i>
Michael McRaith	<i>Illinois</i>	Mike Kriedler	<i>Washington</i>
Jim Atterholt	<i>Indiana</i>	Jane L. Cline	<i>West Virginia</i>
James J. Donelon	<i>Louisiana</i>	Sean Dilweg	<i>Wisconsin</i>
Mila Kofman	<i>Maine</i>		

## AGENDA

- 1. Discuss Implementation Process for Reinsurance Regulatory Modernization Framework Proposal –**  
*Robert Kasinow (NJ)*
  - Review discussion from May 6-7 interim meeting
  - Subsequent comments: Attachments One and Two
  - Next steps
- 2. Discuss Proposal to Amend Credit for Reinsurance Model Law with respect to the Minimum Trusteed Surplus Requirement for Multiple Beneficiary Trusts (Tawa Proposal) –**  
*Robert Kasinow (NJ)*
  - Attachments: Three through Seven
- 3. Consider Adoption of the Reinsurance Collateral Guidance Memo –**  
*Robert Kasinow (NJ)*
  - Attachment: Eight
- 4. Update on Reinsurance Related Issues in Congress –**  
*Amanda Yanek (NAIC)*
- 5. Update on IAIS Reinsurance Subcommittee and Reinsurance Transparency Group Activity –**  
*Robert Kasinow (NJ)*
- 6. Receive Minutes from May 6-7, 2009 Interim Meeting –**  
*Robert Kasinow (NJ)*
  - Attachment: Nine
- 7. Any Other Matters Brought Before the Task Force –**  
*Robert Kasinow (NJ)*

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# Agenda Item 1

## **Discuss Implementation Process for Reinsurance Regulatory Modernization Proposal**

### **Attachments:**

**Comments submitted as requested by the Task Force during the May 6-7 interim meeting:**

- **Attachment One: Dewey & LeBoeuf letter**
- **Attachment Two: Reinsurance Association of America letter**

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DEWEY & LEBOEUF

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27 May 2009

The Honourable Steven M. Goldman  
Chair, NAIC Reinsurance Task Force  
Commissioner, Department of Banking and Insurance  
20 West State Street  
P.O. Box 325  
Trenton, New Jersey 08625-0325  
U.S.A.

Dear Commissioner Goldman,

During the May 6, 2009 hearing on the draft Reinsurance Regulatory Modernization Act of 2009 (the "Act"), we discussed the need to amend the provision of the Act concerning solvent schemes of arrangement. As we noted, solvent schemes of arrangement are subject to UK court supervision, UK FSA review and comment and a vote of the reinsurance creditors. They are often used in corporate restructurings and other transactions which enhance the financial strength of insurance groups and otherwise are in the best interest of policy holders, shareholders and other stakeholders in the reinsurer.

At a minimum, we believe that you should amend the legislation to make it clear that the solvent scheme provision only applies where a reinsurer seeking a rating has "proposed" a solvent scheme of arrangement regarding its own business. Other reinsurers, such as creditors of this sponsoring reinsurer may be asked to vote in favour of such a solvent scheme, but we understand you do not intent to capture such reinsurers as "participating" in a solvent scheme. Moreover, we recommend that only where a US cedent is treated unfairly, should any sanctions be applied. The Court and FSA oversight, of course, are both intended to insure that all interested parties are treated fairly.

REGULATED BY THE SOLICITORS REGULATION AUTHORITY  
A LIST OF PARTNERS IS AVAILABLE FOR INSPECTION AT THE ABOVE ADDRESS

NEW YORK | LONDON MULTINATIONAL PARTNERSHIP | WASHINGTON, DC  
ALBANY | ALMATY | BEIJING | BOSTON | BRUSSELS | CHICAGO | DOHA | DUBAI  
FRANKFURT | HONG KONG | HOUSTON | JOHANNESBURG (PTY)LTD. | LOS ANGELES | MILAN | MOSCOW  
PARIS MULTINATIONAL PARTNERSHIP | RIYADH AFFILIATED OFFICE | ROME | SAN FRANCISCO | SILICON VALLEY | WARSAW

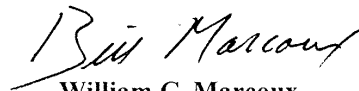
27 May 2009  
Page 2

In light of these concerns, and as you requested, we would suggest that section 7 (c) 11 of the Act be amended to read as follows:

**11. Whether A. the reinsurer's participation in ~~has proposed~~ any solvent scheme of arrangement, or similar procedure, which involves U.S. cedents ~~resulted in U.S. cedents receiving less than the amount reasonably due to them under reinsurance agreements subject to the solvent scheme of arrangement.~~ Entrance into such an arrangement or procedure that involves ~~involved~~ one or more U.S. cedents, and which the POE supervisor concludes unfairly prejudiced the interests of such US cedents, will result in an assignment of a Vulnerable-5 rating;**

We would be pleased to respond to any questions you have concerning this language.

Sincerely yours

  
William C. Marcoux



**REINSURANCE ASSOCIATION OF AMERICA**

1301 Pennsylvania Avenue, N.W., Suite 900, Washington, D.C. 20004-1701

Attachment Two  
Reinsurance (E) Task Force  
6/13/09

Telephone: (202) 638-3690  
Facsimile: (202) 638-0936  
<http://www.reinsurance.org>

May 29, 2009

**Via E-mail**

Dan Shelp, Esq.  
Managing Attorney  
National Association of Insurance Commissioners  
2301 McGee Street, Suite 800  
Kansas City, MO 64108-2662  
[dschelp@naic.org](mailto:dschelp@naic.org)

**Re: RAA Follow-up Comments to March 24, 2009 Reinsurance Task Force Draft Reinsurance Regulatory Modernization Act**

Dear Dan:

After the Reinsurance Task Force (“RTF”) met in New York on May 6<sup>th</sup> and 7<sup>th</sup> to discuss the RTF’s draft legislation to implement the reinsurance regulation modernization framework that was passed by the NAIC in December 2008, the RAA agreed to provide language to the RTF that would strengthen the preemption language to prohibit extraterritorial application of state laws.

Section 5(d) of the NAIC’s March 24, 2009 draft Reinsurance Regulatory Modernization Act (“Draft Legislation”) directs a Host State Supervisor to grant credit for reinsurance for reinsurance obtained from a National Reinsurer or Port of Entry Reinsurer while maintaining the existing ability of Host States to determine risk transfer. As drafted, the RAA is concerned that the Section could allow Host States Supervisors to regulate reinsurance transactions through mechanisms other than the credit for reinsurance laws and regulations. Eliminating the extraterritorial application of state laws is an important element of any meaningful reinsurance regulatory reform proposal and the RAA believes Section 5(d) needs to be clarified in this regard. To address this issue, the RAA suggests Section 5(d) be amended to state:

- (5)(d)(1) No Host shall deny or otherwise refuse to recognize credit as an asset or a reduction from liability on account of reinsurance ceded by a licensed insurer to a National Reinsurer or Port of Entry Reinsurer meeting the requirements of this Act.
- (2) Any Host State law, regulation or action that applies or is interpreted to apply to a reinsurance contract involving a National Reinsurer or Port of Entry Reinsurer is preempted.

(3) A Host State Supervisor shall be authorized to determine whether reinsurance agreements entered into by insurers domiciled in the Host State meet the risk transfer requirements of the NAIC accounting guidance.

