American Insurance Association

1130 Connecticut Ave. NW
Suite 1000
Washington, DC 20036
202-828-7100
Fax 202-293-1219
www.aiadc.org

September 5, 2008

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

Re: Reinsurance Regulatory Modernization Framework

Dear Commissioner Goldman and Members of the Reinsurance Task Force:

The American Insurance Association thanks you for the opportunity to comment on the latest iteration of the reinsurance task force's draft reinsurance regulatory modernization framework. AIA appreciates the effort and time the members of the task force have dedicated to resolution of this issue. Unfortunately, AIA cannot support the draft framework and must reiterate its opposition to the task force's proposed rejection of the current collateral system. AIA also objects to the proposal's rejection of the fundamental insurance principle that it is the domiciliary regulator of the U.S. insurer, and not the state regulator selected by the foreign reinsurer, who should retain ultimate authority and supervision over the financial health of its domestic insurers.

AIA trusts that the members of the task force are familiar with AIA's opposition to the proposed framework and the reasons underlying that opposition. Rather than repeating the entirety of our arguments against the draft framework, for purposes of these comments, AIA refers the task force to the written comments AIA submitted in response to earlier versions of the draft framework. AIA also attach copies of its July 16, 2008 written comments to the task force and its suggested textual modifications to the proposed framework, which were submitted to the task force via email on August 8, 2008. AIA incorporates those prior comments by reference as if fully set forth herein.

AIA opposes changing the current collateral system because, even after years of debate, supporters of change have not adequately demonstrated that change is necessary or that there are any problems with the current collateral requirements. The collateral system is effective: it offers reinsurers a *choice* in entering the U.S. market by either obtaining a U.S. state license or posting collateral *and* it protects U.S. ceding insurers from the threat of insolvency by foreign reinsurers and secures payment of reinsurance recoverables in a timely and appropriate manner with a minimum of disputes. Non-U.S. licensed reinsurers write the majority of reinsurance covering U.S. cessions so arguments that collateral constitutes an unfair trade barrier are unpersuasive.

Even assuming for the sake of argument that the case for eliminating or severely reducing collateral requirements were more compelling than it is, the new framework proposed by the current draft is flawed and would not work in practice. The Port of Entry system depends almost entirely on the soundness of financial ratings provided by nationally recognized statistical rating organizations (NRSROs). NRSROs, unfortunately are notorious for being late with rating downgrades, exemplified only most recently with the subprime home mortgage chaos. Moreover, the draft framework rests on the false assumption that a foreign reinsurer who suffers a financial rating downgrade will somehow, *at that time of financial distress*, have both the ability and the motivation to increase its collateral postings in the U.S. The reality, however, is that a foreign reinsurer undergoing a financial downgrade will have neither the financial wherewithal, nor the motivation, to post additional collateral in the U.S. State regulators must know as a practical matter it will be impossible to compel a foreign reinsurer, without a U.S. license, who has just been downgraded from, for example, an A- rating to a BBB rating to increase its collateral postings in the U.S. from 20% of expected losses to 75% of expected losses. It simply will not happen. When that reality hits, of course, it will be the U.S. insurer who feels the pain when it first loses financial credit for its reinsurance and, next, when it ultimately is never paid for recoverables due under its reinsurance agreements.

The framework also has a provision that permits Port of Entry reinsurers to postpone the posting of collateral for catastrophic recoverables for a period of one year from the date of a catastrophic occurrence. As an initial matter, AIA recognizes that this provision was modified in the latest draft to require that the Port of Entry reinsurer continue to pay claims in a timely manner to take advantage of the one year deferral. AIA appreciates the amendment and believes it improves the draft. However, AIA still believes this is a dangerous provision from the perspective of U.S. insurers. Collateral is needed more, not less, at times of catastrophes. Moreover, there will likely be practical difficulties in defining whether some event is a qualifying catastrophe and what happens when, as is a possibility at the present, multiple natural catastrophes take place at, or near, the same time.

