NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS
Covered Agreement Public Hearing held on February 20, 2018

COMMENT LETTERS

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February 6, 2018

Superintendent Maria T. Vullo, Chair (New York)
Director Chlora Lindley-Myers, Vice Chair (Missouri)
National Association of Insurance Commissioners, Reinsurance (E) Task Force

Attention: Mr. Jake Stultz, jstultz@naic.org

RE: NAIC Implementation of reinsurance collateral provisions of the Bilateral Agreement Between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement)

Dear Superintendent Vullo, Director Lindley-Myers, Members of the Task Force & Interested Regulators,

I write on behalf of The Association of Bermuda Insurers and Reinsurers (ABIR[1]), which represents the public policy interests of Bermuda's international insurers and reinsurers that protect consumers around the world.

Thank you for the opportunity to comment on the NAIC Implementation of reinsurance collateral provisions of the Bilateral Agreement Between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement).

NAIC Credit for Reinsurance Reform

In November 2011, over six years ago, the NAIC passed amendments to its *Credit for Reinsurance Model Law* (#785) and its *Credit for Reinsurance Model Regulation* (#786) that, once implemented by a state, allow foreign reinsurers to post significantly less than 100% collateral for U.S. claims, provided the reinsurer is evaluated and certified. The NAIC developed a process to evaluate the reinsurance supervisory systems of non-U.S. jurisdictions, for purposes of developing and maintaining a list of jurisdictions recommended for recognition by the states as Qualified Jurisdictions. The purpose of the *Process for Developing and*

[1] ABIR members have headquarters and operations in Bermuda with operating subsidiaries in the United States and Europe and do business in more than 150 countries. Members employ nearly 35,000 people around the globe including more than 16,000 employees in the US, nearly 1,600 employees in Bermuda, and more than 8,600 in Europe. Over the past twenty years, ABIR members have paid policyholders and ceding companies over $208 billion in the U.S. and over $72 billion in the European Union.

Maintaining the NAIC Lists of Qualified Jurisdictions was to provide a documented evaluation process for creating and maintaining this NAIC list. The NAIC adopted the *Process* on August 27, 2013, which was further amended on August 19, 2014.

The NAIC has established the Reinsurance Financial Analysis Working Group (ReFAWG). Its purpose is to provide advisory support and assistance to states in the review of applications for certified reinsurers reinsurance collateral reduction. ReFAWG makes available to the states a uniform application for certification of reinsurers based upon the requirements of the NAIC *Credit for Reinsurance Model Law* (Model #785) and *Credit for Reinsurance Model Regulation* (Model #786).

Assuming insurers (reinsurers) are encouraged to submit initial applications to a single state to allow the application to be considered through the ReFAWG process and in an effort to facilitate multi-state recognition of a certification, known as passporting. If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, other states have the discretion to defer to that jurisdiction's certification, and to defer to the collateral level assigned by that jurisdiction. ReFAWG helps facilitate passporting of certified reinsurers and address issues of uniformity among the states with respect to certification and assignment of collateral levels by the states.

Through a confidential review process, ReFAWG makes a recommendation to NAIC member jurisdictions whether to approve or deny a certified reinsurer's application for passporting. Ultimately, states have the discretion to defer to the certification and collateral reduction of a reinsurer assigned by the lead state. ReFAWG also facilitates ongoing monitoring of certified reinsurers.

Bermuda Market

The NAIC invited the Bermuda Monetary Authority (BMA) to participate in an expedited review under the Qualified Jurisdiction Process by letter dated August 29, 2013, which was immediately accepted by the BMA. The NAIC issued a public notice on its website of the BMA's participation in the evaluation process and requested interested parties to submit public comments with respect to the BMA. The Working Group received one comment letter in support of designating Bermuda as a conditional qualified jurisdiction effective January 1, 2014 and the designation continued for one (1) year.

On December 16, 2014, the NAIC Executive (EX) Committee and Plenary approved the NAIC Qualified Jurisdiction Working Group's Summary of Findings and Determination of the Bermuda Monetary Authority and recommendation to recognize approving Bermuda as a Qualified Jurisdiction and place it on the *NAIC List of Qualified Jurisdictions*, effective January 1, 2015 for a 5-year period.[2]

[2] As of January 1, 2017, the NAIC List of Qualified Jurisdictions include Bermuda, France, Germany, Ireland, Japan, Switzerland and the United Kingdom (UK).

Individual reinsurers have been analyzed and certified by regulators based on specific criteria including financial strength, timely claims payment history, and the requirement that a reinsurer be domiciled and licensed in a "qualified jurisdiction."

As of February 2, 2018, NAIC ReFAWG recommends twenty-six (26), certified reinsurers for passporting by the states. **Eighteen (18) of these certified reinsurers—nearly 70%—have Bermuda as a domiciliary jurisdiction.**[3]

In addition to being a leading qualified jurisdiction in the U.S., in November 2015, the European Commission published a "Delegated Act" which recognized Bermuda's insurance regulatory framework as being fully equivalent to regulatory standards applied to European insurance and reinsurance companies and insurance groups in accordance with the requirements of the Solvency II Directive.[4]

Guidance for Implementation of the Covered Agreement

ABIR member companies offer the following comments as principles for the NAIC to consider as it addresses the Covered Agreement implementation:

I. Recognition of NAIC commitment to conducting its business openly

ABIR appreciates the NAIC open meeting process[5] and looks forward to a consultative engagement among regulators and interested parties in the NAIC Implementation of the Bilateral Agreement Between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement). ABIR encourages state regulators and NAIC to continue to advocate for open and transparent discussions at all levels in the implementation of the covered agreement.