The RAA would also like to express our disappointment that the concept of mutual recognition appears to have disappeared from the RTF's proposal. As we have stated on numerous occasions, to provide comprehensive, meaningful reform of reinsurance regulation, the Draft Legislation must address the lack of authority to fully engage in the international arena that is inherent in the current 50-state system. Importantly, the December 2, 2007 Framework Memorandum approved by the NAIC Plenary sets forth a three prong approach for modernizing reinsurance regulation. The first prong of the adopted approach calls for "mutual recognition to determine which non-U.S. jurisdictions are entitled to enter into mutual recognition agreements." This was a critical element for RAA to support the proposal. However, the concept of mutual recognition is now absent in the Draft Legislation.

The issue could be addressed in Section 6(c). If the eligibility requirements of the RSRB included a process for recognizing 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 Framework Memorandum would be reflected in the Draft Legislation. However, as currently drafted, Section 6(c) merely states that the RSRB will "determine the appropriate supervisory recognition approach" for non-U.S. jurisdictions after "consider[ing] the rights, benefits and the extent of reciprocal recognition afforded by non-U.S. jurisdictions to reinsurers licensed and domiciled in the U.S." This section does not require reciprocity nor does it provide the proper Congressional authority for states, or the RSRB, to negotiate with non-U.S. jurisdictions to achieve reciprocal treatment for U.S. companies. The Draft Legislation gives companies from foreign jurisdictions the ability to write creditable reinsurance in the United States without a license yet does nothing to further the interests of U.S. licensed companies doing business abroad.

We look forward to revised legislation that meets all of the elements of the December 2, 2007 Framework Memorandum and that provides meaningful comprehensive regulatory reform for reinsurance. We are available if you would like to discuss our comments further.

Sincerely yours,



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Tracey Laws

cc: Ryan Couch  
Steven Goldman  
Bob Kasinow

# Agenda Item 2

## **Discuss Proposal to Amend Credit for Reinsurance Model Law with respect to the Minimum Trusteed Surplus Requirement for Multiple Beneficiary Trusts (Tawa Proposal)**

### **Attachments:**

- **Attachment Three: Memo on summary and status of issue**
- **Attachment Four: American Insurance Association comment letter**
- **Attachment Five: American International Group comment letter**
- **Attachment Six: Tawa Management, Ltd. comment letter #1**
- **Attachment Seven: Tawa Management, Ltd. comment letter #2**

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National Association of Insurance Commissioners

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

FROM: Ryan Couch, NAIC staff

DATE: June 11, 2009

SUBJECT: Proposed Amendment to Sections 2(D)(3) of the Credit for Reinsurance Model Law regarding Minimum Trusteed Surplus (Tawa Proposal)

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**ISSUE**

During the Winter 2008 National Meeting, the Reinsurance Task Force received a presentation from Tawa Management, LLC, proposing modification to Section 2D(3) of the Credit for Reinsurance Model Law (Model Law). The proposed amendment would modify the Model Law to allow a non-U.S. assuming insurer in run-off to maintain less than the \$20 million trustee surplus that is required for multiple beneficiary trusts under this section, at the sole discretion of the domiciliary commissioner. Tawa representatives offered the following primary points as support for the proposed amendment:

- The purpose of maintaining a multiple beneficiary trust fund is to allow U.S. cedants to receive balance sheet credit for reinsurance ceded to a non-U.S. reinsurer without the need for the reinsurer to post collateral for each cedant.
- The Model Law requires a minimum trustee surplus of \$20 million regardless of liabilities.
- The trustee surplus requirement is consistent with the surplus required for a U.S. reinsurer to obtain accredited status and generally is not a problem for active reinsurers.
- The \$20 million trustee surplus becomes problematic for reinsurers that go into run-off.
- As a run-off reinsurer’s liabilities are reduced through the normal course of business, the required minimum trustee surplus can cause liquidity problems:
  - Income is generally limited to investment income
  - Gross, undiscounted reserves
  - As liabilities attributable to the U.S. trust are reduced, the percentage of collateral in the trust becomes disproportionately high in relation to the reinsurer’s other obligations
  - The \$20 million minimum trustee surplus is required by law
- Tawa proposes that the Model Law be amended to allow the domiciliary commissioner to reduce the minimum trustee surplus at the commissioner’s sole discretion, subject to a minimum trustee surplus of 5% of the trust’s liabilities. Tawa added the following points regarding this issue:
  - In determining the amount of trustee surplus that the reinsurer is required to maintain, the commissioner will take into account:
    - The affect that the trustee surplus has on the reinsurer’s solvency and liquidity; and
    - The protection of U.S. cedants and policyholders.

**TAWA’S PROPOSED AMENDMENT**

The proposed amendment to the Model Law is as follows (**amended language is underlined and bolded**):

Proposed amendment to NAIC Model Credit for Reinsurance Law

“Section 2

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 Section 4B, 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 trustee surplus of not less than \$20,000,000.

**(b) Notwithstanding the provisions in subsection (a), 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 trustee 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. In no event shall the minimum trustee surplus be less than 5% of non U.S run-off assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers.**

#### **DISCUSSION AND STATUS OF ISSUE**

The Reinsurance Task Force discussed the issue and generally agrees with the principle of the proposal, but believes that a more conservative minimum trustee surplus should apply than what has been proposed by Tawa. Accordingly, the Task Force drafted alternative language regarding the proposed amendment.

On March 15, 2009, the Task Force exposed for comment the following alternative proposed amendment to Section 2(D)(3) of the Credit for Reinsurance Model Law (**amended language is bolded and underlined**):

(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. In addition, the assuming insurer shall maintain a trustee surplus of not less than \$20,000,000 **except as provided in subparagraph (b).**



National Association of Insurance Commissioners

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**(b) At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trusted surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer's liquidity or solvency. The minimum required trusted surplus may not be reduced to an amount less than 50% of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers.**

In response to the exposure draft, Tawa submitted comments requesting a minimum trusted surplus of 30% as opposed to the 50% level included in the Task Force's proposed revision. Comment letters were also submitted by the American Insurance Association (AIA) and American International Group (AIG) to express opposition to the proposed changes in the minimum trusted surplus requirement.

Tawa submitted additional comments requesting that the proposed language be included as a provision within the draft "Reinsurance Regulatory Modernization Act of 2009", which is being drafted by the Task Force for the purpose of implementing the Reinsurance Regulatory Modernization Framework. On May 7, 2009, the Task Force discussed this aspect of Tawa's proposal during an interim meeting in New York, NY. It was the consensus of the Task Force members present at the meeting that this proposal is not consistent with the purposes of the draft federal legislation, and that the language should not be included within the bill. It was noted, however, that the Task Force would continue to consider the proposal as an amendment to the Credit for Reinsurance Model Law.

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## **Model Law Considerations**

If it is agreed that the Model Law should be amended, the following procedures must be considered:

These Procedures for Model Law Development outline the process for development of a new Model Law or amendment to an existing Model Law. Prior to development of a new or amended Model Law, approval of the responsible Parent Committee and the NAIC's Executive Committee is required. The NAIC's Executive Committee will consider whether the request fits the criteria for Model Law development.