While AIA remains opposed to the draft proposal, it strongly believes that were a case made to reduce collateral for financially strong reinsurers who lack a U.S. license, the proposed tiers and reductions in collateral levels are seriously flawed and inconsistent with the original intent of the proposal. During the years of discussions of the collateral issue, members of the task force always maintained that the change in collateral levels would be reserved for only the most financially strong reinsurers. Indeed, earlier iterations of the framework adhered to this concept by requiring, for example, an A+ rated reinsurer to post 80% collateral. The current draft, however, violates the intent of the discussions by allowing A- reinsurers to post only 20% collateral. As a practical matter, few insurers will purchase reinsurance from reinsurers with ratings below A-. It is difficult to reconcile the stated goal of reducing collateral for only the most financially strong reinsurers with a proposal allowing minimally-acceptable reinsurers to reduce collateral levels by 80%. The current draft becomes even more extreme when it provides that even BBB- rated reinsurers-- reinsurers who are perhaps just days away from junk status--may reduce collateral requirements by 25%. It is difficult to understand how such a proposal can be marketed as being limited to the most financially sound entities or can be viewed as one that adequately protects the solvency of U.S. insurers. For purposes of discussion, AIA in the past has suggested that if the task force does want to modify the current collateralization rules, A- rated reinsurers without a U.S. license should at a minimum post 75% collateral and those reinsurers rated BBB+ or below without a U.S. license should post 100% collateral.

The draft framework does not provide any exception to the collateralization rules for cessions by a U.S. insurer to affiliates. AIA believes there should be an exception for cessions to affiliates where the affiliates are from approved jurisdictions and have financial ratings of A- or better. Such affiliated transactions are already under the supervision of the holding company laws so they are already regulated. While AIA is opposed to the framework, it would support an exception for affiliated transactions to A- rated insurers or better from approved jurisdictions.

AIA also opposes the framework because it would replace the ultimate authority of the U.S. insurer's domiciliary regulator to supervise the financial condition of its domestic insurers and replace it with the Port of Entry supervisor chosen by the foreign reinsurer. It is a fundamental insurance principle that determinations regarding the financial soundness of a domestic insurer, including whether financial statement credit should be given under the insurer's reinsurance agreements, should be retained by the insurer's domiciliary regulator.

Following is a synopsis of AIA's main points in opposition to the draft framework:

● **The Current Collateral System Works**: The proposal significantly modifies a collateral system that has worked with no known problems for decades. Under the current collateral system, reinsurance capacity has not been a problem, payment of recoverables from unlicensed reinsurers has not been problematic, and reinsurance premium amounts have not been a pressing issue.

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

● **Proposed Framework is Not Workable in Practice**: The draft framework relies on the proposition that foreign reinsurers who are not licensed in the U.S. will agree to post addition collateral in the U.S. *after* the reinsurer has received a financial rating downgrade from a rating organization. This is an extremely unwise gamble. When a non-U.S. licensed reinsurer's credit is downgraded, this is exactly the time when it will have the least inclination and the least ability to increase its U.S. collateral. From the perspective of seeking to protect the security and solvency of U.S. insurers and their policyholders, it is necessary to already have the 100% collateral in the U.S. than trying to seek additional collateral *after* the reinsurer is in financial distress.

● **Reducing Collateral May Lessen Capacity in the U.S. Primary Market**: An argument offered in support of eliminating/sharply reducing collateral requirements is that it may increase capacity in the reinsurance market. There is little or no evidence that overturning collateral requirements will increase reinsurance capacity. More importantly, eliminating or significantly reducing collateral may have an adverse impact on capacity in the U.S. primary insurance market. If eliminating or reducing collateral makes it more uncertain, time-consuming, expensive and problematic to receive reinsurance payments from foreign reinsurers, a likely result would be lowered capacity in the U.S. primary market. An insurer may be more hesitant to write direct coverages if it does not feel confident that it will receive reinsurance payments in a prompt and appropriate manner.

