

Rating Proposal

An Alternative Procedure to Grant Credit for Ceded Reinsurance

1. Overview

This proposal will establish new regulatory requirements that will provide reasonable and prudent controls over the reinsurance credit risk exposure of U.S. ceding insurers. These requirements include both regulatory controls and standards by which ceding insurers will manage their reinsurance credit risks. As with other requirements regarding valuation and control of credit risks, these new reinsurance rules will have appropriate financial strength and other credit risk control requirements, including an assessment of the quality of regulation in the reinsurer's country of domicile and an assessment of the reinsurers record of prompt payment of valid claims. The new rules will apply to all reinsurers and insurers assuming reinsurance, irrespective of the country of domicile.

It is expected that these new credit for reinsurance rules will enhance solvency regulation, by requiring collateral from all reinsurers who do not meet the standards set forth below and will eliminate unnecessary costs and disincentives to write U.S. business by eliminating collateral where it is not reasonably required. In addition, these new rules will ensure that US credit for reinsurance rules are consistent with developments in international standards before the International Association of Insurance Supervisors.

2. Establishment of Reinsurer Rating Mechanism

State insurance regulators ("regulators") will establish procedures and standards for evaluating the counter party credit risk of reinsurers. "Reinsurers" shall include all insurers or reinsurers assuming risks from U.S. ceding companies. This process will include identification of regulatory jurisdictions which are determined to adequately regulate reinsurers and a process by which to identify "slow paying reinsurers".

The new process will result in the rating of reinsurers who meet the agreed standards in one of the following Reinsurer Rating ("RR") categories: RR 1; RR 2; RR 3; or RR 4.

3. Collateral Requirements for Reinsurers

Pursuant to the rating requirements provided in section 4, the collateral requirements for reinsurers shall be as follows:

RR 1 = 0% of gross liabilities

RR 2 = 25% of gross liabilities

RR 3 = 50% of gross liabilities

RR 4 = 75% of gross liabilities

Acceptable collateral shall mean 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 thereunder, 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 for the benefit of all of the assuming reinsurer's United States ceding insurers, as defined in Section [cite appropriate reference to State credit for reinsurance law] and which trust meets the standards of [insert appropriate reference to trust fund requirements]. This security may be in the form of:

- Cash;
- Securities listed and rated NAIC 1 by the Securities Valuation Office of the National Association of Insurance Commissioners and qualifying as admitted assets;
- Clean, irrevocable, unconditional and "evergreen" letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section ____, 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; or
- Any other form of acceptable security.

U.S. ceding insurers will be authorized to take annual statement credit, i.e., count reinsurance recoverables from rated reinsurers as an asset or deduction from liabilities, provided the reinsurer meets the applicable collateral requirements and provided the relevant reinsurance agreements meet other applicable regulatory requirements (e.g. insolvency clause, transfer of risk, agent for service of process, U.S. choice of law).

Reinsurers who are not rated will also be permitted to reinsure U.S. ceding insurers, but annual statement credit will be allowed only to the extent that collateral is provided by the reinsurer.

The new requirements for rated reinsurer status will apply to all reinsurers – U.S. and non-U.S. Similarly the collateral requirements for reinsurers who are not rated will apply to both U.S. and non-U.S. reinsurers.

These new rules will apply prospectively only; i.e., only to reinsurance contracts that incept from the date these rules become effective provided, however, these rules may be applied retrospectively with the agreement of both parties to a reinsurance contract.

Nothing in these new requirements will preclude ceding insurers from requiring a reinsurer to post collateral to secure some or all of its obligations, as a matter of commercial contractual commitment.

4. Reinsurer Rating Requirements

A. Review by Regulators

Regulators will be required to make two important assessments regarding the credit risk of reinsurers assuming risks from U.S. ceding insurers. It is anticipated that these determinations would be made by the Reinsurance Task Force of the NAIC, or the NAIC Task Force, Committee or Sub-Committee that succeeds the Reinsurance Task Force as having primary jurisdiction over credit for reinsurance standards

1. Recognized Regulatory Jurisdictions

The NAIC Reinsurance Task Force (or its successor) will publish a list semi-annually of all countries or states which are to be recognized as adequately regulating reinsurers domiciled in their jurisdictions. In making this determination of adequate regulation, regulators shall consider:

- a. The structure and authority of the domiciliary regulator;
- b. The substance of financial and operating standards for reinsurers in the domiciliary jurisdiction;
- c. The form and substance of financial reports required to be filed by reinsurers in their domiciliary jurisdiction, which reports must be filed at least annually;
- d. The regulator's demonstrated willingness to co-operate with U.S. regulators;
- e. The history of performance by reinsurers in the domiciliary jurisdiction;
- f. Any documented evidence of substantial problems with the enforcement of valid U.S. judgments in the domiciliary jurisdiction;
- g. Any other matters deemed relevant by the Reinsurance Task Force, or any other entity or person making this determination.

