

Interpretation of the Emerging Accounting Issues Working Group

INT 02-09: A-785 and Syndicated Letters of Credit

ISSUE NULLIFIED BY SSAP NO. 61 AND SSAP NO. 62R

INT 02-09 Dates Discussed

March 18, 2002; June 13, 2004; September 12, 2004

INT 02-09 References

SSAP No. 62R—Property and Casualty Reinsurance (SSAP No. 62R)

Appendix A-785—Credit for Reinsurance (A-785)

INT 02-09 Issue

1. The aggregate size of the ceded liabilities assumed by a reinsurer may be too large for a single bank to issue letters of credit to support the entire liability. More than one bank will need to support the credits. There are three general ways in which the reinsurer may obtain letters of credit in which multiple banks are participants.

- a. The first alternative (“Multiple LCs”) requires the reinsurer to approach several banks and individually arrange several, separate letters of credit, each of which is issued on a stand-alone basis by the issuing banks.
- b. The second alternative (the “Fronted LC”) allows the reinsurer to approach only one bank, which issues a single letter of credit as a fronting bank. The fronting bank participates, or sells to other banks undivided interests in, its obligations under the credit. The fronting bank remains directly liable to the beneficiary for the full amount of the credit regardless of the amount participated. The beneficiary has payment rights only against the fronting bank and none against the participant banks.
- c. The third alternative (the “Syndicated LC”) avoids the disadvantages of the first two alternatives and is overall the superior alternative from the perspectives of the banks, the reinsurer and the ceding insurer. The Syndicated LC is a structure for standby letters of credit frequently employed in other contexts where standby credit support from multiple banks is required. (For example, letters of credit supporting commercial paper issued by corporations and industrial revenue bonds, which have received ratings by Moody’s and S&P as the result of letter of credit backup support.) In essence, the Syndicated LC is Multiple LCs arranged through an agent bank. The Syndicated LC thus combines the credit diversification and lower costs of Multiple LCs with the convenience of a Fronted LC.

2. With a Syndicated LC, the reinsurer enters into an agreement with a group of banks (the “Issuing Banks”) and an agent bank (the “Agent”). Each Issuing Bank and the Agent is a NAIC-approved bank and a “qualified bank”. This agreement requires the Agent to issue, on behalf of the each of the Issuing Banks, letters of credit in favor of ceding insurers. The credit is issued (as an administrative matter) only through the Agent’s letter of credit department. Each issuing bank signs the Syndicated Letter of Credit through the Agent, as its attorney-in-fact.

3. A drawing by the beneficiary of a Syndicated LC need only be presented to the Agent. The Agent notifies the Issuing Banks of the draw and forwards all documentation. With respect to each complying drawing, each Issuing Bank agrees to deliver its portion of the draw to the Agent, which in turn delivers the funds to the beneficiary. The payment to the beneficiary typically is made on the same day as the drawing or, if a drawing is made late in the day, on the next day.

4. The Syndicated LC provides that each Issuing Bank is severally, not jointly, liable to pay its specified percentage of the total dollar amount of each drawing made by the beneficiary. A schedule containing each Issuing Bank's respective percentage of the total liability is set forth in the letter of credit. The several liability of the Issuing Banks means that the failure of any Issuing Bank to fund its portion does not relieve the other banks from the obligation to fund their respective portions. Conversely, if one bank fails to fund its portion of a drawing, the other banks are not obligated to fund such portion for the defaulting bank. In this respect, the Syndicated LC is identical to Multiple LCs.

5. The accounting issue is whether Syndicated LCs, as described above, are consistent with the requirements of paragraphs 40-47 of A-785?

INT 02-09 Discussion

6. The working group reached a consensus that the Syndicated LC is consistent with A-785, in that the Syndicated LC is the legal equivalent of multiple letters of credit separately issued by each of the issuing banks. Reporting entities shall take a reduction in liability on account of reinsurance recoverables secured by the Syndicated LC if all of the following conditions are met:

- a. All listed banks on the letter of credit are qualified and meet the criteria of the NAIC SVO approved bank listing;
- b. Banks are severally and not jointly liable; and
- c. Specific percentages for each assuming bank are listed in the letter of credit.

INT 02-09 Status

7. No further discussion is planned.