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

● **Statistical Rating Organizations Are Often Too Late in Rating Downgrades**: The foundation of the draft framework relies almost entirely on the accuracy of financial rating givens to reinsurers by NRSROs. A problem with reliance on statistical rating organizations is that they too often are too late with their rating downgrades. The ratings are downgraded only after the fact and after the financial problems of the company being downgraded already have been made public. These after-the-fact downgrades have been seen previously with certain foreign reinsurers and more recently with companies associated with the sub-prime home mortgage fallout.

● **Security Deposits Are Required for Licensed U.S. Insurers**: A majority of states, including New York, New Jersey, California, and Florida, require U.S. primary insurers to post collateral in the form of state deposits. It is difficult to understand why it is good public policy to eliminate or substantially reduce collateral requirements for foreign reinsurers who are not licensed in the U.S. and who may maintain no assets in the U.S, while at the same time requiring U.S. insurers to post security deposits in states in which the U.S. insurer is licensed and/or domiciled.

● **Severe Lowering of Collateral**: AIA supports retention of the current 100% collateral requirement. However, even if one were to support lowering collateral requirements for certain financially strong foreign reinsurers, the draft framework's proposed reductions in collateral levels are shockingly high. AIA recommends that reinsurers rated A- post at least 75% collateral. Reinsurers rated BBB+ or below should post 100% collateral. Moreover, all reinsurers not licensed in the U.S. should post some collateral because they may maintain no other assets in the U.S. Thus, AAA rated reinsurers should post at least 10% collateral, with increasing amounts required for all lower levels.

● **Postponement of Posting Collateral for Catastrophe Recoverables**: The draft framework would allow alien reinsurers to postpone the posting of collateral for catastrophe recoverables for a period of one year. This is a dangerous provision for the U.S. primary industry. Securing reinsurance recoverables at times of catastrophes is one of the critical roles collateral plays in the current system. The security created by collateral is needed more, not less, after a catastrophe.

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

● **Credit for Reinsurance Clause May Be Ineffective in Practice**: The draft framework sets forth a mandatory contractual term requiring the reinsurer to post additional collateral where the reinsurance provided does not qualify for full statutory accounting credit. While the proposed requirement may be a step in the right direction, such mandatory provisions may have limited practical impact. Where an alien reinsurer is not licensed in the U.S. and has no assets in the U.S., there may be little teeth in a contractual provision that the reinsurer simply ignores. Moreover, foreign countries may refuse to enforce the contractual term. For example, recently UK courts and the UK Treasury have simply ignored contractual terms placed in contracts by U.S. cedents to respond to UK reinsurers' involuntary transfers of reinsurance agreements without the U.S. cedent's consent.

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

One issue of legal risk that should be addressed is whether any country that permits solvent schemes of arrangement or involuntary transfers of risk shall be eligible for collateral elimination or reduction. While the newest draft contains a provision requiring a reinsurer to post 100% collateral *after* engaging in a solvent scheme of arrangement, this may be too little too late for the U.S. insurer adversely impacted by the solvent scheme. Likewise, foreign countries that permit involuntary transfers of risks or who do not enforce the proposed credit for reinsurance provisions should be barred from the list of eligible countries.

● **Port of Entry State Criteria Lacks Specifics**: The RSRD is authorized to establish criteria for a state to qualify as a port of entry state. The criteria outlined in the draft framework is very general and non-specific. If there are too many port of entry states, there is a danger of a "race to the bottom" as foreign reinsurers will have an incentive to pick the most lax and liberal state to assign the reinsurer to the highest tier level possible for that reinsurer. More specific standards are needed for determining whether a state is eligible to be certified as a port of entry state. For example, some part of the evaluation must include whether the port of entry state is actually evaluating the claims payment history of the foreign reinsurers or whether the port of entry state simply relies on the NRSRO rating to determine the alien reinsurer's tier level. The RSRD should be required to de-certify a state as a port of entry state if it fails to undertake proper evaluations of claim payment histories of its port of entry reinsurers and fails to lower tier levels of foreign reinsurers who are below standards in such categories as number of disputes and timeliness of payments.