### ***Model Law Development Criteria***

The Executive Committee of the NAIC, upon a recommendation of the Parent Committee, will determine if a proposed new Model Law (or Regulation) or amendment to an existing Model Law (or Regulation) meets a two-pronged test ("Model Law Development Criteria") as follows:

- 1. The issue that is the subject of the Model Law necessitates a *minimum national standard* and/or requires *uniformity* amongst all states; and/or**
- 2. Where NAIC Members are *committed to devoting significant regulator and association resources* to educate, communicate and support a model that has been adopted by the membership.**

A Committee, Task Force, Working Group or Subgroup (collectively referred to as "NAIC Group") may discuss the issue of developing a Model Law but shall not devote resources to actual development or drafting of a Model Law until it receives approval of the Parent Committee and Executive Committee.

New Model Laws or amendments to existing Model Laws that are mandated by federal law are exempt from seeking initial Executive Committee approval, but development of such Models or amendments should be orally reported to the Executive Committee. New Model Laws or amendments to existing Model Laws that are mandated by federal law are subject to all Model Law drafting timelines as well as the requirement to obtain adoption by two-thirds majority at both the Parent Committee and Executive/Plenary Committee levels.

For amendments to existing Model Laws where the Model itself was not subject to Executive Committee approval under the Model Law Development Criteria, the Model itself as well as the proposed amendments should be presented for Executive Committee review and approval for development.

### ***Development of Guidelines***

If the NAIC Group determines the proposal does not meet the criteria for development of a Model Law, or if the Parent Committee and/or Executive Committee determines the criteria is not met, the NAIC Group may proceed with efforts to address the issue through Guidelines provided these efforts are consistent with the NAIC Group's charges. Guidelines are not considered Model Laws of the NAIC though are considered regulatory best practices such as laws, regulations, handbooks, guidance, white papers, and/or bulletins.

### ***Executive Committee Consideration Process***

The Executive Committee will meet at the NAIC's quarterly meetings, and in the interim as necessary, in order to consider requests to develop a new Model Law or an amendment to an existing Model Law. Upon approval by the responsible Parent Committee, the Chair of the Committee will present the request to the Executive Committee for consideration. The Executive Committee may allow an opportunity for comments from Members, regulators and interested parties prior to making a determination.

If the Executive Committee approves the request, the NAIC Group shall follow the procedures below. If the Executive Committee does not approve the request, the responsible Parent Committee is to reevaluate the NAIC Group's charge in light of the decision and provide further direction. If the denied request involves an amendment to an existing Model Law, the Executive Committee will determine whether the existing Model Law as a whole meets the Model Law Development Criteria and if not, reclassify the Model Law as a Guideline.

#### ***Approval of Request and Development of Model Law***

Upon approval of the Executive Committee, the NAIC Group shall develop the Model Law within one year from the date of approval. A Model Law must be ready for action by the Executive/Plenary at the next quarterly NAIC meeting following the one-year anniversary (or such other date as determined by the Executive Committee) of the Executive Committee's approval of the request. The Parent Committee, upon a showing of good cause by the NAIC Group, may grant an extension of time for development of the Model Law. The NAIC Group, through its Parent Committee, shall provide a quarterly report to the Executive Committee regarding the status of its Model Law development efforts.

#### ***Adoption of the Model Law***

A Model Law shall only be presented to the NAIC Executive/Plenary for consideration if a minimum two-thirds majority of the responsible parent committee has voted to adopt the Model Law. A minimum two-thirds majority vote of the NAIC Executive/Plenary in favor of adoption is required with each Member required to vote based on whether he or she will make efforts to have the model law introduced in his or her respective state legislature or that the law in his or her state already meets or exceeds the minimum national standard set by the Model Law.

#### ***Implementation of the Model Law***

Upon NAIC adoption of the Model Law, it will be a priority of the NAIC, through the collective efforts of the Members, to uniformly adopt the Model Law in a majority of states within three years after its adoption by the NAIC membership. The NAIC Members will devote significant regulator and NAIC resources to communicate, educate and support the Model Law. The NAIC staff will provide briefing materials, testimony, make state visits and answer questions. The Executive Committee shall provide quarterly updates to the NAIC Plenary on the status of adoption by states of the Model Law. The NAIC will post information on its website and issue public releases when a state adopts a Model Law.

#### ***Review of Existing Model Laws***

The Executive Committee may undertake a review of the adoption rates of existing Model Laws. If the Executive Committee determines the existing Model Law does not meet the criteria, it shall be reclassified as a Guideline as defined above. If the Executive Committee determines the existing Model Law meets the criteria, it will be made a priority of the NAIC to pursue uniform adoption in the remaining states.

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American Insurance Association

Attachment Four  
Reinsurance (E) Task Force  
6/13/09

2101 L Street NW  
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202-828-7100  
Fax 202-293-1219  
www.aiadc.org

April 23, 2009

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

*Re: Proposed Amendment to the Minimum Trusteed Surplus Requirement*

Dear Commissioner Goldman and Members of the Reinsurance Task Force;

The American Insurance Association thanks you for the opportunity to comment on the NAIC reinsurance task force's proposed amendment to section 2(D)(3) of the credit for reinsurance model law regarding minimum trusteed surplus.

AIA opposes the task force's proposed amendment to the credit for reinsurance model law that would exempt alien reinsurer's in run-off from the model law's requirement that a multiple beneficiary trust retain at least a \$20 million trusteed surplus. The proposal would allow the alien reinsurer to reduce the \$20 million surplus requirement to an amount determined at the discretion of the commissioner, but not less than 50% of the alien reinsurer's liabilities attributable to reinsurance ceded by U.S. insurers.

AIA believes the proposed amendment would weaken solvency protection for U.S. insurers and make it even more difficult for U.S. insurers to be paid amounts due under contract with alien reinsurers who no longer write in the U.S. market.

Under current law it is already extremely difficult for U.S. insurers to receive proper claim payments from alien reinsurers who have left the U.S. market and are in runoff. Removing the surplus requirement for those alien reinsurers in runoff will only make payment more difficult and elusive for U.S. insurers. In addition, it would seem that the necessity of a minimum level of surplus is needed more, not less, when an alien reinsurer goes into runoff and stops writing in the U.S. AIA is confused regarding why U.S. regulators would lower surplus requirements for alien reinsurers in runoff who no longer write in the U.S. Certainly such a change will not benefit U.S. insurers in any manner.

In any event, a \$20 million surplus requirement is honestly not a very onerous or difficult standard to satisfy. Requiring a reinsurer to have a \$20 million surplus is truly a pretty minimal standard on a relative basis. The \$20 million minimum requirement should, if anything, be increased to reflect market conditions and the passage of time since adoption of the standard. The \$20 million requirement should not be lowered, particularly for those alien reinsurers who are in runoff and no longer write in the U.S.

AIA thanks you for your consideration of these concerns.

