

March 15, 2011

Via E-Mail

The Honorable Thomas Considine  
Commissioner of Insurance  
State of New Jersey  
Chair, NAIC Reinsurance Task Force

Subject: ABIR Comments, NAIC Credit for Reinsurance Model Law and Regulation: Collateral Reduction

Dear Chair Considine:

On behalf of the 22 members of the Association of Bermuda Insurers and Reinsurers (ABIR), we offer these comments on the Feb. 22, 2011, draft revisions to the NAIC Model Law on Credit for Reinsurance and the Model Regulation on Credit for Reinsurance. ABIR members are regulated by the Bermuda Monetary Authority which has in place a robust prudential regulation framework for the internationally active insurance groups; and is one of only two jurisdictional candidates for first wave equivalence under all three equivalency elements of Europe's Solvency II prudential regulation framework. ABIR members at yearend 2010 wrote an estimated \$61 billion in global gross written premiums on a group capital base of nearly \$90 billion.

ABIR members and the Bermuda (re)insurance market have developed in such a way as to provide large amounts of capacity to North American, South American, European, Asian/Pacific and other global customers. Let's look at four 2010 large loss events from around the world to explain what we mean. According to published reports, ABIR members and other Bermuda (re)insurers have:

- \*37% of the reported claims liabilities for Europe's 2010 Windstorm Xynthia;
- \*38% of the reported claims liabilities for Chile's 2010 earthquake;
- \*25% of the reported claims liabilities for the US's 2010 Gulf of Mexico oil spill; and
- \*51% of the reported claims liabilities for New Zealand's 2010 earthquake.

We do not yet have published reports on the great 2011 Northeast Japan Earthquake and Tsunami. These large loss events demonstrate the value of reinsurance in supporting local insurance markets and underscore the important role Bermuda (re)insurers play in distributing large losses into global reinsurance markets. With such pooling and diversification of risk reinsurers can offer more capacity with their available capital at better prices than otherwise would be the case.

The members of ABIR are largely new companies, established within the last 25 years and created to write internationally diverse portfolios of business in the wholesale commercial sector. Twenty of ABIR's 22 members have licensed subsidiaries in Europe and the US. Individual members also have licensed operating companies in Africa, Australia, Asia, Latin America and North America. As such, they are subject to varied prudential supervision regimes from around the world. ABIR members are believers in international insurance regulatory standards and support the work of the BMA to comply with international standards and that of the IAIS to modernize, develop and establish global standards. The BMA has implemented its group supervision regime and many ABIR members will also have group level supervision from the BMA. The BMA makes every effort to include US state regulators in regulatory colleges that the BMA conducts on internationally active insurance groups.

### An Alternative Regulatory Recognition Approach

In 2008 ABIR supported the work of the NAIC and the Reinsurance Task Force in developing the Reinsurance Regulatory Modernization Framework and we have supported the work of individual states in the last several years to enact their own laws and regulations to allow approved international reinsurers from qualified jurisdictions to conduct business with US clients while providing less than 100% collateral. In the three years since the approval of the NAIC reinsurance regulatory modernization framework, the playing field has shifted and we'd recommend the NAIC consider a new approach to collateral reduction. Rather than focusing on the two additional levels of regulation in the current draft (individual jurisdiction approval followed by the individual reinsurer approval) tied to rating agency assessment and a sliding scale of required collateral, we'd recommend a simplified "regulatory recognition" approach. With this approach, the NAIC's or the state's efforts would be focused on an analysis of the comparability of the regulation in place in the foreign jurisdiction. Does the regulatory system provide for a robust solvency regulation framework upon which an assessment can be made that the framework provides outcomes in terms of solvency oversight comparable to the state based regulatory requirements under which the NAIC evaluates the states in the accreditation program? That assessment is the key element of any movement away from regulatory mandated collateral. After all, in practice this is the approach taken in major global reinsurance markets today to the benefit of US reinsurers doing business outside the US.

Since 2008, much has changed in the US and global regulatory environment. We think there are at least four factors that make the case for the NAIC to consider a new approach in the proposed amendments to the NAIC model law and regulation on credit for reinsurance.

1. IMF Financial Sector Assessment Program (FSAP). The NAIC and several states have now been assessed by the International Monetary Fund under the FSAP program. This is a peer review process under which individual jurisdictions are measured against the International Association of Insurance Supervisors (IAIS) standards and principles for prudential supervision. The US government (as part of the G 20) is a driving force behind the IAIS global standards and the IMF FSAP reviews. All the major reinsurance

domiciles have now been subject to such an FSAP review. Bermuda has twice had an FSAP review.