● **Need to Prevent Forum Shopping in Choice of Port of Entry State**: The NRSRO credit rating for an alien foreign reinsurer is the reinsurer's maximum tier rating. There is some concern that the NRSRO rating in practice may become the de facto tier level. In addition, there is likely to be a "race to the bottom." An alien reinsurer can apply for certification as a port of entry reinsurer in any port of entry state. If a reinsurer gets "dinged" by a particular port of entry state regulator for failure to pay claims in a timely manner or some other factor, there is nothing in the draft framework to prevent the reinsurer from applying at other port of entry states until some state provides the foreign reinsurer with the maximum tier level.

● **Lack of Specifics Regarding Tier Level Evaluation Process**: The framework lacks specific standards regarding how a port of entry state is to evaluate a foreign reinsurer applicant for determining tier level. The draft framework states that the port of entry state is to evaluate an alien reinsurer for disputed claims and late payments but fails to specify what is acceptable or not. The lack of standards means the port of entry state is doing little more than guessing and will likely just revert to using the objective NRSRO rating as the de facto rating. The framework should require that any alien reinsurer who is below average in timely claim payments or number of disputes be lowered at least one tier from its maximum tier level based on the NRSRO rating. Those who are more than a standard deviation from the average scale should be required to post 100% collateral.

● **Affiliate Transaction Exemption**: The framework should provide an exemption from the collateral requirements for cessions from U.S. insurers to certain affiliated reinsurers. Cessions to affiliates are already subject to supervision under the domiciliary state's holding company laws. Cessions to affiliated companies that are port of entry reinsurers and have a tier rating level of "Secure 3" or better under the current draft of the framework should not be required to post collateral.

● **A Security Fund Must Be Created to Secure Risks**: A security fund should be established. Proponents of the need to overhaul collateral requirements argue that U.S. insurer's fears of uncollectible reinsurance recoveries are exaggerated. Throughout the years of debate on collateralization, U.S. insurers have requested that the advocates of change endorse a security fund whereby the alien reinsurers would be liable for payment of recoverables when a U.S. ceding insurer is not paid on an appropriate claim where collateral is no longer available. The advocates of change have repeatedly rejected this suggestion, perhaps suggesting that in actual practice loss of recoverables due to the absence of collateral may become common practice.

● **Collateral Requirements for Unlicensed Reinsurers is not an Unfair Trade Issue**: Requiring collateral from an alien reinsurer who refuses to obtain a license in any U.S. state or maintain assets in the U.S. is not an unfair trade issue or an artificial or discriminatory barrier. The U.S. reinsurance market is actually pro-competitive and offers foreign reinsurers a choice between being licensed and submitting to financial supervision in the U.S. or remaining unlicensed, foregoing regulatory supervision and the need to maintain assets in the U.S., but posting collateral to cover expected losses. It should be noted that other countries, including members of the European Union, impose barriers against U.S. insurers who do not obtain licenses or maintain assets in their countries.

● **Diversity Requirements for U.S. Insurers**: The draft framework would place new requirements on U.S. ceding insurers. AIA objects to the inclusion of these new diversity requirements. Many primary insurers have extremely divergent views on diversification requirements based on factors such as whether they are a relatively smaller insurer, whether they write a specialized line such as medical malpractice, or how their reinsurance programs in general are structured. Including diversification requirements in the collateralization proposal is unnecessary, controversial, and creates an unlevel playing field for U.S. insurers.

AIA thanks you for your continued consideration of these issues.

Steven Bennett
Assistant General Counsel
American Insurance Association

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1130 Connecticut Ave. NW
Suite 1000
Washington, DC 20036
202-828-7100
Fax 202-293-1219
www.aiadc.org

July 16, 2008

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

Re: Reinsurance Regulatory Modernization Framework

Dear Commissioner Goldman and Members of the Reinsurance Task Force:

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

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

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

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

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

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

Following are AIA's objections to the draft framework:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

