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September 5, 2008

Via E-mail

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

Re: RAA Comments to August 20 Reinsurance (E) Task Force Activities Memorandum – Reinsurance Regulatory Modernization Framework Proposal ("August 20 Memorandum" or "the Proposal")

Dear Commissioner Goldman:

The RAA appreciates the opportunity to comment on the August 20 Memorandum. We applaud your continued leadership in the Task Force's pursuit of state-based comprehensive reinsurance regulatory reform. Substantial progress has been made, including the Task Force's recent acknowledgment that federal enabling legislation is necessary to implement the Proposal and to achieve the necessary uniformity. The RAA has serious concerns, however, with some of the latest revisions to the Proposal and urges the Task Force to address them before the September vote on the Proposal.

The December 2, 2007 Framework Memorandum approved by the NAIC Plenary sets forth a three prong approach for modernizing reinsurance regulation: (1) Mutual recognition to determine which non-U.S. jurisdictions are entitled to enter into mutual recognition agreements; (2) Single state U.S. regulator for U.S. licensed reinsurers to avoid inappropriate extraterritorial regulation; and (3) Single state U.S. regulator for non-U.S. licensed reinsurers to allow them to access the U.S. market through one approved jurisdiction. While we have raised issues regarding specific features and technical points of the Task Force's work product throughout this process, we have supported the basic structure of this approach. Unfortunately, recent fundamental changes to the Proposal are of serious concern to our members and may jeopardize the RAA's ability to support the Proposal. Most notably, the very recent addition of reinsurance collateral for licensed U.S. companies rated Tier-3 (or above) and the disappearance of any explicit statement that there will be regulatory consideration of whether other supervisory authorities will provide reciprocal legal benefits for U.S. licensees in their jurisdiction raise are critical issues. Both of these points are fundamental policy concerns for the RAA's support and must be addressed.

Collateral on Licensed U.S. Companies

The Proposal now requires National Reinsurers rated Secure-3 and above to post collateral. This substantive issue was not discussed at the July 23-24 open meetings and we were quite surprised to see such a significant revision at this point in the Task Force's process. As we have set forth in prior letters, collateral has historically been a substitute for licensing; if a reinsurer does not wish to submit to the direct regulation by one or more states, it can post collateral. By requiring collateral to be posted by companies that you directly regulate, and whose assets that you can directly access, you are nullifying the value of a U.S. license, demonstrating a bias against the U.S.' own regulatory system and sending mixed signals to the global marketplace. As the global regulatory framework attempts to move towards a system of international supervisory recognition, this would be an enormous and confusing step backwards by regulators of the largest single market.

The U.S. regulatory system is already the most expensive and conservative in the world. The Proposal assumes that collateral is only a hedge against credit risk while in reality, it has served as a hedge against an entire spectrum of risks, including enforcement of judgments, collectability of recoverables, and asset availability. Under the Proposal, National Reinsurers would now have to not only comply with the U.S.' current conservative capital and surplus requirements, restrictive investment guidelines and high corporate tax rates, but also post collateral. Moreover, in the situation where a U.S. licensed subsidiary retrocedes business to its non-U.S. parent, the U.S. company would be required to provide collateral to its clients while also holding collateral from its parent, resulting in redundant collateral for the same risk. Such a structure unnecessarily and ineffectively adds costs to the U.S. insurance system, puts U.S. licensed companies at a further competitive disadvantage and disincentivizes the maintenance of a U.S. license (as well as the formation of any new U.S. reinsurance companies). Under the Proposal, the option for U.S. licensed reinsurers to avoid posting collateral is to remain in the current 50-state system. The RTF concluded over a year ago that the current U.S. reinsurance regulatory system needed to be modernized so this is obviously not an attractive alternative that would provide any meaningful reform to U.S. licensed reinsurers (see Appendix A for a brief summary of some of the reasons why a single national regulator for reinsurers is necessary and a copy of the RAA's Policy on Comprehensive Regulatory Reform which sets out the mandate for a single national regulator). This lack of progress for U.S. licensed reinsurers raises the serious question: Why should U.S. licensed reinsurers support a revised reinsurance regulatory system that affords them no benefits and in fact, puts them at a further competitive disadvantage?

Moreover, the NAIC's July 15, 2008 legal memorandum does not require this result. The memo examines whether the Proposal complies with GATS' national treatment requirement and concludes that disparate collateral requirements could be justified under the prudential carve-out for "identifiable and meaningful differences" between the U.S. regulatory scheme and the non-U.S. regulatory schemes as we move towards a genuine system of mutual recognition.