II. Amendments to the *Credit for Reinsurance Model Law* #785 and the *Credit for Reinsurance Model Regulation* #786 should be as streamlined and as minimal as possible.

Implementation of the covered agreement is best achieved by building upon the existing credit for reinsurance regulatory framework. Over several years, state regulators and state legislatures have successfully improved reinsurance regulation through the Credit for Reinsurance Model Law #785 and the Credit for Reinsurance Model Regulation #786. Passage of the models in forty-two (42) states is a

[3] NAIC ReFAWG lists Lloyds of London (UK) entities collectively as one reinsurer.

[4] The Delegated Act extends full equivalence for Bermuda commercial insurers and reinsurers licensed as Class 3A, 3B, 4, C, D and E insurers, and Bermuda insurance groups. Bermuda is considered by all European member states as applying an equivalent statutory insurance regime in accordance with the requirements of the three Solvency II Articles: reinsurance (Article 172), group solvency calculation (Article 227) and group supervision (Article 260).

[5] NAIC Policy Statement on Open Meetings Revised: 4/01/2014

testament to the comprehensive and thoughtful approach of state regulators. Amendments to address the implementation of the covered agreement should be streamlined and minimal to allow for ease in adoption by the state policymakers and implementation by state regulators.

III. The NAIC should maintain the current qualified jurisdiction and certification process in the model law and regulation

Modifications to the Credit for Reinsurance Model Law #785 and the Credit for Reinsurance Model Regulation #786 should be primarily additive to include the terms of the covered agreement for the EU. The modifications should maintain the existing qualified jurisdiction process currently providing a structure for full vetting of qualified jurisdictions and subsequent certification of reinsurers. The prospective terms of the covered agreement and collateral requirements will logically be aided by maintaining the current qualified jurisdiction and certified reinsurer process.

The NAIC and state regulators are encouraged to continue their efforts to improve and expedite the passporting process of certified reinsurers to effectuate national implementation of reinsurance modernization.

IV. The NAIC should amend the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to add an additional category to eliminate reinsurance collateral requirements for EU-based reinsurers AND provide certified reinsurers domiciled in NAIC Qualified Jurisdictions the option to utilize this category with the same reinsurance collateral elimination.

The terms of the Covered Agreement provide for the financial strength and market conduct requirements of EU reinsurers qualified to be certified and ultimately receive the phasing out of collateral requirements.[6] State regulators will be tasked with reconciling these requirements with existing requirements of the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786), specifically the terms of the Uniform Application Checklist for Certified Reinsurers. Any requirements from the checklist not provided in the Covered Agreement would not be subject to potential preemption, if the state insurance regulator applies the same requirements in the case of reinsurance agreements with U.S. reinsurers. The process of certifying eligible reinsurers should continue under the modified requirements.

The states now have a four-year experience period of qualified jurisdiction review and designation of certified reinsurers. The elimination of collateral is a logical extension of this experience period of limited collateral requirements. The due

[6] See ARTICLE 3, Bilateral Agreement between the United States of America and the European Union on Prudential Measurers Regarding Insurance and Reinsurance

diligence performed by state regulators and the NAIC in the qualified jurisdiction review and importantly, the certification of reinsurers should provide confidence to regulators in the further reduction and ultimate elimination of collateral. The certification of reinsurers continues to be a responsibility of the state regulation and ensures consumer protection.

The tremendous work done by the NAIC and states to evaluate regulatory regimes and qualify jurisdictions should be recognized by extending the same terms for EU-based certified reinsurers to those reinsurers domiciled in qualified jurisdictions and individually certified. The principles of fairness, a level playing field and continuing sound, vetted options for ceding companies and consumers require providing the reinsurers domiciled in NAIC qualified jurisdictions, including Bermuda, with the same reinsurance collateral elimination extended to EU certified reinsurers. These qualified jurisdictions and certified reinsurers have demonstrated their responsiveness to reinsurance coverage and payments and should be entitled to the most favored terms.

Extending covered agreement treatment to NAIC qualified jurisdictions other than the E.U. – including Bermuda – could easily be facilitated by a qualified jurisdiction's recognition of the U.S. group supervision authority over its domiciled groups, including solvency and capital, governance and reporting requirements in addition to eliminating any local presence or collateral requirements in the qualified jurisdiction. The vehicle for these terms could be through written agreements or Memoranda of Understanding.

V. Before considering whether additional 'guardrails' are needed, NAIC should leverage experience of the 2017 U.S. natural catastrophes to assess whether any regulatory gaps exist

Preliminary estimates indicate 2017 to be one of the costliest catastrophe loss years ever. Market data suggest 2017 may be the second costliest hurricane season after 2005 with the U.S. hit the hardest with historic losses from hurricanes Harvey, Irma and Maria. This is also the first major natural catastrophe year since the NAIC has reformed its reinsurance collateral regulatory structure.

