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

FROM: Ryan Couch, NAIC

DATE: September 12, 2008

SUBJECT: Reinsurance (E) Task Force Activities

1. During 2008 the Reinsurance (E) Task Force (RTF) met in Newark, NJ for regulator-to-regulator meetings on March 11-12, May 7-9, and June 25-27; in New York, NY for an open meeting on July 23-24, followed by a regulator-to-regulator meeting for a portion of July 24-25; by regulator-to-regulator conference call on August 15; by open conference call on September 9; and by regulator-to-regulator conference calls on September 9 and September 11. During these meetings, the RTF considered comments received from interested parties and developed the reinsurance regulatory modernization framework outlined in this proposal.

Definition of Terms

"Domiciliary jurisdiction" 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 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.

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

"Port of entry (POE) 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. Certification by a port of entry state does not provide independent authority to transact the business of insurance in the United States.

"Port of entry (POE) 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 (POE) supervisor"** means the insurance supervisory agency of the port of entry state.

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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 POE reinsurers. Each would be supervised by a single state (the home state or POE state). National reinsurers would be licensed by the home state and POE reinsurers would be certified by the POE state.

3. In order to qualify as a home state supervisor or a POE 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 on a cross-border basis 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. Reinsurers shall have a minimum capital and surplus 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 minimum capital and surplus equivalents (net of liabilities) of at least $ 250 million and a Central Fund containing a balance of at least $ 250 million.

5. 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 host state supervisor retains the same authority it has under existing law to determine whether the contract transfers risk.

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

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

   b. The host state supervisor 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 provide creditable reinsurance to the U.S. market through the POE state.

7. 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 who do not choose to become a national reinsurer or a POE 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. Under Section 2 of the current NAIC Model Credit for Reinsurance Law, as an assuming reinsurer that is licensed, accredited, or otherwise meets the requirements within Section 2 of the current NAIC Model; or

d. Under Section 3 of the current NAIC Model Credit for Reinsurance Law, as an assuming reinsurer (U.S. or non-U.S.) that does not meet the requirements within Section 2 of the current NAIC Model, by posting the required collateral.

8. The proposed reinsurance regulatory modernization initiative, including changes to collateral requirements and any amendments to current credit for reinsurance rules, will apply only to reinsurance contracts entered into or renewed on or after the effective date of this proposal**.** An appropriate implementation period will be developed.

Role, Structure and Requirements of the RSRD

9. 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.

10. The functions and requirements 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 evaluate the supervisory regimes of non-U.S. jurisdictions, both initially and on an ongoing basis, consider the rights, benefits and the extent of reciprocal recognition afforded by non-U.S. jurisdictions to reinsurers licensed and domiciled in the U.S., determine the appropriate supervisory recognition approach for such jurisdictions, and create a list of jurisdictions eligible to be recognized by POE states. 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 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 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, depth and experience in regulating reinsurance transactions, including taking into account ceded premium volume.

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

g. The following contractual clauses shall be mandatory for both ceding insurers and reinsurers:

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.

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:

> "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."

[Note: the Task Force will submit a referral to the NAIC Statutory Accounting Principles Working Group, recommending review of *SSAP No. 62—Property and Casualty Reinsurance,* and consideration of necessary contract clause requirements.]

Role of Home State Supervisor

11. 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

12. The POE 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 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 final 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.

13. A POE reinsurer must file the following reports with the POE supervisor in the time frames specified below:

a. Notification within 10 days of any regulatory actions taken against the reinsurer, any change in the provisions of its domiciliary license or any change in rating by an SEC-approved rating agency, including a statement describing such changes and the reasons therefore;

b. Annually, information comparable to relevant provisions of the NAIC financial statement for use by insurance markets, a report filed annually in the form of the applicable NAIC Annual Filing Blank, either Schedule F or Schedule S. 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;

c. Annually, an independent audit opinion of the reinsurer;

d. Annually, audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis), regulatory filings, and 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;

e. At least annually, an updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers; and

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

Role of Host State Supervisors

14. In addition to the normal regulatory duties, 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;

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 and verify that the agreements are properly accounted for and reported by the ceding insurer;

e. have the ability to require diversification of reinsurance risk for ceding insurers;

f. have the discretion to require the ceding insurer to obtain prior written approval if, for any twelve-month period, the ceded reinsurance premium or anticipated change in the ceding insurer's liabilities related to a single non-affiliated reinsurer 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

15. 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). National reinsurers and POE reinsurers will be evaluated on a legal entity basis, with due consideration being given to the group rating where appropriate, for purposes of establishing their collateral requirements. The rating and corresponding collateral calculation would be as follows:

Ratings	Collateral Required
Secure – 1	0%
Secure – 2	10%
Secure – 3	20%
Secure – 4	75%
Vulnerable – 5	100%

16. 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. A significant basis for this determination is that U.S. domiciled reinsurers are required to maintain capital in the U.S. well in excess of 100% of their reinsurance liabilities in order to meet U.S. licensing standards and U.S. Risk Based Capital requirements. In addition, 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, annual audited statutory financial statements, and many other regulatory rules.