Rather than impose this additional unnecessary burden on U.S. licensed reinsurers, we would suggest that the Proposal include a sunset provision setting a date in the future where the POE supervisor would have to determine, on a jurisdiction-by-jurisdiction basis, whether to continue, eliminate or modify collateral requirements for recognized non-U.S. jurisdictions. By providing

a specific timeframe, the Proposal would continue to move the U.S. regulatory regime towards its ultimate goal of genuine "mutual recognition". This would allow POE supervisors the time to gain first-hand knowledge of other jurisdictions and allow the equivalence evaluation process to evolve while providing notice of a date certain for this issue to be revisited.

We strongly urge the Task Force to reinsert Paragraph 19 and to not further burden U.S. licensed reinsurers that are rated Secure-3 and above.

Disappearance of Legal Reciprocal Benefits for Licensees of Both Jurisdictions

The RAA is also very concerned that the current draft of the Proposal is missing one of the three core components identified in the December 2 2007 Framework Memorandum that was passed by Plenary - the "mutual recognition" component. This key element was described as "assessing regulatory effectiveness through an 'outcomes-oriented' approach" to "determine which non-US jurisdictions are entitled to enter into mutual recognition agreements." This representation was made again in the NAIC's April 5, 2008 letter to Senator Jack Reid asking the U.S. Senate to forego consideration of the reinsurance section of H.R. 1065, the Nonadmitted and Reinsurance Reform Act of 2007, because the RTF had adopted a framework for the reinsurance modernization initiative that included 3 critical components . . .": (1) mutual recognition of different regulatory regimes (both within and outside the US) and a process to attain mutual recognition . . ." Three months after this representation to Congress, however, the first critical component has disappeared and with it the ability to implement the objectives of the 3rd point – the equivalent treatment of non-U.S. reinsurers pursuant to a process which assures the appropriate protection to the U.S. insurance market through assessment of non-U.S. jurisdictions to determine if they employ substantially equivalent legal standards and regulatory requirements.

This issue first arises in Paragraph 6(c). If the eligibility requirements of the RSRD included a process for recognizing jurisdictions that maintain a substantially equivalent level of reinsurance regulation and which provide for reciprocal legal benefits for the licensees of each jurisdiction, the spirit of the original Framework Memorandum would be reflected in the Proposal and could be fleshed out in the implementation phase. However, that is not the case under the current draft of the Proposal. Paragraph 10(b) merely states that "the RSRD will determine the appropriate supervisory recognition approach for non-U.S. jurisdictions." Paragraph 10(c) states that the RSRD will develop a protocol for recognition – a term which is undefined in the Proposal. The Proposal notes that the IAIS Guidance Paper on Mutual Recognition should serve as a reference document, yet that paper does not require reciprocity and is based upon recognition of "acceptable" regimes. This standard likely will not give Host states comfort that reinsurers from an "acceptable" jurisdiction are regulated on an equally strong basis as reinsurers in the U.S. At best, the current Proposal is unclear as to the standard that will be applied in the evaluative process.

The word "mutual" has always been discussed at the Task Force in terms of ensuring reciprocal benefits to U.S. licensed companies in the countries with whom there is a supervisory arrangement. The Proposal gives companies from foreign jurisdictions the ability to write creditable reinsurance in the United States without a license yet does nothing to further the interests of U.S. licensed companies doing business abroad. Inherent in this concept of

reciprocity is the idea that U.S. reinsurers would receive the same benefits and access to non-U.S. jurisdictions that non-U.S. reinsurers from recognized jurisdictions would receive in the U.S. This is the approach of other major jurisdictions. Notably, Article 49 of the Reinsurance Directive states:

> "A Member State shall not apply to reinsurance undertakings having their head offices outside the Community and commencing or carrying out reinsurance activities in its territory provisions which result in a treatment more favorable than that accorded to reinsurance undertakings having their head office in that Member State."

The Article makes clear that EU regulators are concerned about the welfare of their own companies and seek to ensure that non-licensed companies are not treated more favorably than EU licensed entities. U.S. regulators should do the same.