● **<u>Port of Entry State Criteria Lacks Specifics</u>**: The RSRD is authorized to establish criteria for a state to qualify as a port of entry state. The criteria outlined in the draft framework is very general and non-specific. The criteria includes staff expertise, accreditation by the NAIC, experience, staff size and "sufficient ceded premium volume." More specific guidance and standards need to be set forth for determining whether a state is eligible to be certified as a port of entry state. For example, some part of the evaluation must include whether the port of entry state is actually evaluating the claims payment history of the foreign reinsurers or whether the port of entry state simply relies on the NRSRO rating to determine the alien reinsurer's tier level. The RSRD should be required to de-certify a state as a port of entry state if it fails to undertake proper evaluations of claim payment histories of its port of entry reinsurers and fails to lower tier levels of foreign reinsurers who are below standards in such categories as number of disputes and timeliness of payments.

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

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

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

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

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

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

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

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

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

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

AIA thanks you for your consideration of these issues

Steven Bennett
Assistant General Counsel
American Insurance Association

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The American Insurance Association's Suggested Modifications to the Proposed Reinsurance Regulatory Modernization Framework Proposal

The American Insurance Association opposes the reinsurance task force's current reinsurance regulatory modernization framework. AIA reasserts its arguments in opposition to the proposal as set forth in its July 16, 2008 written comments to the task force and its testimony to the task force during the interim meeting of the task force in New York on July 23 and 24. Without waiver of those objections, AIA, in response to the request of the task force during the interim hearing, submits the following suggested modifications to the proposed framework on "core" issues as discussed during the New York meeting.

● Modifications to Rating Levels

AIA believes the proposed reductions in collateral levels are too severe. A- rated reinsurers should be placed in a separate tier level and should be required to post additional collateral. All reinsurers rated below A- should be required to post 100% collateral. Even the highest rated reinsurers should need to post some minimal level of collateral as otherwise no assets at all may be maintained in the U.S.

AIA recommends the following modification to the proposed collateral levels in the framework:

Rating	Collateral Required	Best's	S&P	Moody's	Fitch
Secure 1	10%	A++	AAA	Aaa	AAA
Secure 2	20%	A+	AA+,AA,AA-	Aa1-3	AA+,AA,AA-
Secure 3	25%	A	A+, A	A1, A2	A+, A-
Secure 4	75%	A-	A-	A3	A-
Secure 5	100%	B++, B+	BBB+, BBB, BBB-	Baa1-3	BBB+, BBB, BBB-
Vulnerable 6	100%	B thru F	BB+ thru R	B1-C	BB+, DD

● Retention of Authority by U.S. Domiciliary Regulator

Collateral requirements are part of the credit for reinsurance laws, which, of course, relate to the financial supervision of the U.S. ceding insurer, not the assuming reinsurer. It is fundamental that supervision and determinations of the financial strength of the U.S. ceding insurer should be retained by the domiciliary regulator of the U.S. insurer and should not be determined by the port of entry choice of the foreign reinsurer. The proposed framework should be amended to provide that the domiciliary regulator of the U.S. insurer has final authority on the level of collateral necessary for the domiciled insurer to receive credit for reinsurance.

AIA recommends the following amendments to Sections 3, 6, and 7 of the proposed framework:

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

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

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

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

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

● Strengthening the Standards for Listing of "Eligible" Countries

The proposed framework fails to provide any specifics on the standards that the reinsurance supervision review department shall apply in determining whether a particular country is eligible to have its reinsurers apply for port of entry status. The framework needs to include certain specific factors that would exclude a foreign country from being listed as an eligible country. A country should not be eligible if it permits solvent schemes of arrangements or involuntary transfers of risks. These laws may be utilized to unfairly deny U.S. insurers the benefit of reinsurance previously purchased. Similarly, a country should not be an eligible country if it refuses to promptly enforce all final U.S. judgments and arbitration awards. Likewise, a country should not be eligible if reinsurers domiciled in that country fail to adhere to the framework's requirements by, for example, refusing to post additional collateral as necessary.