2. Prompt Settlement of Reinsurance Claims and Related Funding Adjustments

The NAIC Reinsurance Task Force (or its successor) will publish a list semi-annually of those reinsurers who, in the judgment of the Task Force, do not meet the criteria set forth below. This list shall be first published one year from enactment of this proposal.

Reinsurers who, for a period of six months or more, have had reinsurance recoverables to U.S. cedents that are more than 90 days past due in an amount that is more than ____% of their total liabilities to U.S. ceding insurers for paid claims

shall be deemed to have failed to meet desirable standards for prompt settlement of undisputed claims under their reinsurance agreements and shall be placed on the list provided for in this section.

In calculating overdue reinsurance recoverables, regulators will exclude from the calculation liabilities which are supported by 100% collateral and those which have been disputed by the reinsurer. Disputed claims will mean those with regard to which the reinsurer has commenced litigation, mediation or arbitration proceedings, or has provided written notice of its intent to do so.

[Consider report to reinsurer's domiciliary regulator, right of appeal / clarification. Also need to consider ways to mitigate fact that % formula will rely exclusively on data provided by ceding insurer.].

If a reinsurer is on the list provided for in this section, it will drop one rating band, or become ineligible for reduced collateral requirements if it was originally rated RR4.

B. Review by Ceding Insurer

An insurer will be able to count reinsurance recoverables as an asset or deduction from liabilities on its balance sheet if:

1. The reinsurer does not meet the requirements of sections 3 and 4 of this proposal, but the reinsurer provides the ceding insurer with acceptable collateral. In this case, credit shall only be allowed to the extent that the ceding insurer is protected by acceptable collateral posted by that reinsurer.
2. The ceding insurer shall:
 - (a) Determine that the reinsurer, or if a member of a group that includes individual unincorporated underwriters, the group has been licensed by its domiciliary regulator to assume reinsurance, and in fact has assumed reinsurance, for three or more years.
 - (b) Verify that the reinsurer is domiciled in a recognized regulatory jurisdiction.
 - (c) Ensure that the reinsurer has agreed to submit to the jurisdiction of U.S. courts for the resolution of any disputes under its reinsurance agreements with the ceding insurer, or the enforcement of any arbitral awards, as appropriate. The submission to U.S. judicial jurisdiction shall not override any agreement between the parties to arbitrate.
 - (d) Determine whether the reinsurer is on the list published pursuant to section 4(A)(2) of this proposal.

- (e) Determine the RR of the reinsurer and obtain acceptable collateral from the reinsurer (or be the beneficiary of an acceptable reinsurance trust) in the amounts set forth in Section 3.

C. Assignment of Rating

Ratings shall be as assigned as follows:

Ratings will be Standard & Poor's rating or the equivalent from another nationally recognized rating organization. If the reinsurer has multiple ratings, the highest applicable rating shall apply.

RR 1: Reinsurers that are either (1) domiciled in a recognized regulatory jurisdiction and rated [] or higher or (2) rated [] or higher.

RR 2: Reinsurers rated [] or higher.

RR 3: Reinsurers rated [] or higher.

RR 4: Reinsurers rated [] or higher.

As noted above, if the reinsurer is on the list published pursuant to Section 4A(2), that reinsurer's rating will drop one rating band.

[Further consideration should be given to possible additional factors which could move a reinsurer up or down one rating band.]

D. Change in or Revocation of Rating

If the rating of a reinsurer improves, then it will be permitted to meet the collateral requirements applicable to its new rating for all existing and new contracts. Provided, however, that no reduction in collateral will be permitted, without the consent of the ceding insurers for contracts entered into prior to the establishment of these new rules.

In the event of a deterioration in the rating of a reinsurer, the reinsurer will be required to meet the collateral requirements applicable to its new rating for all existing and new contracts.

Notwithstanding the change or withdrawal of a reinsurer's rating, U.S. ceding companies may for a period of [3] months continue to take annual statement credit for all reinsurance ceded to that reinsurer.

5. Authority to implement regulations

Regulators will be authorized to adopt regulations to govern the specific requirements and procedures to implement this new system of credit for reinsurance regulation.