At a minimum, the reciprocal treatment of U.S. companies by non-U.S. jurisdictions should be one of the criteria used in evaluating jurisdictions. Although the NAIC's July 15th Legal Memorandum questioned the ability of states, or the RSRD, to negotiate with foreign countries to achieve reciprocal treatment of U.S. companies absent Congressional consent, it did not prohibit the consideration of reciprocity in evaluating other jurisdictions. Clearly, the maintenance of competition in the insurance markets affects both the availability and affordability of coverage and therefore constitutes a legitimate regulatory responsibility.

The RAA also notes the suggested reliance upon the IAIS Guidance Paper on Mutual Recognition. Because the paper addresses all possible options for recognition of other supervisory authorities (unilateral, bilateral and multilateral), the concept of ensuring reciprocal benefits is diminished under certain mechanisms.

The RAA urges the Task Force to again expressly include the concept of "mutual recognition" or "reciprocity" in the Proposal by amending paragraph 10 as follows:

- Paragraph 10(b) should state:

  The RSRD will evaluate the supervisory regimes of non-U.S. jurisdictions, both initially and on an ongoing basis, <u>to establish whether the non-U.S. jurisdiction provides reciprocal recognition of the U.S. reinsurance regulatory regime and affords substantially equivalent legal rights and benefits to reinsurers licensed and domiciled in the U.S.,</u> 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 can serve as a reference document for this purpose;

Thank you for the opportunity to comment. It is very important that these two issues be addressed in the Proposal before the RTF votes in September. As set forth in the attached Appendix B, the RAA has already expressed concerns about other aspects of the Proposal, including: 1) mandatory contact provisions, and in particular the credit for reinsurance "downgrade" clause; 2) the wide discretion afforded to supervisors in assigning a rating; 3) the

fact that affiliate transactions should receive further collateral reductions; 4) the lack of utilizing a group rating when a rating agency has either enhanced the rating of a subsidiary or has assigned the parental rating to the subsidiary; and 5) the lack of clarity regarding how the certification mechanism will operate. Nonetheless, until the August 20 draft, it appeared that U.S. licensed reinsurers might be able to achieve some tangible regulatory reform under the Proposal. However, if collateral is not removed from Tier-1 through Tier-3 U.S. licensed companies and a consideration of reciprocity for U.S. licensed reinsurers doing business abroad is not reflected in the Proposal, we may well have reached the tipping point whereby the regulatory system for U.S. licensed reinsurers is not truly being modernized and we will be unable to support the Proposal.

We look forward to working with you towards a revised Proposal. We are available if you would like to discuss our comments further.

Sincerely yours,

Tracey Laws

cc: Ryan Couch
Bob Kasinow

Attachments

<u>Appendix A</u>

Multi-Jurisdiction Requirements and Extra-Territorial Application of Law

There is a need for greater efficiency and uniformity in the regulation of reinsurance. As a result of our 50-state system of regulation, significant differences have emerged among the states with respect to reinsurance regulatory requirements. The cost associated with addressing these differences among the states, in addition to the basic expense of multi-state systems add extra costs to transactions, which are ultimately reflected in premiums paid by consumers.

While the National Association of Insurance Commissioners ("NAIC") and state regulators have made strides toward greater uniformity with their model laws and model regulations and the creation of the accreditation system, this has not achieved uniformity and has not prevented states from pursuing varying and sometimes inconsistent regulatory approaches. The accreditation program was created to achieve a consistent, state-based system of solvency regulation throughout the country by defining a common set of basic regulatory requirements for solvency regulation and encouraging their adoption by all states. To be accredited, states must show that they have solvency laws and regulations that protect insurance consumers; effective, efficient financial analysis and examination processes; and appropriate organizational and personnel practices. While the program encourages adoption of NAIC model laws, the inclusion of the "substantially similar" standard by which most state laws are judged allows for substantive differences among the states. The presence of such differences does not incentivize states to recognize and defer to the regulatory authority of other states. One of the best examples of this is the extra-territorial application of state laws.

Thirteen states apply at least some of their regulatory laws on an extra-territorial basis, meaning that the state law not only applies to the insurers domiciled in that state, but to insurers domiciled in other states if the extra-territorial state has granted a license to the insurer. For example, an insurer that is domiciled in a state other than New York, but licensed in New York, will find that New York asserts that it has the authority to regulate any entity that is licensed in New York. Since most U.S. based reinsurers are licensed in all 50 states, this extra-territorial application of state law results in inconsistent application of multiple state laws. This can extend to contract terms. Because reinsurance involves contracts between sophisticated entities, the terms and conditions of reinsurance agreements should be left to the parties to negotiate. It is difficult for insurers and their reinsurers to contend with inconsistent contract requirements between the states and this is only exacerbated when the contract requirements are in conflict with one another. States applying at least some of their laws extra-territorially include: California, Florida, Kentucky, Maryland, Michigan, New Jersey, New Mexico, New York, Pennsylvania, Texas, Utah, Virginia and West Virginia.