Anecdotally, the property and casualty market has not reported any significant issues with reinsurance claim adjudication, payments, cash flow or capital. The events of 2017 have been largely reported as earnings events rather than having any significant impact on capital. The Bermuda Monetary Authority estimates the Bermuda market share of these significant U.S. losses will be approximately 30% or over $31 billion. These amounts are in addition to the $152.7 billion of claim payments to U.S. policyholders and cedents between 2007 and 2016.[7]

[7] Bermuda Monetary Authority, November 21, 2017 release

The NAIC should leverage the historical data including the 2017 market performance over the coming months and be cautious in its evaluation of whether any additional 'guardrails' are needed in the elimination of reinsurance collateral in light of the claims payment history and the 2017 claims paying experience.

ABIR appreciates the opportunity to provide these comments and we look forward to the February 20, 2018, hearing in New York to begin the discussion of the NAIC and state regulators implementation of the covered agreement.

Sincerely,

John M. Huff
President & Chief Executive Officer

Cc: Commissioner Julie Mix McPeak (Tennessee), President
Superintendent Eric Cioppa (Maine), President Elect
Director Raymond Farmer (South Carolina), Vice President
Commissioner Gordon Ito (Hawaii), Secretary-Treasurer

ACLI
Financial Security...for Life.

ACLI Principles on Collateral Reform

INTRODUCTION

The American Council of Life Insurers (ACLI) appreciates the NAIC's thoughtful, coordinated, and pragmatic approach to the U.S.-EU Covered Agreement as well as its leadership in bringing the Agreement across the finish line. ACLI was pleased that the U.S.'s signing statement recognized the primacy of state insurance regulation, which has been a critical part of ACLI's policy and approach on the Covered Agreement.

The Agreement provides regulatory certainty for insurers and reinsurers. It establishes the terms for companies operating in both the United States and the European Union to do business there. It enables American companies to be competitive with foreign firms in domestic and foreign markets. ACLI members will benefit from the assurance provided by the Covered Agreement, allowing them to dedicate resources to protecting the financial security of their customers. Through retirement and insurance products provided by life insurance companies, 75 million American families are better able to plan, save and guarantee their savings for a secure retirement.

ACLI appreciates the opportunity to participate in the NAIC's public hearing on February 20, 2018, to address implementation of the reinsurance collateral provisions in Article 3 of the Agreement. We urge that the following principles guide the Reinsurance (E) Task Force in its deliberations on any amendments to the Credit for Reinsurance Model Law and Model Regulation.

PRINCIPLES

- Amendments to the Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) should be as succinct and uncomplicated as possible in order to avoid confusion in the implementation process.
- We recommend adding a new section to #785 to 'recognize' EU-based reinsurers.
- We also recommend extending similar treatment to reinsurers based in other qualified jurisdictions. Amendments to the Models to do so should require the reinsurer's home country to recognize the validity of U.S. group supervision, including solvency and capital, governance, and reporting requirements, and to eliminate any collateral or local presence requirements.
- ACLI believes that the current NAIC and state regulatory framework has ample and effective 'guardrails.'

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the policyholders that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 95 percent of industry assets, 93 percent of life insurance premiums, and 98 percent of annuity considerations in the United States.

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Kevin Spataro
Senior Vice President
Accounting Research

February 6, 2107

OFFICIAL ELECTRONIC MAIL SENT VIA EMAIL. NO HARD COPY TO FOLLOW.

Dear Mr. Stultz:

Allstate Insurance Company ("Allstate") appreciates the opportunity to comment on the issues raised in the notice for this hearing. As one of the world's largest purchasers of catastrophe reinsurance, Allstate is keenly interested in working with regulators and policymakers to ensure laws and regulations that are modified as a result of the Covered Agreement serve the interests of both policyholders and ceding companies.

Allstate favors modernizing reinsurance regulation in a balanced way that ensures the continued financial soundness of ceding companies and reinsurers as well as protection of policyholders.

In proceedings before the NAIC, Allstate provided comments on the Model Law (#785) and Regulation (#786) on Credit for Reinsurance as both evolved. We also have been actively engaged with state lawmakers as they considered the potential reduction in collateral and Qualified Jurisdiction provisions in the current version of these models. Moreover, Allstate provided extensive input to the U.S. Treasury Department by way of the Federal Insurance Office (FIO), the U.S. Trade Representative ("USTR"), interested congressmen, congressional staff and members of the NAIC during discussions leading up to the execution of the Covered Agreement.

IMPORTANCE OF COLLATERAL AS A SOLVENCY SAFEGUARD

Throughout the policy debate over changes in the NAIC models governing reinsurance collateral, Allstate consistently emphasized the value of collateral as a critical safeguard for the interests of ceding companies and their policyholders. As this hearing notice points out, there are indeed "increased financial solvency risks caused by the elimination of reinsurance collateral." When the discussions over the Covered Agreement occurred, Allstate stressed that the Covered Agreement should not further reduce collateral levels below those required by the amended NAIC Model Law. Accordingly, as NAIC members consider next steps in the evolution of insurance-related regulation, we ask that all keep in mind the value of collateral as a tool to protect not only ceding companies but also policyholders.