AIA recommends the following amendment to Section 11(b) of the proposed framework:

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

…

b. The RSRD will determine the appropriate supervisory recognition approach for non-U.S. jurisdictions and create a list of jurisdictions eligible to be recognized by POE states. **A non-U.S. jurisdiction shall not be listed as eligible if its regulatory, legal, political, or enforcement structures pose a risk to U.S. ceding insurers receiving prompt, full and appropriate payment of amounts due under their reinsurance agreements. By way of example only, and not by way of exhaustion, a non-U.S. jurisdiction shall not be listed as an eligible country: 1) if its laws or regulations permit its reinsurers to enter into either solvent schemes of arrangement or to transfers of risks under the reinsurance agreement without the voluntary consent of the U.S. insurer: 2) if the non-U.S. jurisdiction fails to promptly enforce final U.S. judgments or arbitration awards; or 3) reinsurers domiciled in that non-U.S. jurisdiction certified as port of entry reinsurers fail to comply with the requirements of this framework.**

● No Postponement of Posting Collateral for Catastrophes

Section 21 of the proposed framework would postpone the requirement to post collateral for one year from the date of a defined catastrophic occurrence. This is a dangerous provision for U.S. insurers and should be deleted. Collateral is needed more, not less, after a catastrophe.

AIA recommends that section 21 be deleted in its entirety.

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

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

● Reinsurer Ceases Writing in U.S. Market or Enters a Solvent Scheme of Arrangement or an Involuntary Transfer of Risk

Experience indicates that collateral is particularly necessary when a reinsurer ceases issuing new reinsurance policies in the U.S. No reduction in collateral should be permitted when a reinsurer ceases writings. In addition, no collateral reduction should be permitted when a reinsurer engages in a solvent scheme of arrangement or an involuntary transfer of risk, similar to a Part 7 transfer under U.K. law.

AIA recommends the following new section to the proposed framework:

New section: **Upon the event a reinsurer ceases to actively write all lines of reinsurance for domestic ceding insurers or meets any of the criteria outlined below, the reinsurer will considered a Run-Off Reinsurer and will be required to provide collateral equal to 100% of the aggregate Outstanding Liabilities arising from domestic ceding insurers. Such collateral will be adjusted on a quarterly basis to reflect a change in amounts for Outstanding Liabilities.**

A reinsurer will be considered to be a Run-Off reinsurer in the event of one or more of the following:

1. Reinsurance premium writings, for the twelve months ending on December 31, of any year is less than 10% of the premium writings the immediately proceeding year; or
2. has been ordered by a state insurance department or other legal authority to cease writing business, or has been placed under regulatory supervision or in rehabilitation; or
3. has ceased reinsurance underwriting operations or publicly advises their intent to no longer write reinsurance for domestic ceding insurers; or

4. has transferred its claims-paying authority to an unaffiliated entity; or
5. engages in a process of Scheme of Arrangement or similar procedure related to this any contracts of reinsurance, including but not limited to an insurance business transfer scheme pursuant to Part VII of

the Financial Services and Markets Act 2000 (U.K.), as may be amended from time to time; or
6. in any other way has assigned its interests or delegated its obligations under any contracts of reinsurance to an unaffiliated entity.

"Outstanding liabilities" shall mean all present and future obligations of the reinsurer and shall include, without limitation, unearned premiums and losses, loss adjustment expenses and declaratory judgment expenses paid by domestic ceding insurers but not recovered from the reinsurer. It shall also include, outstanding losses that have not been reported to the reinsurer and loss adjustment expense and declaratory judgment expense relating thereto, outstanding losses that have been reported to the reinsurer and loss adjustment expense and declaratory judgment expense relating thereto and losses incurred but not reported to domestic ceding insurers and loss adjustment expense and declaratory judgment expense relating thereto (all collectively referred to as "loss reserves") and all other balances.

● Revising the Form AR-1 to Require Enforcement of all Final U.S. Judgments or Awards

As a minimum condition to posting reduced collateral, a port of entry reinsurer should be required to respect and promptly pay all final U.S. judgments and awards. The proposed framework, currently states only that a port of entry reinsurer must post 100% collateral if it resists enforcement of a "valid and final" U.S. judgment. The inclusion of the word "valid" creates an opportunity for mischief by certain reinsurers who may argue that a final U.S. judgment is not "valid" and thus require the U.S. insurer to relitigate the entire dispute in a foreign jurisdiction. The word "valid" should be removed from the framework.