The RAA strongly supports comprehensive reinsurance regulatory reform. This would include a single national regulator, consistent, national regulation of reinsurance; and enforceable recognition between the U.S. and qualified non-U.S. supervisory authorities.

REINSURANCE ASSOCIATION OF AMERICA
BOARD ACTION ON REINSURANCE REGULATORY STRUCTURE

At its September 26, 2006, the RAA Board of Directors adopted the following goals and core characteristics for evaluating potential reinsurance regulatory structures:

The goals of effective reinsurance regulation in the United States should be to promote:

1. Financially secure reinsurance recoverables and capacity that protects the solvency of US ceding insurers.

2. A competitive and healthy reinsurance market that provides sufficient capacity to meet ceding companies' risk management needs.

3. Effective and efficient national reinsurance regulation.

The core characteristics of an appropriate reinsurance regulatory structure that would assist in achieving these goals should include:

1. A single regulator for reinsurance with national regulatory oversight and the power to preempt conflicting or inconsistent state laws and regulations in an effective and efficient manner.

2. The single regulator's authority should provide for the recognition of substantially equivalent regulatory standards and enforcement in other competent regulatory jurisdictions consistent with RAA policy.

3. The regulatory structure should support global capital and risk management, taking into account capital adequacy, assessment of internal controls, recognition of qualified internal capital models and effective corporate governance.

4. The regulatory structure should provide for financial transparency that encourages and supports the cedents' ability to assess counter party credit risk, including information regarding the reinsurer's financial condition and the reinsurer's performance in paying covered claims.

5. Regulators should have access to all necessary financial information with appropriate provision for the confidentiality of that information, as provided for currently under state law and regulatory practice.

6. The regulatory structure should have an effective transition mechanism between the current system and any future regime that is consistent with these core characteristics. Absent mutual agreement of the parties, any reduction in existing collateral requirements should only apply prospectively.

7. The regulatory structure should utilize principles-based regulation where appropriate.

The RAA Board authorized the RAA staff to assertively pursue changes to the current reinsurance regulatory structure that meet these goals and core characteristics, including but not limited to: **(1)** a single state passport system which allows a reinsurer to be licensed in and regulated by one state but with the ability to then “passport” and assume business in all the other states; or **(2)** an optional federal charter which allows a reinsurer to remain in the 50-state system or obtain a federal charter and be regulated at the federal level pursuant to federal standards; or **(3)** a modified optional federal charter which allows a reinsurer to choose between a single federal regulator, a single state regulator or remain in the current 50-state system. There was a strong consensus for actively advocating, as the RAA’s first preference, a modified optional federal charter. Whatever structure is pursued, it will be important to preserve the value of the reinsurers’ state licenses and to retain the reinsurers’ options to move between various regulatory structures. The RAA Board requested that it be consulted before RAA staff advocates a regulatory structure that is materially different from the three structures identified above.

September 28, 2006

Appendix B

RAA's Section-by-Section Comments

1. The RAA recommends the Task Force include a brief explanation at the beginning of the Proposal setting forth the Task Force's goals and why it is revising the current regulatory structure. We would suggest the following:

Goals/Findings

4. In light of the evolving international marketplace and the global nature of the reinsurance business, reinsurance regulation in the United States needs to be modernized and streamlined in a uniform manner. To accomplish the requisite uniformity throughout the U.S. state jurisdictions, federal enabling legislation is necessary.

5. The goals of the revised regulatory system are to promote:

   a. Financially secure reinsurance recoverables and capacity that protects the solvency of U.S. ceding insurers;

   b. A competitive and healthy reinsurance market for both U.S. licensed and non-U.S. licensed entities that provide sufficient capacity to meet ceding companies' risk management needs;

   c. Effective and efficient national reinsurance regulation through a single state regulator for U.S. licensed reinsurers and a port of entry regulator for non-U.S. licensed reinsurers that will have exclusive jurisdiction over its reinsurers' reinsurance business. All single state regulators and port of entry regulators must be appropriately certified as meeting a defined set of standards to ensure that they have the resources, expertise and experience to regulate reinsurance on a cross border basis.