ANY REDUCTION IN COLLATERAL MUST BE PROSPECTIVE-ONLY

Despite our well-documented concerns about reducing collateral requirements contained in the amended Model Law, Allstate continued to work constructively on issues surrounding the Model Law with lawmakers, NAIC members and other stakeholders. In several states Allstate agreed to withdraw opposition to adoption of the amended Model Law provided additional language was added to clarify the NAIC's intent that the reduced collateral provisions would apply prospectively

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and not to existing, previously executed, reinsurance contracts. Many insurers maintain liabilities that are reinsured and collateralized under longstanding reinsurance agreements. Based on this dialogue, revisions were made to credit for reinsurance laws in many states. Consistent with that approach, Allstate suggested the Covered Agreement should only apply to reinsurance agreements entered into after the effective date of the Covered Agreement. We were pleased with the policy implementation statement from the U.S. Treasury Department and USTR that accompanied the Covered Agreement as it contained "prospective-only" language. Accordingly, we believes that if the NAIC chooses to recommend incorporation of the terms of the Covered Agreement into Model Law #785, there must be inclusion of a provision clearly stating the change would be prospective only.

APPROACHES TO REINSURANCE COLLATERAL REFORM

Allstate believes any potential changes in the Credit for Reinsurance Model Law and Regulation should be carefully considered. Many state legislatures have, in recent years, enacted legislation incorporating the amended Model Law with the Qualified Jurisdiction approach into their statutes. As such, legislators may object if the NAIC goes back to the states seeking additional revisions; especially for situations that remain unclear such as how the preemption process will be operationalized. Accordingly, Allstate is not at this point recommending expansion of the Model Law to incorporate the key elements of the Covered Agreement.

Because of our fundamental belief in the value of collateral, we do not support extending the "zero collateral" provisions of the Covered Agreement to reinsurers beyond the EU. In our view the Covered Agreement was a heavily negotiated agreement and its ultimate provisions were the result of a complex balancing of a number of issues particular to the relationship between the U.S. and EU and the relevant facts and circumstances. As such it would not be appropriate to extend to it other jurisdictions.

Similarly we oppose extending the zero collateral status to reinsurers from Qualified Jurisdictions designated as such by NAIC. Such action would further reduce level of collateral required under the amended NAIC Model Law.

Allstate will remain engaged with NAIC and policymakers on this important topic. We appreciate the opportunity for input on these important issues.

Sincerely yours,

Kevin Spataro
SVP-Accounting Research

cc: Robert L. Zeman
Corporate Counsel

A PUBLIC POLICY PRACTICE NOTE

Credit for Life Reinsurance in U.S. Statutory Financial Statements

February 2018

Developed by
the Credit for Reinsurance Subgroup
of the Reinsurance Committee
of the American Academy of Actuaries

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A PUBLIC POLICY PRACTICE NOTE

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The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

2017-18 Credit for Reinsurance Subgroup

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Special thanks to those who helped finalize the practice note: Tom Campbell, Robert Diefenbacher, Donna Jarvis, Leslie Jones, Richard Daillak, and Wayne Stuenkel.

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This practice note is not a promulgation of the Actuarial Standards Board, is not an actuarial standard of practice, is not binding on any actuary and is not a definitive statement as to what constitutes generally accepted practice in the area under discussion.

Events occurring subsequent to this publication of the practice note may make the practices described in this practice note irrelevant or obsolete.

This revised practice note was prepared by the Credit for Reinsurance Subgroup of the Reinsurance Committee of the American Academy of Actuaries. The practice note represents a description of some of the practices believed by the current subgroup to be commonly employed by actuaries in the United States in 2017-18. The purpose of the practice note is to provide information to actuaries on current practices in the determination of credit for reinsurance that may be taken on statutory financial statements. However, no representation of completeness is made; other approaches may also be in common use. It should be recognized that the information contained in the practice note discusses current and emerging practice, but is not a definitive statement as to what constitutes generally accepted practice in this area. Further, there are variations in the implementation and interpretation of the National Association of Insurance Commissioners' (NAIC) model laws and regulations that may apply to the determination of credit for reinsurance by jurisdiction. The commentary in this practice note does not cover all such variations.

We welcome comments and questions. Please send comments to RMFRCPolicyAnalyst@actuary.org.

Table of Contents

Introduction

This practice note is intended to provide actuaries with information on current and emerging practices used to determine the credit for reinsurance that may be taken on statutory financial statements. Primary source materials referenced in this practice note include (abbreviations by which each document is referenced in this document are given in parentheses):