2. Europe's Solvency II. Europe has now completed its framework for evaluation of jurisdictions to assess the degree to which they provide equivalent outcomes to the Solvency II prudential supervision regime. Bermuda is one of two jurisdictions which will be evaluated for equivalence under the three part Solvency II assessment program. Japan will also be evaluated for its reinsurance regulation framework. The US and other jurisdictions are being evaluated under a separate set of transition rules now in development. The existence of state mandated collateral requirements has been identified by the European Commission as an impediment to consideration of the US under either transition rules or an equivalency assessment. According to both sides, the NAIC and the European Commission have had productive conversations in moving towards agreement.
3. Dodd Frank Act: International Covered Agreements. The US government has now enacted the Dodd Frank Act which includes the provision that calls for agreements to be entered into between the US government and foreign governments with regard to prudential supervision frameworks. The so-called "covered agreement" provision of Dodd-Frank creates a legal mechanism for the US to negotiate such agreements that would effectuate agreements on state supervision of solvency regulation including reinsurance collateral. The Dodd Frank Act does not usurp state regulation in that it does not create a federal regulator for insurance. The act strengthens the hand of domestic state regulators of ceding and assuming carriers.
4. Financial Crisis. Insurance regulators globally have demonstrated the robust nature of their solvency oversight systems and regulatory ladders of intervention have been tested by the global financial crisis. Insurance regulators demonstrated their core competency as solvency regulators. They have also reached new agreements on how to further expand on effective regulatory collaboration. The G 20 nations have strengthened the IAIS's hand in development global prudential regulatory standards.

ABIR recommends for NAIC consideration a simplified model credit for reinsurance law and regulation framework that would operate in an efficient fashion with a focus on assessing the regulation in place in the reinsurer's country of domicile. For the purposes of this statement we will call that a regulatory recognition framework, consistent with the IAIS paper on the same topic. If a regulatory recognition framework is not approvable we would recommend a regulatory recognition structure amended with a company approval process with a 'deemer' provision – the reinsurer is deemed approved as long as that reinsurer attests to certain standards as part of a filing—subject to rejection by the regulator of that filing for cause. Here's an example of how this would work:

1. The NAIC or the states would evaluate the regulatory quality of the foreign jurisdiction. Much as has already been done by New York and Florida in their implementing efforts, the states can determine which foreign jurisdictions would pass regulatory muster. This

provision is already provided for in Section 2, E, (3). Notably, this section also includes a procedure by which a jurisdiction could be disqualified.

2. Once a jurisdiction has met the test, then individual reinsurers from that jurisdiction would be deemed to be able to engage in cross border reinsurance agreements with US ceding insurers without having to post 100% collateral. They would be exempt from collateral requirements as long as those reinsurers met certain conditions. For example, they would have to:
  - a. Maintain the individual capital and surplus requirement, the \$250 million legal entity requirement (or a higher amount) in the current model;
  - b. Present evidence of being licensed in good standing with the foreign domicile;
  - c. Provide prompt notice of material regulatory sanctions if they are imposed by the foreign regulator;
  - d. Provide evidence of their financial standing as assessed by two independent rating agencies and provide notice of any change in financial strength ratings;
  - e. Provide appropriate financial statements;
  - f. Submit to US jurisdiction for service of process.
3. If the state regulator finds that the reinsurer is no longer operating in conformance with capital, rating agency or other tests as noted, then the state regulator would revoke the reinsurer's filing and it would have to provide full collateral on its business going forward. The model law already contains a provision for disqualifying the reinsurer.

This regulatory recognition approach—coupled with the deemer—buttresses the financial security assessment that US ceding insurers are already conducting. At the same time it is more consistent with the approach taken by leading foreign jurisdictions in allowing cross border reinsurance opportunities for US reinsurers. Finally, coupling it with the deemer makes for an efficient regulatory review process while still affording the opportunity to revoke the approval. This process would also provide more consistency in state action and more transparency with regard to the rules actually applied in the varying states.

With the lessons learned from the financial crises, with the attention devoted by the US government in the G 20 process with regard to strengthening insurance regulation, with the new legal authority afforded under the Dodd Frank Act and with greater knowledge about the regulatory systems in place globally via the FSAP program, we believe it is time for the NAIC to adjust its model credit for reinsurance regulatory approach. We recommend the regulatory recognition approach, but if that is not viable we'd recommend an amendment to the provisions in these proposed models to incorporate a deemer approach with regard to qualified reinsurer approvals.

#### Other Comments, Current Draft Proposals Model Law and Regulation

Notably, the NAIC draft regulation includes numerous additional regulatory requirements imposed on foreign reinsurers that foreign governments today do not impose on US reinsurers. We would suggest that all such additional requirements be reviewed. Are such provisions essential when the goal of this effort is to assess comparability of solvency regulation regimes?

We recognize that financial statements and regulatory sanction actions are appropriate subjects for filing requirements. The essential requirements should be maintained, but it is not necessary to create a laundry list of filing requirements when the foundation of this new system is that essential regulatory cooperation will take place between the foreign regulator and the state regulator.