Sincerely,

Steven A. Bennett  
Assistant General Counsel  
American Insurance Association

AMERICAN INTERNATIONAL GROUP, INC.  
70 PINE STREET, 6<sup>TH</sup> FLOOR  
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Honorable Steven M. Goldman, Commissioner  
Chair, National Association of Insurance Commissioners  
Reinsurance Task Force  
c/o New Jersey Department of Banking and Insurance  
20 West State Street  
P.O. Box 325  
Trenton, NJ 08625-0325

April 30, 2009

Dear Commissioner Goldman

This letter is written in response to the proposal submitted to the NAIC's Reinsurance Task Force ("the Task Force") by TAWA Management LLC ("TAWA") for the purpose of amending the NAIC Credit for Reinsurance Model Law regarding Minimum Trusteed Surplus for multiple beneficiary trusts. Under TAWA's proposed amendment, the requirements of assuming reinsurers to provide trust security covering their reinsurance obligations to U.S. cedents are reduced significantly if the assuming reinsurer is domiciled outside of the United States (thus not subject to U.S. regulation), and in run-off. For the reasons set forth below, we write to oppose TAWA's proposal, and respectfully request that it be rejected. We also write to express disagreement with the proposition that alterations to TAWA's proposal, as outlined by the NAIC Reinsurance Task Force at its March 2009 meeting, leave U.S. cedents with adequate security protection. Therefore, we also urge the rejection of these proposed alterations.

To cedents domiciled in the United States, the importance of collateral securing the payment of reinsurance obligations of non-admitted reinsurers cannot be overstated, especially when such reinsurers are in run-off status. Under Section 2D(1) of the NAIC Model Credit for Reinsurance Law (and the existing law of the several states), reserve credit for reinsurance from non-admitted reinsurers is provided to the cedent only when such reinsurance obligations are collateralized, through, for example, maintenance of "a trust fund in a qualified U.S. financial institution...for the payment of the valid claims of [the reinsurer's] U.S. ceding insurers, their assigns and successors in interest." To the extent cedents do not have such security from non-admitted reinsurers, they cannot take reserve credit for any such reinsurance.

It is a common knowledge in the insurance industry that it generally becomes more difficult to collect reinsurance recoverables from a reinsurer in run-off. Companies that are, by definition, no longer writing new business and will therefore receive no income from underwriting, no longer have an incentive to preserve trading relationships. Therefore, a significant incentive for the timely processing and payment of claims is removed. As a general matter, run-off companies respond more slowly and provide greater resistance to claims made against them.

This is particularly true for assuming reinsurers in run-off. Assuming reinsurers are not subject to regulatory rules imposing penalties for failure to pay reinsurance claims in a timely fashion (by contrast, there are significant Schedule F penalties imposed on U.S. cedents that have non-disputed, year-end balances outstanding for more than ninety days). Moreover, as a general matter reinsurance arbitration panels are reluctant to impose punitive or extra-contractual damages for “bad faith” claims handling practices.

The difficulty AIG experiences in collecting reinsurance recoverables from reinsurers with lower financial ratings (e.g., reinsurers in run-off) likely mirrors the experience of other United States cedents. At year-end 2008, the total amount of reinsurance recoverable on paid losses (considering reinsurers with balances of \$1 million or more) owed to AIG's domestic insurance companies from reinsurers with a financial rating of B+ or lower (captives excluded) was \$244,486,000. Over 59% of this amount (\$144,593,000) was over 90 days past due, the vast majority of which, \$140,972,000, was even more overdue at 120 days past due. These results stand in significant contrast to the amount of reinsurance recoverable on paid losses due similarly from reinsurers with financial ratings of “A” or better, which owed these same AIG Companies \$1,153,395,000 as of year-end 2008. Of this amount, 37% (\$439,414,000) was over 90 days past due, with \$399,875,000 of that amount being more than 120 days past due. It is noteworthy that of the 101 non-captive reinsurers with balances of \$1 million or more and which are rated above “B+”, only 4 are run-off companies, whereas of the 32 non-captive reinsurers with balances of \$1 million or more and rated B+ or lower, 26 are run-off companies. The small percentage of higher rated run-off companies (which by the way represent subsidiaries of strongly capitalized very large parent non-US reinsurers) suggests that this proposal would have scant application in any event and would hardly be worth the cost in time and effort to achieve the multiple amount of individual state legislative changes necessary to effect the change.

It is against this backdrop that TAWA requested that the NAIC adopt revisions to its Model Law that would significantly relax existing trusted surplus requirements for run-off reinsurers domiciled outside of the United States. The proposal TAWA sponsors would add a new Section 2.D(3)(b) to the Model Law, allowing a Commissioner to override the \$20 Million minimum requirement for trusted surplus. Subject only to the discretion of a Commissioner, TAWA's proposal would set the minimum trusted surplus requirement at a mere five percent (5%) of such non- U.S. run-off reinsurer's liabilities to cedents in the United States.

The alternative recommended by the Task Force, while more favorable than TAWA's proposal, still allows non-U.S. run-off reinsurers the ability to significantly under-secure their obligations. The Task Force recommendation provides that reinsurers in run-off for at least three years may reduce trusted surplus to as little as 50% of current reinsurance liabilities to U.S. cedents, subject to the discretion of the Commissioner having regulatory oversight over the trust. While the Task Force recommendation at least imposes the requirement that the Commissioner make certain findings relating to risk assessment before authorizing such a reduction (a requirement absent from TAWA's proposal), there is no provision in the Task Force recommendation allowing U.S. cedents the opportunity to object to such reductions, or to offer evidence militating in favor of maintaining trusted surplus at higher levels.

Most importantly, TAWA's proposal and the Task Force's alterations have the significant potential to largely eviscerate the collateral protection afforded to cedents, such protection having been a factor considered by cedents as being fully in place at the time any such contracts were negotiated. It is counter-intuitive for U.S. regulators, concerned with the solvency status of U.S. cedents to grant "relief" to reinsurers that remain outside the purview of a domiciliary state's regulation, and being in run-off, also often provide the greatest resistance to paying reinsurance claims. It is often the case that run-off companies provide the greatest resistance to paying the largest claims submitted to them. It stands to reason that it is the larger claims that tend to remain open for longer periods of time, often under-reserved until the time of resolution, even as smaller claims may be resolved. Contrary to TAWA's suggestion, cedents' need for collateral protection does not diminish as the run-off progresses. Indeed, the requirement for such protection increases. However, under the proposed modifications, trusted surplus might be reduced to as little as 5% (or, under the Task Force's modifications, 50%) of these resisted, and more likely to be under-reserved, liabilities leaving U.S. cedents significantly susceptible to collecting a fraction of the amount to which they are entitled.

It should be noted that the Reinsurance Supervision Review Department ("RSRD") proposal recently adopted by the NAIC is not affected by the rejection of TAWA's proposal concerning minimum trusted surplus or the Task Force's proposed alterations. Under the RSRD proposal, non-U.S. reinsurers may become "Port of Entry" reinsurers if they are certified by a "Port of Entry" supervisory State. The collateral requirements of all such Port of Entry (as well as "National") reinsurers would be subject to a rating imposed by the applicable Port of Entry or National state regulatory authority utilizing the standards identified in Section 7 of the recently proposed Reinsurance Regulatory Modernization Act of 2009. Unlike non-admitted reinsurers in run-off, the financial condition and payment practices of Port of Entry and National reinsurers would be subject to the ongoing review of insurance regulatory authority within the United States.

In light of these realities, AIG Companies oppose the efforts of run-off companies domiciled outside the United States to reduce minimum trusted surplus requirements, at the expense of the protection that is (and should be) afforded to cedents domiciled in the United States.