1. Accounting Practices and Procedures Manual, NAIC, 2016. (APPM)
    a. Statement of Statutory Accounting Principles 61R: *Life, Deposit-Type and Accident and Health Reinsurance*, NAIC, 2015. (SSAP 61R)
    b. Appendix A-785
    c. Appendix A-791
2. *Credit for Reinsurance Model Law* (Model #785), NAIC, 2016.
3. *Credit for Reinsurance Model Regulation* (Model #786), NAIC, 2012.
4. *Term and Universal Life Insurance Reserve Financing Model Regulation* (Model #787), NAIC, 2017. (Reserve Financing Model Regulation)
5. *Life and Health Reinsurance Agreements Model Regulation* (Model #791), NAIC, 2002. (Risk Transfer Regulation)
6. *Standard Valuation Law* (Model #820), NAIC, 2010.
7. *Actuarial Opinion and Memorandum Regulation (Model #822)*, NAIC, 2010. (AOMR)
8. *Valuation of Life Insurance Policies Model Regulation* (Model #830), NAIC, 2009. (Regulation XXX)
9. *Valuation Manual*, *2018 edition*, NAIC, Nov. 22, 2017. (Valuation Manual, 2018 edition)
10. *Recognition of the 2001 CSO Mortality Table for Use in Determining Minimum Reserve Liabilities and Nonforfeiture Benefits Model Regulation* (Model #814), NAIC, 2003.
11. *Life Principle-Based Reserves Under VM-20 practice note*; Life Principle-Based Approach Practice Note Work Group; American Academy of Actuaries; February 2014.
12. Actuarial Guideline XXXVIII: *Application of the Valuation of Life Insurance Policies Model Regulation*, NAIC, 2012. (AG 38)
13. Actuarial Guideline XLVIII: *Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)*, NAIC, 2014. (original version of AG 48)
14. Actuarial Guideline XLVIII: *Actuarial Opinion and Memorandum Requirements for the Reinsurance of Policies Required to be Valued under Sections 6 and 7 of the NAIC Valuation of Life Insurance Policies Model Regulation (Model 830)*, NAIC, 2016. (AG 48)
15. Actuarial Standard of Practice No. 11: *Financial Statement Treatment of Reinsurance* (ASOP No. 11)

16. Actuarial Standard of Practice No. 40: *Compliance with the NAIC Valuation of Life Insurance Policies Model Regulation with Respect to Deficiency Reserve Mortality*, Actuarial Standards Board, 2011. (ASOP No. 40)
17. *Dodd-Frank Wall Street Reform and Consumer Protection Act*, HR 4173, Public Law 111-203, 12 US Code, Chapter 53, U.S. Congress, 2010. (Dodd-Frank Act)
18. *Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance*, 2017 (Covered Agreement)
19. *Transactions Involving Life or Health Insurance*, Actuarial Standards Board, 2011

This practice note represents a description of some of the practices the subgroup believes to be common among some U.S. actuaries; however, other approaches also may be used in practice. Further, there are variations in the implementation and interpretation of the NAIC model laws and regulations by jurisdiction. The commentary in this practice note is based on the model laws and regulations and does not cover all such variations.

This practice note is intended to encourage discussion on the issues set forth below, providing a framework to foster dialogue among the actuaries involved in the process.

Background

In 2005, the Life Valuation Subcommittee of the Academy developed the original *Reinsurance Reserve Credit in U.S. Statutory Financial Statements* practice note, which was intended as a description of the practices at the time that were used by actuaries in the United States regarding credit for reinsurance. The members of the subcommittee responsible for the original Practice Note were:

James Dallas, MAAA, FSA (Chairperson)
Frank Clapper, MAAA, FSA
Andrew Creighton, MAAA, FSA
Arnold Dicke, MAAA, FSA
Donna Jarvis, MAAA, FSA
James Lodermeier, MAAA, FSA
Lloyd Spencer, MAAA, FSA
Michael Taht, MAAA, FSA

After the passage of the Dodd-Frank Act in 2010, the Academy determined the practice note should be updated to reflect the subsequent changes to the law and federal and state regulations associated with the legislation.

The updated practice note reflects the Covered Agreement concluded between the European Union and the United States on Jan. 13, 2017, as well as changes to the Credit for Reinsurance Model Law and Regulation, including those regarding certified reinsurers, the adoption and implementation of AG 48 and the new Reserve Financing Model Regulation, changes to SSAP 61R, and aspects of the Valuation Manual that impact reinsurance. In addition, it covers topics discussed in previous versions of this practice note as well as evolving practice among actuaries.

Section A: General Issues Regarding Credit for Reinsurance

Q1. What regulations, laws, actuarial standards of practice (ASOPs), and other guidance regarding credit for reinsurance would the actuary normally take into account?

To promote uniformity in financial reporting and solvency supervision across the states, the NAIC establishes standards that states and their insurance departments are expected to meet and adopt in law and regulation in order to be certified as "accredited." At this writing, all states have been so certified. Model laws and regulations governing credit for reinsurance are included among the NAIC standards, as is statutory accounting guidance codified in the APPM, which is maintained and updated regularly by the NAIC.

In implementing accreditation standards, the NAIC may choose to permit some degree of variation by state, such that individual state laws and regulations may differ. But, most states have enacted their reinsurance requirements largely as drafted by the NAIC. The APPM is generally adopted as a whole, although some states may prescribe certain accounting deviations through law or regulation.

Among the more relevant NAIC accreditation standards for credit for life reinsurance are:

1. The APPM
    a. SSAP 61R
    b. Appendix A-785
    c. Appendix A-791
2. The Credit for Reinsurance Model Law (Model #785)
3. The Credit for Reinsurance Model Regulation (Model #786)
4. The Life and Health Reinsurance Agreements Model Regulation (Model #791)
5. The Standard Valuation Law (Model #820)
6. Regulation XXX; specifically, the sections addressing yearly renewable term (YRT) reinsurance (see Section B of this practice note for clarifying discussion)

ASOP No. 11 has been developed to provide guidance with respect to the actuary's professional work relating to financial statements that include material reinsurance transactions involving life insurance (including annuities) or health insurance risks. In March 2017, the ASB approved a proposal to revise ASOP No. 11 and to have the ASB Life Committee form an ASOP No. 11 Revision Task Force.