17. Within two years after the first full year of operations under the new collateral requirements, the RSRD will be required to undertake a re-examination of the collateral requirements and make recommendations with respect to the appropriate collateral amounts for national and POE reinsurers including, with regard to POE reinsurers, due consideration of the level of equivalence of prudential regulation and effective market access in the POE reinsurer's jurisdiction.

18. 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 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 approved by the U.S. Securities and Exchange Commission (SEC).

19. As part of the evaluation process, factors to be considered by the home state or POE supervisor in determining the appropriate rating of a reinsurer shall include but not be limited to the following:

a. The reinsurer's financial strength rating from an SEC-approved rating agency. The maximum rating that a reinsurer may be assigned will correspond to the reinsurer's financial strength rating as outlined in the table below. The POE or home state supervisor shall use the lowest financial strength rating received from an SEC-approved rating agency in establishing the maximum rating of a reinsurer. A failure to obtain or maintain at least two financial strength ratings from SEC-approved rating agencies will result in an assignment of a Vulnerable-5 rating:

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

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

c. The business practices of the reinsurer in dealing with its ceding insurers;

d. For national reinsurers, a review of the most recent applicable NAIC Filing Blank, either Schedule F or Schedule S;

e. For POE reinsurers, a review of a report filed annually in the form of the applicable NAIC Annual Filing Blank, either Schedule F or Schedule S. 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;

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

g. Regulatory actions against the reinsurer;

h. An independent audit opinion of the reinsurer;

i. For POE reinsurers, audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis), regulatory filings, and 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;

j. The liquidation preference of obligations to a ceding company in the reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding;

k. A reinsurer's participation in any solvent scheme of arrangement, or similar procedure, which involves U.S. cedents. Entrance into such an arrangement or procedure that involves one or more U.S. cedents will result in an assignment of a Vulnerable-5 rating;

l. Any other information deemed relevant by the home state or POE supervisor.

20. In order to facilitate the prompt payment of claims, a national reinsurer or a POE reinsurer would not have to post collateral for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a defined catastrophic occurrence as recognized by the home state or POE supervisor. The one year deferral period is contingent upon the respective national or POE reinsurer continuing to pay claims in a timely manner. Reinsurance recoverables for only 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

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

21. 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.

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

Change in or Revocation of Rating

23. The POE or home state supervisor will not have discretion to waive additional collateral required in the case of a downgrade by a rating agency or other disqualifying circumstance.

24. The POE supervisor or home state supervisor will have the authority to suspend, amend or withdraw a reinsurer's rating at any time if a reinsurer fails to meet its obligations or collateral requirements under this proposal, or if other financial or operating results of the reinsurer, or documented significant delays in payment by the reinsurer, lead the reinsurer's supervisor to reconsider the reinsurer's ability or willingness to meet its contractual obligations.

25. If the home state supervisor's or POE 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 POE 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.

26. 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.

Implementation of Proposal

27. In order to preserve state-based regulation of reinsurance on a cross-border basis, promote uniformity of regulation throughout the NAIC member jurisdictions, and in light of the opportunity presented in the related federal legislation, House Bill 1065 and Senate Bill 929 – The Nonadmitted and Reinsurance Reform Act of 2007, the Reinsurance Task Force recommends federal enabling legislation. This federal legislation would provide appropriate authority to the RSRD. The RSRD would establish the requirements under which home state and POE supervisors would regulate national or POE reinsurers. A federal approach would facilitate incorporation of the concepts of mutual recognition and reciprocity into the framework by eliminating any legal concerns with respect to inclusion of these concepts under a state-based implementation approach. Congressional approval will allow POE supervisors (or the RSRD) to negotiate reciprocal recognition for reinsurers licensed and domiciled in the U.S. Other items that would need to be considered under the federal implementation approach are any potential changes to state insurance laws, separate enactment for home and POE state qualification and future amendments to the framework to maintain flexibility in cross-border regulation of reinsurance.

Life Reinsurance

28. In an effort to better coordinate the collateral modernization reforms included in this proposal with the life insurance reserve reform efforts currently in process, this proposal would not be applicable to life reinsurance contracts until the earlier of 24 months from the effective date of this proposal, or the implementation of U.S. principles based reserving standards for life insurance. The Reinsurance Task Force will continue to consider other life reinsurance issues following completion of this proposal.