Sincerely,

Martin F. Carus  
Senior State Relations Officer

To: NAIC Reinsurance Task Force  
From: Stewart Keir, on behalf of Tawa Management, Ltd.  
Date: March 19, 2009  
Re: NAIC Model Credit for Reinsurance and Reinsurance Modernization Framework

On behalf of Tawa Management Ltd. (“Tawa”), I want to thank the members of the Reinsurance Task Force for addressing an important issue facing reinsurers in run-off and submit the following in response to your request for comments.

Tawa had proposed that the NAIC Model Credit for Reinsurance Law (“the Model Law”) be amended to allow the domiciliary commissioner authority to reduce the required minimum trusted surplus at the commissioner’s sole discretion, subject to a minimum trusted surplus of 5% of the trust’s liabilities; Tawa proposed adding the following provision to Section 785 s2 d. (3) of the Model Law:

“(b) Notwithstanding the provisions in subsection (a), 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 trusted 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. In no event shall the minimum trusted surplus be less than 5% of non U.S run-off assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers.”

Tawa proposed this change because the \$20 million minimum trusted surplus becomes problematic for reinsurers that go into run-off. As a run-off reinsurer’s liabilities are reduced in the normal course of business, the required minimum trusted surplus can cause liquidity problems because:

- Income is generally limited to investment income
- Reserves are gross and undiscounted
- As liabilities attributable to the U.S. trust are reduced, the percentage of collateral in the trust becomes disproportionately high in relation to the reinsurer’s other obligations
- The \$20 million minimum trusted surplus is required by law.

The Reinsurance Task Force discussed the proposal that Tawa Management Ltd. (“Tawa”) submitted to amend the Model Law and generally agrees with the principle of the proposal, but believes that a more conservative minimum trusted surplus should apply. Accordingly, the Task Force proposed the following amendment and has asked for comments:

“At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trusted surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the assuming insurer’s liquidity or solvency. The minimum required trusted surplus may not be reduced to an amount less than 50% of the assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers”.

Tawa agrees that the surplus that a run-off insurer maintains must be adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. Tawa also believes that the risk assessment should consider all of the factors suggested by the Task Force. However, by mandating a minimum surplus of a relatively high ratio of surplus to reserves, *i.e.*, 50%, the Task Force may be preventing a Commissioner and the run-off reinsurer from addressing temporary cash flow problems and solvency issues. While not as problematic as the existing \$20 million minimum surplus requirement, the proposed 50% ratio of reserves to liabilities has the potential to adversely affect the company's solvency and liquidity.

According to members of the Task force, the 50% ratio was determined by considering the average ratio of surplus to reserves maintained by active insurers. While we agree that this is one measure that should be considered, we feel that by setting the ratio solely on this basis, an individual reinsurer's experience is not being considered. For example, the Commissioner should be able to take into consideration the maturity of a reinsurer's run-off book and the volatility of the book. These factors are not taken into consideration when using a one-size-fits-all approach. A reinsurer that has been in run-off for three years and has a volatile book of reserves will essentially be treated the same as a reinsurer with a mature book and with reserves that have been stable over a period of time. U.S. regulators recognized that minimum capital and surplus standards did not serve their needs and adopted Risk Based Capital ("RBC") standards to better assess the financial condition of an insurer. An insurer's RBC results enabled regulators to determine the amount of surplus required for that insurer. We suggest that the Task Force adopt a similar approach, *i.e.*, assess each reinsurer's surplus requirements using objective standards, while requiring a *de minimus* surplus.

Furthermore, one of the purposes of surplus is provide a cushion for insurers' writing new business. As the insurer writes new business, the acquisition costs cause a drain on surplus because expenses are realized immediately while the premiums are earned over the course of the policy. This is not a factor for an insurer in run-off. Surplus also provides protection against the potential risk of inadequate pricing of new business. This is not a factor for an insurer in run-off.

Furthermore, as stated earlier, the reserves that are required to be maintained are gross as to reinsurance and are undiscounted, therefore eliminating the credit risk associated with collecting balances from retrocessionaires.

Additionally, the State of Washington had proposed that one of the factors that should be considered in allowing a reduction of surplus is whether the reinsurer has a history of slow-pay. Excess surplus trapped in the trust could, in fact, contribute to the reason for a reinsurer not paying claims on a timely basis.

The problem that we are attempting to address exists because the Commissioners do not have authority under the existing regulations - hence our proposal to give Commissioners total authority subject to a *de minimus* 5% cushion. The higher the percentage of surplus to reserves, the less flexibility the Commissioners have in individual cases, which is likely to constrain Commissioners. Although we believe that no minimum surplus should be required and the amount of required surplus should be left to the Commissioner's sole discretion, we recognize that some minimum is needed. New York suggested that a 30% ratio may be reasonable. We can work with 30% as it provides the Commissioner some degree of flexibility when attempting to address problem situations.

Finally, we respectfully request that you consider including this change in the federal legislation that the NAIC will shortly be proposing to implement the Reinsurance Modernization Framework.

Once again, thank you for addressing this issue and allowing us to comment.

AIA –

1. Removing the surplus requirement for those alien reinsurers in runoff will only make payment more difficult and elusive for U.S. insurers. In addition, it would seem that the necessity of a minimum level of surplus is *needed more, not less*, when an alien reinsurer goes into runoff and stops writing in the U.S.

Tawa response: The trust fund is security to be realized in the event of non payment, it is not a mechanism for payment of liabilities. The need to hold a surplus which is large relative to reserves will force reinsurers to stop paying all claims earlier than otherwise would be the case, due to liquidity constraints. Under the Tawa proposal surplus requirements would not be “removed”; the requirements would be modified to take into account the adverse results that the current requirement may cause.

2. In any event, a \$20 million surplus requirement is honestly not a very onerous or difficult standard to satisfy. Requiring a reinsurer to have a \$20 million surplus is truly a pretty minimal standard on a relative basis. The \$20 million minimum requirement should, if anything, be increased to reflect market conditions and the passage of time since adoption of the standard.

Tawa response: This ignores the fact that on a percentage basis, the current minimum surplus requirement becomes unjustified as the reinsurers liabilities are reduced. It cannot be reasonable for a reinsurer with, for example, \$40m of outstanding reserves to be required to hold \$60m in a trust account, reserves being covered 1.5 times, but at the same time to allow a reinsurer with \$400m of outstanding reserves to hold \$420m, with reserves covered 1.05 times.

AIG –

1. To the extent cedents do not have such security from non-admitted reinsurers, they cannot take reserve credit for any such reinsurance.

Tawa response: The proposed change would not affect the ability of a cedent to take reserve credit.

2. Generalization about difficulty in collecting from run-off reinsurers.

Tawa response: This fails to take into account the performance of individual reinsurers.

3. It is a common knowledge in the insurance industry that it generally becomes more difficult to collect reinsurance recoverables from a reinsurer in run-off. Companies that are, by definition, no longer writing new business and will therefore receive no income from underwriting, no longer have an incentive to preserve trading relationships. Therefore, a significant incentive for the timely processing and payment of claims is

removed. As a general matter, run-off companies respond more slowly and provide greater resistance to claims made against them.

Tawa response: Again, this is a generalization that does not take into account the performance of individual reinsurers.

Also, the point that there is no income from underwriting is the very point that Tawa has made. This actually adds to the need for relief since the source of funds, essentially investment income is limited, and the minimum surplus requirement places a strain on liquidity.