As has been noted, the current NAIC drafts—as a condition of operating with reduced collateral requirements—actually impose two new substantive regulatory reviews on foreign reinsurers. Those reviews are the assessment of the foreign jurisdiction as a regulator; and then furthermore the assessment of the reinsurer itself. This regulatory framework is incorrectly being perceived as a reduced regulatory regime when in fact just the opposite is true. The NAIC is designing a regulatory framework that imposes more – not less—regulation and continues to maintain a unique US based set of reinsurance requirements that are far different from the conditions imposed on US reinsurers operating on a cross border basis to meet foreign ceding insurer needs.

### Mandatory Contract Clauses

Furthermore we'd recommend that Model Regulation Section 8, paragraph E, entitled "Mandatory Contract Clauses" be deleted. It is not necessary to mandate reinsurance contract clauses. Reform of mandated collateral requirements is not a reason to impose seven new reinsurance contract mandates. Financial examiners would continue to review reinsurance contracts to determine if they meet existing standards for credit for reinsurance. It is not appropriate to mandate additional contract clauses – they are not needed and are beyond the scope of the legislative drafting project delegated to the Reinsurance Task Force. Whatever existing reinsurance contracts are mandated in the current law and which apply to any reinsurer regardless of domicile would remain; for example, the insolvency clause, and arbitration clause are already cited in the model regulation and a reference is made to existing state laws governing intermediaries. Those contract clauses evaluated in the course of financial examination would continue to be reviewed in accordance with NAIC guidance. Such NAIC guidance appropriately applies to all reinsurers, domestic and foreign. The system works today and we believe the case has been made as to why it should be substantially amended in this model law and regulation rewrite.

Reinsurance markets operate free of forms regulation around the world. The statutory inclusion of mandatory contract terms leads us down the path of mandatory contract wording. We think that would limit future reinsurance capacity. In addition, inclusion of contract mandates creates the mischief of specific contract wording being dictated in state law and regulation amendments; and of course the opportunity for conflicting wording to be adopted in different states. Since reinsurance is often provided to the benefit of an insurance group, conflicts with wording would inevitably surface via different laws applying to the individual legal entities.

### Other Suggested Changes

Here is a list of other suggested changes to the draft proposals:

1. Model Law: Section 2, E(1)(f); Model Regulation: Section 8,B,(8) and Model Regulation: Section 8,C(2)(j): “The assuming insurer must satisfy any other requirements for certification deemed relevant by the commissioner.” This clause should be deleted. It is an open ended statement that empowers a host of individual state action thus moving completely away from the goals of a state model uniformly implemented. The clause also would create opaqueness in the requirements in a system otherwise designed to be transparent.
2. Model Law: Section 2, E(7): Inactive status. This paragraph details the process for a reinsurer choosing to become “inactive” but continuing to comply with the requirements of the law. A statement should be added making it clear that “inactive” status does not compel funding beyond the collateral required during the time in which the company was active.
3. Model Regulation: Section 8,A(3): 100% funding based on ceding insurer’s order of liquidation. Compelling full funding for a single ceding insurer imperils equitable support for all the reinsurer’s clients. A ceding insurer’s self interested request for full funding at the time of insolvency would likely be inflated and thus funding at this level would be detrimental to other clients of the reinsurer.
4. Model Regulation: Section 8,B,(4)(j): Solvent schemes. The reference here is too broad. The words “in any” should be replaced by the words “as a beneficiary of a”. This would make it clear we are talking about an insurer which has sought protection from a solvent scheme for itself.
5. Model Regulation: Section 8,B,(6)(a): Regulatory action. The word “material” should be inserted in front of the words “regulatory action.” A “regulatory action” broadly construed could be a note from a regulator that the wrong amount was paid for a routine filing fee.
6. Model Regulation: Section 8,B,(7),(c): Downgrade. This clause suggests that if a rating upgrade is provided, that the benefit to the reinsurer applies prospectively, but in the event of a downgrade the detrimental impact to the reinsurer applies retroactively. The downgrade clause can only equitably apply the increased funding provision to business written prospectively. It would be punitive to impose the provision on a retroactive basis.

## Conclusion

We appreciate the opportunity to present these views. We also appreciate the tremendous effort the members of the Task Force have taken in rewriting the model law and regulation provisions. We also support the efforts undertaken in Florida and New York to implement their new collateral reduction measures and we believe these measures will inure to the benefit of their domestic ceding insurers by affording a more efficient reinsurance market. We support the work soon to be completed in New Jersey in enacting a similar law. Finally we recognize that legislation is also pending, or soon to be introduced in Illinois, Indiana, Louisiana and Texas. Prior to the NAIC completing its work on revisions in the model law and regulation it is time to once again reassess the approach embarked upon in 2008 to see if it is consistent with the

environment which presents itself today. We believe the goal of the NAIC should be to move to a regulatory recognition system that is more consistent with the way reinsurance markets will be regulated globally in the future according to IAIS standards.

Sincerely,

A handwritten signature in black ink, reading "Bradley L. Kading". The signature is written in a cursive style with a large, prominent initial 'B'.

Bradley L. Kading

Cc: Mr. Robert Kasinow, NJ DOBI  
Mr. Ryan Couch, Dan Schelp, NAIC