6. The revised regulatory system should reflect the fact that reinsurance is a business to business transaction and that there is no contractual relationship between the reinsurer and the consumer. The revised regulatory system should also reflect the manner in which reinsurance is written (i.e., typically on a national or international basis, not on a state-by-state basis).

7. The International Association of Insurance Supervisors is continuing to develop suggested standards and guidelines in an effort to create a global framework for regulation. The revised regulatory structure needs to remain flexible to consider these international developments and how they might interact with the U.S. regulatory system.

8. Any revisions to the regulatory system should be harmonized with existing laws and regulations that affect the business of reinsurance to minimize duplicative and inconsistent regulation.

2. Paragraph 3: The RAA is concerned that, without federal oversight, the NAIC through the RSRD (which is not a governmental body and which is not accountable to any governmental body) does not have the authority to implement the certification mechanism for evaluating and determining which states should be single state/POE regulators. Although the Task Force has recommended federal enabling legislation as part of the Proposal and notes that the legislation will address various concerns, the RAA urges the NAIC to specifically address the certification mechanism in the federal implementation section (Paragraph 25) of the Proposal. Specifically, the Proposal should state that the federal legislation will provide for appropriate oversight of the RSRD to ensure the RSRD properly carries out its functions.

3. Paragraphs 5(b) and 6(b): These provisions leave the determination of risk transfer to the ceding company's domiciliary regulator. The RAA is concerned that a regulator could use this authority to require additional contract terms and conditions in order for a contract to qualify as transferring risk. The Proposal should explicitly state that risk transfer should be determined in a consistent manner in accordance with statutory accounting rules and that the ceding company's domiciliary regulator has no authority to require additional contract terms or conditions. The RAA suggests the provisions be rewritten as follows:

> 5(b) – The host state supervisor retains the same authority it has under existing law to determine whether the contract transfers risk. The determination of risk transfer shall be made in accordance with established statutory accounting rules generally applicable throughout the United States (e.g., NAIC Accounting Practices and Procedures) and not be conditioned on the requirement of additional contractual terms or conditions.
>
> 6(b) – The host state supervisor retains the same authority it has under existing law to determine whether the contract transfers risk. The determination of risk transfer shall be made in accordance with established statutory accounting rules generally applicable throughout the United States (e.g., NAIC Accounting Practices and Procedures) and not be conditioned on the requirement of additional contractual terms or conditions; and

4. Paragraph 6(c): The paragraph states that in order to be certified as a POE reinsurer, a company/reinsurer "must be organized and licensed by a non-U.S. jurisdiction recommended as eligible for recognition by the RSRD." As discussed above, requiring reciprocity, which was a cornerstone of the Framework Proposal passed by Plenary, is absent and should be re-inserted here to make clear that is a significant component of the Proposal that must be addressed in the implementation phase. The RAA suggests the paragraph be rewritten as follows:

> 6(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 that provides reciprocal recognition of the U.S. reinsurance regulatory regime, substantially equivalent legal rights and benefits to

reinsurers licensed and domiciled in the U.S. and is recommended as eligible for recognition by the RSRD. …

5. Paragraph 8. This paragraph provides that changes to collateral requirements will now apply to "reinsurance contracts entered into or renewed on or after" the effective date of the Proposal. The addition of the term "renewed" alters the prospective only application of the Proposal. Unlike the "prospective basis" standard in the prior Proposal, this Proposal will now impact reinsurance deals written before enactment under the old rules. This application of the Proposal changes the rules mid-game and could reduce collateral in circumstances where it was integral to the deal. The RAA suggests returning to the "prospective basis" standard.

6. Paragraph 10: This paragraph addresses the functions and requirements of the RSRD. Along with Paragraph (6), this Paragraph is a section of the Proposal that must specifically reference the requirement of reciprocity. In this regard, the RAA suggests that reciprocal treatment of U.S. reinsurers by non-U.S. jurisdictions be a threshold consideration by the RSRD in determining recognition eligibility.

The regulatory recognition should then either be embodied in an agreement wherein each supervisory authority identifies those areas where the host jurisdiction will defer to and rely upon the exclusive exercise of the home jurisdiction's supervision, or it may be effected through other lawfully prescribed methods (e.g., regulatory certification, authorization) that provide reciprocal legal benefits for the licensees of each jurisdiction. It is critical that this regulatory recognition be accomplished in a lawful manner (either at the federal level or by an appropriate authorization from the federal government to the state(s)).