4. There is no provision in the Task Force recommendation allowing U.S. cedents the opportunity to object to such reductions, or to offer evidence militating in favor of maintaining trusteed surplus at higher levels.

Tawa response: The domiciliary regulator has the responsibility to safeguard policyholder rights.

5. It stands to reason that it is the larger claims that tend to remain open for longer periods of time, often under-reserved until the time of resolution, even as smaller claims may be resolved.

Tawa response: Often this may be because of valid claims issues, not because the reinsurer wishes to slow down claims. In fact, with low investment returns reinsurers are not benefited by any strategy to hold up payment of valid claims. In addition, the point fails to recognize that, under a properly conducted run-off, the volatility is actually reduced in a mature run-off.

6. However, under the proposed modifications, trusteed surplus might be reduced to as little as 5% (or, under the Task Force's modifications, 50%) of these resisted, and more likely to be under-reserved, liabilities leaving U.S. cedents significantly susceptible to collecting a fraction of the amount to which they are entitled.

Tawa response:

1. Independent actuarial reports are submitted to the regulator to support the reserves and such reserves are adjusted quarterly.
2. Failure to provide relief from the current minimum surplus requirement has the potential to force a run-off reinsurer into receivership and this increases the possibility of the cedent having to collect from a drawn out collection process.

# Agenda Item 3

## **Consider Adoption of the Reinsurance Collateral Guidance Memo**

### **Attachments:**

- **Attachment Eight: Reinsurance Collateral Guidance Memo**
- **No comments were received on this item.**

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TO: Commissioners, Directors and Superintendents of NAIC Member Jurisdictions

FROM: NAIC Reinsurance (E) Task Force

DATE: March 15, 2009

SUBJECT: Guidance Regarding Reinsurance Collateral Requirements

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Concern has been expressed to NAIC members that current conditions in the financial markets are presenting challenges as U.S. ceding insurers seek to obtain sufficient collateral to secure reinsurance recoverable balances from unauthorized assuming insurers. Current reinsurance law requires that these balances be appropriately collateralized in order for a U.S. ceding insurer to receive credit for reinsurance in the statutory financial statements. Particular areas of concern that have been raised are a potential reduced supply of letters of credit (LOC) due to credit contraction by U.S. banks, and diminished trust account balances resulting from a general decline in the values of trust assets.

As these concerns have been communicated, many members have also been presented with proposals to consider a variety of alternative collateral arrangements. This has resulted in requests for clarification regarding the authority granted to commissioners under the NAIC Credit for Reinsurance Model Law (Model Law) and the Credit for Reinsurance Model Regulation (Model Regulation) to accept “any other form of security acceptable to the commissioner,” and to determine that a financial institution meets the criteria to be considered a “Qualified U.S. Financial Institution” for the purposes of issuing or confirming LOCs or for holding assets in trust on behalf of a U.S. ceding company.

In an effort to assist our members as questions and proposals are considered, the NAIC determined that it would be beneficial to distribute general guidance to commissioners regarding the application of this authority. Please note that this guidance is not intended to be binding interpretation, nor is it intended to amend existing law or expand current practices. Also, please note that not all jurisdictions grant this authority within their respective laws to the same extent as is allowed under the Model Law and Model Regulation. As such, each jurisdiction’s applicable laws should be reviewed during consideration of the general guidance provided within this memorandum.

The provisions of the Model Law and Model Regulation were thoroughly contemplated through a well-thought-out, conservative and deliberate process. Therefore, caution should be used when considering expansion of these provisions as a response to current circumstances. Due to the importance of case-by-case evaluation of each proposal, it is not practical or feasible to provide an exhaustive list of items which have been, or could be considered acceptable. Regulators’ analysis of any arrangement that is considered for acceptability should include, but not be limited to, consideration of the following guidance.

Subsequent to issuance of this guidance letter, the NAIC will consider the development of a reporting mechanism to facilitate communication among NAIC members in situations where forms of security other than those specifically included in the Model Law and Model Regulation have been accepted.

### Guidance on Reinsurance Collateral Requirements

Section 3 of the Model Law provides the following:

**Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2**

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations there under, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

- A. Cash;
- B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners and qualifying as admitted assets;
- C. (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding company on or before the filing date of its annual statement;
- (2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or
- D. Any other form of security acceptable to the commissioner.

Section 9 of the Model Regulation provides the following:

**Section 9. Asset or Reduction from Liability for Reinsurance Ceded to an Unauthorized Assuming Insurer not Meeting the Requirements of Sections 4 Through 8**

A. Pursuant to Section [cite state law equivalent of Section 3 of the Credit for Reinsurance Model Law], the commissioner shall allow a reduction from liability for reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section [cite state law equivalent of Section 2 or other appropriate section of the Credit for Reinsurance Model Law] in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the exclusive benefit of the ceding insurer, under a reinsurance contract with such assuming insurer as security for the payment of obligations under the reinsurance contract. The security shall be held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer or, in the case of a trust, held in a qualified United States financial institution as defined in Section [cite state law equivalent of Section 4B of the Credit for Reinsurance Model Law]. This security may be in the form of any of the following:

- (1) Cash;
- (2) Securities listed by the Securities Valuation Office of the NAIC and qualifying as admitted assets;
- (3) Clean, irrevocable, unconditional and "evergreen" letters of credit issued or confirmed by a qualified United States institution, as defined in Section [cite state law equivalent of Section 4A of the Credit for Reinsurance Model Law], effective no later than

December 31 of the year for which filing is being made, and in the possession of, or in trust for, the ceding company on or before the filing date of its annual statement. Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

(4) Any other form of security acceptable to the commissioner.

B. An admitted asset or reduction from liability for reinsurance ceded to an unauthorized assuming insurer pursuant to this section shall be allowed only when the requirements of Section 13 and the applicable portions of Sections 10, 11 and 12 of this regulation have been satisfied.

Section 12 of the Model Regulation provides the following:

**Section 12. Other Security**

A ceding insurer may take credit for unencumbered funds withheld by the ceding insurer in the United States subject to withdrawal solely by the ceding insurer and under its exclusive control.

- So long as the credit for reinsurance law in a jurisdiction provides this authority to the same extent granted to commissioners under Section 3(D) of the Model Law and Section 9(A)(4) of the Model Regulation, it is the opinion of the NAIC that commissioners should utilize this authority on a case-by-case basis only after careful and thorough evaluation of all information relevant to each situation.
- Section 3 of the Model Law and Section 9(A) of the Model Regulation requires any security to be held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B of the Model Law, or the equivalent law of the respective jurisdiction.
- Security permitted under these sections should be provided for the sole benefit of the applicable ceding insurer.
- This authority is not intended to allow a ceding insurer to take credit in excess of the amount of collateral that is provided.
- LOCs should be limited to those issued or confirmed by “qualified U.S. financial institutions,” as defined within Section 4(A) of the Model Law, unless otherwise permitted by existing law and regulation.

**Guidance on Qualified U.S. Financial Institutions**

Section 4 of the Model Law provides the following:

**Section 4. Qualified U.S. Financial Institutions**

A. For purposes of Section 3C, a “qualified U.S. financial institution” means an institution that:

- (1) Is organized or (in the case of a U.S. office of a foreign banking organization) licensed, under the laws of the United States or any state thereof;
- (2) Is regulated, supervised and examined by U.S. federal or state authorities having regulatory authority over banks and trust companies; and
- (3) Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to

regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.