Similarly, Form AR-1s should not be accepted from any reinsurer domiciled in a country or state that does not adequately and promptly enforce all final U.S. judgments or arbitration awards.

AIA recommends the following amendment to Section 13(b):

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

…

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

● Strengthening Port of Entry Determinations

The proposed framework lacks specific standards to guide the port of entry regulator in assigning a "rating level" to a port of entry reinsurer. While the NRSRO rating becomes the maximum rating for the reinsurer, the port of entry regulator may lower the rating level for such factors as amount of disputed claims and late payments. The lack of specific standards, particularly in relation to the objective nature of the NRSRO rating, suggests that the NRSRO rating will become the de facto rating for the port of entry reinsurer. The proposed framework needs to be revised to provide clear guidance to the port of entry regulator regarding when the rating level of the reinsurer should be lowered.

AIA recommends the following amendment to Section 20(b) of the proposed framework:

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

a. a list of all disputed or overdue recoverables;

b. The reinsurer's reputation for prompt payment of valid claims under reinsurance agreements, including the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute, including receivables payable to companies that are in administrative supervision or receivership. **If the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute is higher than the average for the proportion of all reinsurer's obligations that are more than 90 days past due or in dispute, the reinsurer's rating level shall be lowered by at least one tier level. If the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute is one standard deviation or more than the average for the proportion of all reinsurer's obligations that are more than 90 days past due or in dispute, the reinsurer shall post 100% collateral.**

● Prohibit Forum Shopping by Port of Entry Reinsurers

The proposed framework establishes the NRSRO credit rating as the maximum rating level for a port of entry reinsurer. Under the framework, the port of entry regulator may lower the rating level based on an evaluation of factors specific to the reinsurer, including the timeliness of claim payments and a review of the foreign reinsurer's financial statements. The proposed framework, however, would allow a foreign reinsurer who has had its rating level dropped, simply apply to another port of entry regulator to obtain a maximum rating level. The proposed framework should specifically prohibit such “forum shopping” by foreign reinsurers.

AIA recommends the following amendment to Section 16 of the proposed framework:

16. The POE or home state supervisor will assign a reinsurer one of five ratings (Secure-1, Secure-2, Secure-3, Secure-4 or Vulnerable-5). The maximum rating that a reinsurer may be assigned will correspond to the reinsurer’s Nationally Recognized Statistical Rating Organization (NRSRO) rating as outlined in the table below. The POE or home state supervisor shall use the lowest rating received from an NRSRO in establishing the maximum rating of a reinsurer. A failure to obtain or maintain at least two NRSRO ratings will result in an assignment of a Vulnerable-5 rating. The additional factors listed below may result in a lower rating as determined by the POE or home state supervisor. **If the evaluation by the POE or home state supervisor lowers the reinsurer’s rating level below the maximum NRSRO rating level, the reinsurer may not apply for certification with another POE or home state supervisor.** National reinsurers and POE reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements.

● Elimination of Diversity Requirements on U.S. Ceding Insurers

The proposed framework includes new diversity requirements on U.S. ceding insurers. Many primary insurers have divergent perspectives on diversification requirements based on factors such as whether they are a relatively small insurer, whether they write a specialized line, such as medical malpractice, whether they cede to licensed affiliated companies, or how their general reinsurance programs are structured. Adding diversification requirements is unnecessary and would create an unlevel playing field for insurers.

AIA recommends the deletion of proposed Section 15(f) and Section 15(g):

15. The host state supervisor shall:

…

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

~~**g. require the ceding insurer to provide notification within 30 days if any single reinsurer represents more than twenty percent (20%) of the**~~

~~**ceding insurer's gross written premium or if it is likely to exceed this limit, except for approved affiliated transactions.**~~