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

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

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

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

D. Financial accounting and reporting;

E. Regulating insurance holding company systems;

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

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

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

Other comments on this Paragraph include:

i. Paragraph 10(a) should be amended to make it clear that unless the RSRD is subject to federal authorization that provides otherwise, because the RSRD is a non-governmental entity, it will be a repository for non-privileged information. Further, the Proposal should clarify that the RSRD is the repository for existing data, not the source of new filing requirements.

ii. Paragraph 10(b) should explicitly state that the RSRD can only conduct the evaluation and make a recommendation to the appropriate federal regulatory authority; it cannot make the decision or enter into any supervisory agreements without delegation from the federal government. This will ensure that this specific issue is addressed in the implementation phase.

iii. Paragraph 10(c) states that the RSRD will develop a standard supervisory recognition agreement and a protocol for recognition. The RTF Proposal should explicitly state that any recognition agreement or protocol must include a requirement that each jurisdiction provide reciprocal legal benefits to the licensees of the other jurisdiction and maintain substantially equivalent regulatory standards and enforcement capabilities.

iv. Paragraph 10(g) empowers state regulators to mandate numerous reinsurance contract terms and specifies the exact language of the "credit for reinsurance clause." This is a departure from the current NAIC model laws and accounting guidance, which require only a few specific contract clauses and do not dictate specific language. International regulatory practice follows the same approach. The departure from this custom puts the Proposal at odds with the way reinsurance is commonly transacted on a national and global basis. Reinsurance

involves contracts between sophisticated entities and therefore the terms and conditions of reinsurance agreements should be left to the marketplace. The RAA strongly supports freedom to contract in a competitive market with respect to terms and conditions, other than those uniformly required by SSAP 62. There has been no rationale given for why mandatory contractual terms are necessary in a business-to-business transaction. The Task Force has indicated it is including the list of clauses for the purpose of uniformity, but the uniformity needed is in regulatory standards and treatment, not contractual terms among sophisticated parties. We urge you to delete these requirements.

As an example, the intermediary clause is currently not uniformly required by state law nor part of the NAIC's Credit for Reinsurance Model Law or accounting guidance. Whether to include this type of clause is better left to the negotiation between the parties. It long has been established as a matter of law that the typical activities of a reinsurance intermediary create an agency relationship between the intermediary and the ceding company. (*See In the Matter of Pritchard & Baird, Inc.*, 8 B.R. 265 (D.N.Y. 1980)) This principal-agent relationship between the ceding company and its intermediary broker is underscored by the NAIC Model Intermediary Act's definition of an intermediary broker and the requirements that the cedent and the broker enter into a written contract. Dictating a specific intermediary clause attempts to alter fundamental principal-agent law that payments made to an agent constitute payments to principal. Instead, the mandated clause attempts to shift credit risk to a third party (the reinsurer) with whom there is no contractual relationship or control over the intermediary broker. While commercial parties can (and, in the context of reinsurance transactions, often do) negotiate contract terms that shift credit risk, the RSRD has no authority to change fundamental agency law principles to require a third party to bear the credit risk for payments made to a principal's agent.

<u>Credit for Reinsurance Clause:</u> We strongly object to the inclusion of the new "downgrade" credit for reinsurance clause that requires a reinsurer to provide the necessary amount of collateral to enable the cedent to take "full statutory accounting credit." For the reasons set forth elsewhere in our comments (#12), there should not be any obligation to post collateral for a National reinsurer. Further, the RAA strongly objects to statutorily mandated "downgrade" clauses in reinsurance agreements as a matter that should be left to the parties to negotiate. Mandating inclusion of such a clause does not encourage the proper type of risk management where parties appropriately identify and capitalize risk. Notwithstanding the above, current credit for reinsurance laws recognize situations where the cedent may take credit only for the amount of collateral provided (i.e., less than 100%). We suggest that, at a minimum, this provision be modified to allow this to continue.

The term "Obligations" needs to be defined as it is unclear whether IBNR is included. Cedents and reinsurers sometimes disagree on the valuation of

liabilities. Under the Proposal who decides what the reinsurer's share of Obligations will be? Where parties cannot agree either on the amount of collateral or its use for payment of claims, a neutral dispute resolution process should be provided.

To the extent the Task Force proceeds with this clause, it should make clear that any collateral must only be used for the payment of actual, known and approved claims (specifically, that the collateral cannot be used to pay claims based on IBNR).