The revision to the Model Standard Valuation Law (SVL) adopted by the NAIC in 2009 introduces the concept of principle-based reserves (PBR), calculated subject to requirements set forth in a Valuation Manual, the requirements for which are specified in the SVL. The Valuation Manual has an operative date of Jan. 1, 2017. Reserves for new business written after this date may be principle-based; reserves for certain business written after Jan. 1, 2020, will be required to be principle-based. See Section F below for more details regarding credit for reinsurance for policies subject to principle-based reserving.

AG 48 became effective Jan. 1, 2015, and sets forth requirements for the reinsurance of level term and universal life with secondary guarantees under certain circumstances (primarily in

situations in which the reinsurance is ceded to insurer-owned captive reinsurers). See Section G below for more details regarding credit for reinsurance for policies subject to AG 48. As of the drafting of this practice note, the NAIC had adopted a revision of the Credit for Reinsurance Model Law and a new Reserve Financing Model Regulation that would replace AG 48 upon adoption by a state. AG 48 has also been updated, effective as of Jan. 1, 2017, to make it as substantially identical to the Reserve Financing Model Regulation as possible to ensure uniformity in treatment among states. Section G of this practice note will make note of the differences between AG 48 and the Reserve Financing Model Regulation.

Q2. What are the regulatory requirements that must be satisfied for a reinsurance agreement to provide credit for reinsurance?

A company is not prohibited from entering into a reinsurance agreement that does not satisfy all the requirements of the Risk Transfer Regulation and the APPM; however, if a company wishes to take statutory credit for reinsurance, then (i) the reinsurance agreement must qualify for reinsurance accounting treatment per the APPM, requiring satisfaction of the relevant risk transfer requirements in A-791 and (ii) additional security must be established for reinsurance arrangements with certain types of assuming insurers. Requirements for additional security, including the forms of acceptable security, are specified in the Credit for Reinsurance Model Law (Model #785) and Regulation (Model #786), as described Question 3 below. Both AG 48 and the Reserve Financing Model Regulation set forth additional requirements that will be discussed in Section G.

The APPM incorporates and references credit for reinsurance rules as Appendix A-785 (which includes relevant provisions from the Credit for Reinsurance Model Law) and Appendix A-791 (which includes relevant provisions from the Risk Transfer Regulation). Appendix A-791 also incorporates questions and answers clarifying its scope and application; these clarifications are substantive and the actuary may wish to review them. For example, the Q&A immediately following paragraph 2.a reflects the language of the Risk Transfer Regulation: "The primary purpose of the accounting requirements is to prohibit credit for reinsurance under financial arrangements where the ceding company enters into the agreement for the principal purpose of producing significant surplus aid for the ceding insurer on a temporary basis, while not transferring all of the significant risks inherent in the business being reinsured."

The Risk Transfer Regulation, Appendix A-791, and SSAP 61R specify risk transfer conditions that must be met to "reduce any liability or establish any asset in the financial statement" on account of reinsurance ceded. The SSAP specifies risk transfer conditions necessary for "reinsurance accounting treatment" as described in the SSAP, including establishing a reinsurance credit or asset, and further specifies that deposit accounting treatment is required if these conditions are not met.

YRT reinsurance and certain non-proportional agreements, such as agreements covering stop loss and catastrophic risks, are specifically addressed in SSAP 61R, Appendix A-791, and the Risk Transfer Regulation. They are defined and exempted from certain risk transfer conditions that would otherwise apply. The APPM also clarifies how and when reserves and credit for reinsurance for certain non-proportional agreements are to be calculated.

Policies subject to principle-based reserving are subject to additional requirements. VM-20, Section A.3, permits reinsurance cash flows and SSAP 61R credits to be taken into account if the

reinsurance agreement meets the requirements of the APPM for taking credit for reinsurance, but not otherwise. Furthermore, Section 8.A.4 provides, "If a reinsurance agreement or amendment does not qualify for credit for reinsurance, but treating the reinsurance agreement or amendment as if it did so qualify would result in a reduction to the company's surplus, then the company shall increase the minimum reserve by the absolute value of such reductions in surplus." Section F below provides more details about the impact of principle-based reserving on credit for reinsurance.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q3. What are the rules that govern the collateral that a reinsurer must provide for the ceding company to take credit for reinsurance?