- B. A “qualified U.S. financial institution” means, for purposes of those provisions of this law specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:
- (1) Is organized, or, in the case of a U.S. branch or agency office of a foreign banking organization, licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and
  - (2) Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.
- An institution must meet the criteria within Sections 4(A)(1), (2) and (3) of the Model Law in order to be considered a “qualified U.S. financial institution” for the purposes of issuing or confirming an LOC under Section 3 of the Model Law.
  - The SVO maintains a list of U.S. financial institutions that have, upon application to the SVO, been determined to meet the eligibility standards within Part Ten of its *Purposes and Procedures Manual*. Though Section 4(A)(3) of the Model Law grants commissioners the authority to conduct such an evaluation, for the sake of uniformity there is a tendency among regulators to defer exclusively to the SVO for this analysis and to accept only those institutions currently included on the NAIC List of Banks when considering whether an institution is qualified to issue or confirm an LOC.
  - If an “unlisted” financial institution meets the provisions of Sections 4(A)(1) and (2) and will be providing collateral for a ceding insurer, a commissioner may require the financial institution to submit an application to the SVO for review. This process ordinarily takes approximately 30 days. Please see Attachment 1 for applicable information regarding these eligibility standards as well as information regarding the process for submitting application to the SVO for an entity to be considered for inclusion on the NAIC List of Banks.
  - It is important to note that the SVO process is not an evaluation of the terms of a particular LOC. Regulators should evaluate an LOC to verify that it meets the requirements within applicable law and regulation. Approval of an entity for listing on the NAIC List of Banks should not be considered an indication that any individual LOC meets required terms.

### **Additional Guidance Regarding LOCs**

Section 3(C)(1) of the Model Law and Section 9(A)(3) of the Model Regulation requires that an LOC be effective no later than December 31 in order for a U.S. ceding company to be able to receive credit for reinsurance for the related recoverables. However, these sections do allow a ceding company until the filing date of the annual statement to have the LOC in its possession or in trust.

Section 3(C)(1) of the Model Law provides the following:

Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding company on or before the filing date of its annual statement;

Section 9(A)(3) of Model Regulation provides the following:

Clean, irrevocable, unconditional and “evergreen” letters of credit issued or confirmed by a qualified United States institution, as defined in Section [cite state law equivalent of Section 4A of the Credit for Reinsurance Model Law], effective no later than December 31 of the year for which filing is being made, and in the possession of, or in trust for, the ceding company on or before the filing date of its annual statement. Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution’s subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

## **Attachment 1**

*From the Purposes and Procedures Manual of the NAIC Securities Valuation Office*

### **Part Ten: Creation and Maintenance of Bank List**

#### **Section 1. List to be Compiled**

The staff is instructed to compile and maintain a list of banks that meet the credit standards identified in Section 2 below (Bank List). The Bank List may be used by state insurance departments for any purpose consistent with the NAIC Financial Conditions Framework, including, but not limited to, evaluation of the reinsurance credits claimed by ceding insurers and the determination of eligibility to serve as trustee for a nonadmitted insurer for purposes of the NAIC's International Insurers Department Plan of Operation and the NAIC's standard trust agreement. Inclusion on the Bank List does not imply an opinion of the suitability or unsuitability of those entities on the list to serve as providers of credit enhancement of securities.

#### **Section 2. Eligibility Standards**

##### **(a) Domestic Issuers**

Issuing or confirming banks may be placed on the Bank List if they meet the following requirements: the bank is authorized to issue or confirm bank letters of credit, is capable of performing the duties of a Trustee or both, and either (i) has an NAIC ARO rating of "Baa/BBB" or better for long-term debt or a "P2/A2" or better for short-term debt, or (ii) has the equivalent rating from a specialized securities rating company or service that is not an NAIC ARO.

##### **(b) Foreign Issuers**

U.S. Branches or agencies of foreign Letter of Credit issuers may be placed on the Bank List if they (i) issue letters of credit for reinsurance, (ii) are a part of foreign institution that (a) have attained an NAIC ARO rating of "Aa/AA" or better for long-term debt or a "P1/A1" or better for short-term debt by an NAIC ARO or (b) the equivalent rating by a securities rating company or service specializing in banks that is not an NAIC ARO.

##### **(c) General**

All standby letters of credit must be clean, irrevocable and unconditional. Additionally, these letters of credit must be issued or confirmed by, and must be presentable and payable at, an office of the qualifying bank located in the United States. Standby letters of credit issued by a foreign (non-U.S.) office of a qualifying U.S. institution must be confirmed by a United States office of the qualifying bank. The SVO does not review individual letters of credit and a bank's presence on the Bank List does not in any way imply that the requirements of this Section 2(c) have not been met.

#### **Section 3. Administration**

##### **(a) Reporting**

A party interested in having a bank listed on the Bank List should first determine whether the bank meets the minimum qualifications discussed above. If the bank meets the minimum qualifications discussed above, it should submit to the SVO:

- (i) An ATF Initial Filing Form; and
- (ii) A copy of its most recent Audited Financial Statement or call report; and

- (iii) Proof of current long and/or short-term rating from all NAIC AROs that have rated the bank, which may consist of:
  - (1) A copy of the rating letter from the NAIC ARO; or
  - (2) A copy of the page from the NAIC AROs rating publication showing the rating and the date of publication; or
  - (3) A copy of the Bloomberg display screen.

Upon receipt of the above documents and the filing fee, the SVO shall perform a financial review of the bank. Upon completion of that review, the applicant bank shall be informed in writing that it has been approved or disapproved for listing on the Bank List. Insurance companies that apply for reinsurance credit shall report the name of the issuer of the Letter of Credit to the SVO only if the issuer is not on the Bank List.

**(b) Monitoring and Updates**

Annually, the SVO shall contact by mail the banks then listed on the Bank List, inviting each bank to renew its listing by submitting the then application renewal fee and copies of the most recent Audited Financial Statements. The Bank List will be updated by the staff and disseminated as necessary to administer the intent of this Part. A bank on the Bank List that fails to provide the required documents and renewal fee or any bank whose credit quality has deteriorated to a level below the minimum standards identified above shall be deleted from the Bank List without notice.

**(c) Downgraded Banks**

Letters of credit issued by banks that have been removed from the Bank List after they have issued a Letter of Credit in support of a reinsurance contract shall be rated as if they were still on the Bank List until the initial expiration date of the letter of credit. The extension, renewal, modification or amendment of the letter of credit will only be recognized if the bank is re-listed on the Bank List. Restoration of a bank to the List will occur only after the bank has met the standards described above for five consecutive quarters.

# Agenda Item 6

**Receive Minutes from May 6-7, 2009 Interim Meeting**

**Attachments:**

- Attachment Nine: May 6-7 interim meeting minutes

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Draft: 6/9/09

Reinsurance (E) Task Force  
New York, NY  
May 6-7, 2009

The Reinsurance (E) Task Force met in New York, NY, May 6 and 7, 2009. The following Task Force members participated: Steven M. Goldman, Chair, and Bob Kasinow (NJ); Steve Poizner represented by Kim Hudson (CA); Thomas R. Sullivan represented by Kathy Belfi and Elaine Wieche (CT); Thomas E. Hampton represented by Philip Barlow (DC); James J. Donelon represented by Stewart Guerin (LA); Nonnie Burnes (MA); Roger A. Sevigny represented by Paul Kropp (NH); Eric Dinallo represented by Joe Fritsch (NY); Alfred W. Gross represented by Doug Stolte (VA); Paulette Thabault represented by David Provost (VT); and Sean Dilweg represented by Peter Medley (WI).