7. Paragraph 12: The provision does not address the situation where multiple states serve as POE supervisors to several different reinsurers in a single jurisdiction. Assuming they even have the authority to enter into such agreements, has the RTF considered the practicalities of each POE state entering into a separate agreement with the non-U.S. jurisdiction? The RAA believe the better approach is to provide for one, legally enforceable agreement.

8. Paragraph 13: The provisions requiring various report filing are ambiguous as to what would be required and leave too much discretion to the POE supervisory authority. Furthermore, many of the items are more properly the subject of any applicable recognition arrangement. Paragraph 13(e) provides that POE reinsurers must file "at least annually" reports with their POE supervisor listing all disputed and overdue reinsurance. The information sought by the report is currently available from ceding insurers. Only a change in information materially relevant to a reinsurer's individual financial situation should be required by the POE supervisor. At a minimum, there should be a materiality standard for this reporting requirement.

9. Paragraph 14: The paragraph provides that the "host state supervisor" retains the authority to require diversification of reinsurance risk for ceding insurers. First, a host state supervisor should not be permitted to apply diversification requirements in a manner that discriminates against a reinsurer based on its status as a National Reinsurer or a POE reinsurer. Second, this sentence should be modified to require diversification only for unaffiliated reinsurance risk for ceding insurers. Intra-group (retro)cessions can exceed 50% of the cedent's policyholder surplus; because these transactions are already subject to notification and review under holding company act laws, these transactions should be exempt from this requirement. Third, the notice requirement if the cession to a single reinsurer exceeds 20% of the ceding insurer's gross written premium is too low and should be changed to, at a minimum, 50%. The appropriate degree of diversification in a ceding company's reinsurance program depends on many variables that must be considered by that company's management. Setting a low fixed percentage by rule may encourage imprudent decision-making. Ceding companies should be free to manage their credit risk and reinsurance purchases without regulatory interference so long as they meet RBC levels and overall enterprise risk management requirements.

10. Paragraph 15: The paragraph states that reinsurers will be evaluated on a legal entity basis versus a group basis for purposes of establishing their collateral requirements. We would urge the Task Force to utilize a group rating where a rating agency has either enhanced the rating of a subsidiary, or has assigned the parent's rating to the subsidiary. If regulators are going to rely

upon ratings, and the rating agency has determined that a legal entity is considered a core subsidiary, that decision should be respected and reflected in the Proposal.

This paragraph also does not address how individual Lloyd's syndicates will be treated (i.e., will Lloyds' as a group receive a rating?) This should be expressly addressed.

11. Paragraphs 15 – 17: The paragraphs continue to raise a fundamental problem with the rating system – the realities of the impact of such a system on cedents. Importantly, collateral has historically been utilized as a substitute for licensing. A reinsurer's rating may change over time and, under the system outlined in the Proposal, would require cedents to continuously monitor and modify their collateral. A drop in a reinsurer's rating from A- to B++ requires the imposition of 55% more collateral on the reinsurer. The reinsurer may have difficulty, or not be able to post, this unnecessary collateral; if that is the case, this should be a licensing issue, not a collateral issue.

Moreover, the current credit crisis has demonstrated again the problems with relying on rating agencies' ratings. Not only did the rating agencies fail to predict situations like Enron and Parmalat but more recently they failed to predict the downgrades of several monoline insurers (in at least once instance, the downgrade occurred after a recent upgrade). In a supervisory recognition situation as outlined above in comment # 6, this would not be an issue because the safeguards built into the recognition process would provide the certainty to regulators that the domiciliary jurisdictions are taking necessary and appropriate action against such entities. A provision such as this defeats that purpose and interferes with the domiciliary regulator's ability to appropriately deal with the company (similarly, requiring such a topping up of collateral in another jurisdiction of a U.S. company would interfere with the U.S. regulator's ability to address a U.S. reinsurer's issues.) True supervisory recognition should be based upon evaluation and reliance upon the other jurisdiction's regulation.

Further, home state and POE supervisors have additional discretion to assign reinsurer ratings based on a list of factors in Paragraph 17. The RAA is concerned that this additional discretion is based on subjective evaluations which will be difficult for reinsurers to predict and could be subject to misuse and abuse. All these factors are more properly the subject of evaluative criteria the RSRD should consider when vetting a jurisdiction.