Model #785 and Model #786 distinguish seven categories of assuming insurers, determined from the perspective of the ceding company's state of domicile:

1. An assuming insurer licensed to transact insurance or reinsurance in the state of domicile of the ceding company (Model #785 Section 2.A);
2. An assuming insurer accredited by the commissioner as a reinsurer in the state of domicile of the ceding company, together with additional conditions including minimum surplus (Model #785 Section 2.B);
3. An assuming insurer that is domiciled in (or entered through, in the case of a U.S. branch of a non-U.S. assuming insurer) a state that employs substantially similar standards for reinsurance, together with additional conditions including minimum surplus (Model #785 Section 2.C);
4. An assuming insurer that maintains a trust fund in a qualified U.S. financial institution for payment of claims together with additional conditions including minimum surplus (Model #785 Section 2.D);
5. An assuming insurer that is certified by the commissioner of the state of domicile of the ceding company, together with additional conditions, including domicile of the assuming insurer in a qualified jurisdiction, most often non-U.S., financial condition review, and minimum capital and surplus (Model #785 Section 2.E);
6. An assuming reinsurer not falling in categories 1 to 5, but only as to the insurance of risks in jurisdictions where the reinsurance is required by law or regulation (Model #785 Section 2.F); and
7. An assuming insurer not meeting one of the conditions above, deemed an unauthorized reinsurer (Model #785 Section 3).

Under the provisions of Model #785 and Model #786, if the conditions required for reinsurance accounting treatment as described in A-791 are met:

- reinsurance ceded to assuming insurers in categories 1-4 and 6 receives credit without the requirement for the reinsurer to provide additional security;
- reinsurance ceded to a certified reinsurer, category 5, is eligible for full credit if the certified reinsurer provides collateral equal to a percentage of the credit for reinsurance determined by the reinsurer's assignment to one of several security tiers (currently zero percent, 10 percent, 20 percent, 50 percent, 75 percent, or 100 percent); placement may be no more favorable than that determined by the reinsurer's lowest financial strength

rating and can be moved to a less favorable, that is, more conservative, tier at the discretion of the commissioner (Section D below provides additional information on this matter); and

- reinsurance ceded to an unauthorized reinsurer, as described in category 7, receives full credit only if the reinsurer provides collateral equal to 100 percent of the reserve credit.

Model #786, Section 10A, specifies that collateral, when required, must be "in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the exclusive benefit of the ceding insurer under a reinsurance contract with such assuming insurer as security for the payment of obligations under the reinsurance contract."

Conditions that must be met by the trust agreement are specified in the law and regulation, as are eligible forms of security:

1. Cash;
2. Securities listed by the SVO and qualifying as admitted assets;
3. Clean, irrevocable, unconditional letters of credit issued or confirmed by a U.S. financial institution that met the standards for qualification as of the date of issue of the letter of credit; or
4. Any other form of security acceptable to the commissioner.

AG 48, as well as the 2016 revision of the Credit for Reinsurance Model Law and the Reserve Financing Model Regulation, referring to the reinsurance of term and universal life with secondary guarantees, has more restrictive requirements for the assets in the trust, as discussed in the response to Question 1 above and in Section G below. In response to the Covered Agreement (see Section E) adopted by the U.S. and the European Union, the NAIC is expected to make significant changes to collateral requirements in model regulations.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q4. Is a company required to have a signed reinsurance agreement in place to take statutory credit for reinsurance?

Section 5A of the Risk Transfer Regulation states, "No agreement or amendment to any agreement may be used to reduce any liability or establish any asset … unless the agreement, amendment, or a binding letter of intent has been duly executed by both parties no later than the 'as of' date of the financial statement" in which the credit for reinsurance is reported. Furthermore, according to Section 5B of the regulation, the reinsurance agreement or amendment must be executed within a reasonable period of time after the signing of the letter of intent, not exceeding 90 days. Should the 90-day period end without a reinsurance agreement being executed, the letter of intent may not be used as the basis for reporting reinsurance credit in any statutory financial statement.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q5. How is credit for reinsurance determined for non-proportional reinsurance, such as an aggregate cap on benefit payments?

SSAP 61R includes requirements for determining credit for reinsurance for non-proportional reinsurance. It states that "to reflect reserve credit on a prospective basis, the entity will need to demonstrate that the present value of expected recoveries, using realistic assumptions, to be realized from the reinsurer are in excess of the present value of reinsurance premiums guaranteed to be paid by the ceding entity under the terms of the contract."

Some actuaries believe this can only be measured accurately by modeling the impact of the reinsurance over a broad range of scenarios. The modeling usually directly recognizes the impact of any non-proportional features of the reinsurance program, such as aggregate claim caps and/or deductibles. Other actuaries believe that the existence of non-proportional features, such as a cap on benefit payments, could jeopardize the ability to take even partial credit for a reinsurance agreement.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q6. What are the accounting requirements for the reinsurance of inforce business?

The treatment of gains and losses arising from indemnity reinsurance agreements relating to inforce business is addressed in SSAP 61R and in Appendix A-791.

Gains and losses are accounted for differently, and the parties to a treaty may reflect different financial effects in their respective annual statements resulting from the same reinsurance transaction. Gains related to reinsurance of inforce blocks of business that occur in the initial calendar year are to be accounted for in accordance with Appendix A-791, paragraph 3 of the APPM, which states that "any increase in surplus net of federal income tax resulting from reinsurance agreements entered into or amended after the effective date of the Codification which involve the reinsurance of business issued prior to the effective date of the agreements shall be identified separately on the insurer's financial statement as a surplus item and recognition of the surplus increase as income shall be reflected on a net of tax basis as earnings emerge from the business reinsured."