1. Discussion on Exposure Draft “Reinsurance Regulatory Modernization Act of 2009” – Non-Constitutional Issues

Commissioner Goldman directed the Task Force to an exposure draft federal bill (Attachment \_\_) that was developed by the NAIC as an initial step in the process to implement the Reinsurance Regulatory Modernization Act. He noted that several comment letters had been submitted pertaining to this exposure draft, and stated that the purpose of this meeting was to receive comments from interested parties and discuss this draft legislation. He stated that the Task Force would first focus the discussion on issues other than those pertaining to the U.S. Constitution.

Steve Bennett (American Insurance Association—AIA) summarized written comments included in the AIA letter dated April 23 (Attachment \_\_). Mr. Bennett encouraged the Task Force to reconsider its efforts to amend current collateral requirements due to the potential risks to ceding company solvency. Commissioner Goldman emphasized that ceding company solvency is of primary concern to state insurance regulators. He reiterated that the Task Force was careful in developing the framework to include many provisions that not only address the concerns of ceding companies, but address the concerns of regulators, as well.

Tracey Laws (Reinsurance Association of America—RAA) referred the Task Force to written comments included in the RAA letter dated April 23 (Attachment \_\_). In addition, she discussed concerns related to the confidentiality of information, the contemplated use of the NAIC model law process, the need for a process to handle decertification of a state supervisor, extraterritorial application of state law, and the need for a mechanism to resolve any disputes that arise related to preemption issues. Mr. Fritsch requested that the RAA provide suggested language regarding the extraterritorial issues.

Bill Marcoux (Dewey & LeBeouf LLP, representing the International Underwriting Association—IUA and Hannover Re) referred to written comments submitted by these respective parties (Attachment \_\_ and \_\_). He discussed issues related to the importance of confidentiality of information; the intended role of the NAIC in this process going forward; the contemplated use of model laws in the process; the fees contemplated within the proposal; the lack of an appeal process for non-U.S. jurisdictions in the event of disagreement with a decision made by the Reinsurance Supervision Review Department Board (Board); the language regarding solvent schemes of arrangement; and the need for flexibility in the financial reporting requirements for port of entry (POE) reinsurers. Discussion followed regarding the process that an agency of a foreign government would likely follow to address a dispute with an agency of the U.S. government, and it was noted that such disputes would likely be addressed through government relations. Commissioner Goldman requested that Mr. Marcoux submit language to address his concerns related to solvent schemes of arrangement.

Marty Carous (American International Group—AIG) discussed issues related to the adoption of Solvency II in the European Union, the potential costs and challenges to U.S. ceding companies when trying to obtain additional capital to meet solvency requirements after collateral rules change, and the lack of leverage for some ceding companies when trying to obtain additional collateral on a contract-by-contract basis.

Brad Kading (Association of Bermuda Insurers and Reinsurers—ABIR) commented on the unique opportunity before the NAIC to enact federal law, and suggested that the NAIC likely has a window of two years to enact this proposal. He then discussed issues related to the role of the NAIC vs. the role of the Board, the need for increased flexibility within the financial reporting requirements for POE reinsurers, and the need for an exemption for affiliated transactions. Mr. Kading reiterated support for the one-year collateral deferral provision for catastrophe recoverables. He noted the ABIR’s agreement with the current draft’s exemption from collateral requirements for national reinsurers rated Secure-3 or above, since this is contemplated to be an interim step in the regulatory modernization process. He emphasized, however, that the ABIR would not agree with the collateral requirements for POE reinsurers on a long-term basis.

Mr. Kasinow provided a summary of clarifications pertaining to comments submitted by various interested parties. He noted that these clarifications and explanations would be included in a response document to be distributed when a revised draft federal bill is exposed for public comment.

Stewart Kier (Tawa Management, Ltd.) referred to written comments submitted in the Tawa letter (Attachment \_\_) pertaining to proposed changes to the minimum trustee surplus requirement for a multiple beneficiary trust maintained by an assuming insurer in run-off. Mr. Kasinow stated that the issue was initially proposed by Tawa as a recommended amendment to the Credit for Reinsurance Model Law (Model Law), and noted that the Task Force had voted to expose revised language pertaining to this proposal during the Spring National Meeting. Mr. Kasinow stated that Tawa had submitted an additional request to include the proposed language within the federal legislation related to implementation of the reinsurance modernization framework. Mr. Medley noted that this framework is intended to apply only to agreements entered into or renewed after the effective date of this legislation, and suggested that Tawa's proposal is not consistent with the purpose of this legislation. Mr. Barlow agreed. Mr. Carous referred to written comments submitted by AIG (Attachment \_\_) and expressed AIG's opposition to any of the proposed changes to the minimum trustee surplus requirement for a multiple beneficiary trust, whether they be in the federal legislation or the Model Law. Mr. Bennett referred to written comments submitted in the AIA letter dated April 23 (Attachment \_\_) and noted the AIA's opposition to the proposed changes to the minimum trustee surplus requirement, as well. Mr. Kier referred to written comments submitted by Tawa on May 6 (Attachment \_\_), and noted that these comments were submitted as a response to the comments from AIG and the AIA. Mr. Kasinow said that the Task Force would give further consideration to comments related to the proposed amendment to the Model Law and discuss the issue during a subsequent meeting.

2. Discussion on Exposure Draft "Reinsurance Regulatory Modernization Act of 2009" – Constitutional Issues

Dan Schelp (NAIC) provided a brief summary of the comments received related to Article II, Section 2, Clause 2 of the U.S. Constitution (Appointments Clause), and the Tenth and Fourteenth Amendments to the U.S. Constitution. Commissioner Goldman stated that the NAIC would retain outside counsel to assist in the review of these constitutional issues.

Ms. Laws again referred to written comments included in the RAA letter dated April 23, and emphasized the substance of these constitutional issues. She discussed issues related to supervisory recognition, the ability of the states to enter into agreements with non-U.S. jurisdictions, the ability of non-U.S. jurisdictions to enter into agreements with non-governmental entities, and the need for federal oversight of the Board due to the delegation of federal authority. She expressed concern over recent comments that the EU would not recognize U.S. individual states under the EU evaluation process. Discussion followed regarding supervisory recognition, the nature and extent of the agreements contemplated in the current proposal, and the rights or implications of such agreements. Marika Brady (American Council of Life Insurers—ACLI) referred to comments included in the ACLI letter dated April 23 (Attachment \_\_). She noted that the primary concern was related to delegation of governmental authority to a non-governmental entity without corresponding governmental oversight.

Commissioner Goldman reiterated that the NAIC would be retaining outside counsel to review the draft bill. He noted that the Task Force would distribute a revised draft in the near future along with explanations for any changes.

Though not presented formally during the meeting, additional comment letters were submitted by other interested parties with respect to this exposure draft federal legislation. (Attachments \_\_ through \_\_).

Having no further business, the Reinsurance (E) Task Force adjourned.

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