12. Paragraph 17: The paragraph is unnecessary for the same reasons the collateral system should be unnecessary in a truly modernized regulatory regime based upon meaningful, enforceable supervisory recognition with reciprocal obligations. A better alternative would be to consider some of these factors during the evaluation process of the non-U.S. jurisdiction. Moreover, consideration of these factors in determining the appropriate rating appears to be very vague and subjective. It is also unclear what weight will be given to each of these factors – i.e., can these factors positively influence a rating or only negatively influence a rating? Is there an appeal process if a reinsurer believes that its assigned rating is not justified?

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

- How will a regulator evaluate a reinsurer's reputation for prompt payment of valid claims under Paragraph 17(f) or compliance with reinsurance contractual terms under 17(b)? What information will be utilized and who will provide this information?

- It is unclear what is meant by "business practices" in Paragraph 17(c). This term is nebulous and should be defined.

This Paragraph, along with Paragraphs 21 and 22, gives unfettered discretion to regulators to assign reinsurer ratings and thereby trigger collateral requirements regardless of financial security. Regulators have other tools available to address concerns over claims paying or market practices without the threat of an arbitrary collateral requirement. If the RTF continues with the approach outlined in Paragraph 17, all the factors in sections (b) through (l) should be evaluated on a legal entity basis.

13. Paragraph 17(k): The paragraph requires a vulnerable-5 rating for any reinsurer who participates in "any solvent scheme of arrangement, or similar procedure." First, the draft is unclear what is meant by "participates" – does this refer only to a company availing itself of a scheme or also to a company who involuntarily becomes subject to a scheme. Second, the draft should clarify that the evaluation is on a legal entity basis. A subsidiary reinsurer should not be punished for the participation by its parent or an affiliate in a procedure that may be perfectly legal, and even court sanctioned, in another jurisdiction.

Moreover, this provision is more appropriately included as a criterion for the RSRD to consider in vetting non-U.S. jurisdictions – whether the jurisdiction treats all stakeholders in runoff/insolvency situations as fairly as the U.S. The approach in 17(k), especially with the "similar procedure" language, is subject to overly broad interpretations and is highly subjective and discretionary.

14. Paragraph 19: The RAA strongly objects to Paragraph 19 which requires all reinsurers to post 100% collateral upon the entry of an order of rehabilitation, liquidation or conservation against the cedent. There is no direct correlation between ceding company insolvency and reinsurer financial difficulties. A highly-rated reinsurer that is meeting its obligations should not be required to collateralize its liabilities in this scenario because there is no increased credit risk. Also, the possibility that a reinsurer might have to post collateral in the event of the cedent's insolvency is not currently contemplated in the negotiating process. The RTF should consider the ramifications of introducing this factor into the negotiation of reinsurance agreements.

To the extent that this provision requires a reinsurer to post collateral for IBNR, the RAA strongly opposes this provision based upon valuation and claims acceleration concerns. These unknown liabilities (IBNR) are actuarial estimates that insurers and reinsurers use for accounting purposes in order to ensure that sufficient funds will be available to pay for any claims which, in the future, may be reported, adjudicated and paid. Reinsurers are not required to pay, under their reinsurance contracts, on the basis of unknown potential losses in the form of IBNR. They are obligated to pay only known claims that have been fully identified, for which liability has been established and value has been determined. IBNR does not meet any of these requirements. At

most the RTF should consider requiring collateralization for known claims. The RTF should also consider a neutral process for determining the appropriate amount of collateral. Because reinsurance if often the largest asset of an insolvent estate, placing collateralized funds within reach of a receiver presents opportunities for mischief in the face of pressure to maximize estate values.

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

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

15. Paragraph 20: The paragraph places affiliate transactions on the same footing as other reinsurance transactions. As we have stated before, affiliate transactions are subject to direct regulatory review under state holding company laws. This review subjects them not only to the typical risk transfer and other requirements imposed on unaffiliated reinsurance transactions but also provides a higher standard of regulatory scrutiny by requiring the transaction be fair and reasonable and to result in surplus that is reasonable to liabilities. The holding company laws also require submission of information about the entire holding company system and the controlling entity. Moreover, the non-U.S. affiliated entity has demonstrated a significant capital commitment to the U.S. Finally, all material affiliate reinsurance contracts must be submitted to the U.S. licensee's domestic regulator for prior approval, which approval can be subject to regulatory conditions including the establishment of security sufficient to satisfy any regulatory concerns. Reduced collateral for these transactions is warranted. In the alternative, the Task Force should consider no collateral requirements where the subsidiary has been designated by the rating agencies as a core subsidiary.

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