To effect this requirement, some actuaries do not adjust reserves, but book all line items (including federal income tax) in the summary of operations as would be the case without the requirement, except commissions (ceded), which are adjusted by the after-tax impact of the transaction in order to zero out the net gain after tax and move it to line 51.4 within the Capital and Surplus account section of the summary of operations (line reference is based on 2014 Annual Statement blank). Other actuaries may use different line item adjustments that result in the same adjustment to the net gain after tax. Some actuaries believe that the accounting treatment for gains resulting from inforce reinsurance transactions, as set forth in paragraph 3 of Appendix A-791, does not apply to YRT reinsurance.

According to SSAP 61R, if all or a portion of an assumed inforce block of business is "contemporaneously" retroceded, any resulting net gain (net of retrocession) recognized by the reinsurer is accounted for in the same way as a gain resulting from an inforce reinsurance agreement (i.e., "below-the-line"). Any net loss is immediately recognized in the company's

earnings (i.e., "above-the-line").

If the reinsurance is recaptured, all income and surplus effects of the reinsurance arrangement are reversed for the reporting period in which recapture is effective.

SSAP 61R requires that interest-related gains or losses (net of federal income tax) associated with the reinsurance of an inforce block of business be credited or charged to the interest maintenance reserve (IMR) in accordance with the IMR instructions included in the NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies and amortized into income in future accounting periods.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q7. Is it permissible under statutory accounting to reflect credit for reinsurance on a policy that exceeds the reserve that would be set up for the reinsured portion of the policy if there were no reinsurance?

ASOP No. 11, Section 3.3 states, "The actuary should calculate adjustments for reinsurance ceded financial statement items using assumptions that are consistent with those underlying the calculation of the direct items, except as otherwise indicated by the terms and conditions of the reinsurance agreement, even though the values of the direct financial statement values (before reinsurance) and adjustments for reinsurance ceded are generally determined separately."

Terms and conditions that may vary between direct and ceded business include premium mode, policy fee, and modal loadings. These differences can result in a calculated reserve credit on ceded reinsurance that exceeds the before-reinsurance reserve amount. Practice varies regarding the maximum reserve credit that may be established in the financial statements. Some actuaries believe that it is appropriate to fully reflect these differences in establishing the reserve credit on ceded reinsurance, while other actuaries believe it is not appropriate to establish a reserve credit on ceded reinsurance that exceeds the before-reinsurance reserve amount under any conditions. Finally, some actuaries believe that any excess of the reserve credit over the before-reinsurance reserve on the reinsured portion that is not received by the ceding company upon termination of the reinsurance should not be recognized. These actuaries believe that, otherwise, the reinsurance agreement would be out of compliance with Accounting Requirement 2b of Appendix A-791 of the APPM, as the occurrence of an event such as death, lapse, or surrender would deprive the ceding company of surplus.

Furthermore, regarding reinsurance ceded to a company not meeting the requirements of Section 2 of the Credit for Reinsurance Model Law (reinsurers that are not licensed, accredited, or certified in the state), ceding companies are permitted to take credit for reinsurance in the normal fashion but must establish an offsetting liability equal to the excess of the ceded reserve over the amount of satisfactory security.

Section 8.D.1 of the Valuation Manual states that "credit for reinsurance ceded shall be the excess, if any, of the pre-reinsurance-ceded minimum reserve over the post-reinsurance-ceded minimum reserve." This requirement, however, is an aggregate requirement that applies to all policies subject to principle-based valuation and does not apply on a policy-by-policy basis. See Section F below.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q8. Is it permissible under statutory accounting to reflect credit for reinsurance for just a specific benefit in a policy, such as for the no-lapse guarantee provided in a universal life policy or a guaranteed living or death benefit provided in a variable annuity contract?

Accounting requirement 2f of Appendix A-791 of the APPM states that all significant risk inherent in the business being reinsured must be transferred as one of the conditions to reflect credit for reinsurance. Some actuaries believe that reinsurance credit is therefore not permitted when a secondary benefit or guarantee is ceded by itself. Some actuaries believe that reinsurance credit should be permitted if reserves can be calculated separately for the secondary benefit. Other actuaries believe that it is not enough for just the reserves to be calculated separately, but that the actuary must be able to identify the premium and the portion of renewal expenses that pertain to the secondary benefit or guarantee. These actuaries believe this is necessary in order to be able to determine that all the accounting requirements are satisfied. Both AG 48 and the Reserve Financing Model Regulation include provisions regarding the allowance of reserve credit if only the secondary guarantee risk is reinsured (see Question 27).

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Section B: Credit for Reinsurance Issues Relating to the Valuation of Life Insurance Policies Model Regulation ("Regulation XXX")

Q9. What credit for reinsurance issues are there related to YRT reinsurance; e.g., what limitations on credit for reinsurance taken by a ceding company apply when the reinsurer elects the optional exemption for YRT reinsurance under Regulation XXX?

[Note: For valuations of term policies and policies assumed under YRT reinsurance agreements, as well as many universal life insurance policies with secondary guarantees, issued on or after January 1, 2017, a company may choose to apply Section VM-20 of the Valuation Manual instead of Regulation XXX; for all policies issued on or after January 1, 2020, application of VM-20 is mandatory. See Section F below.]

As noted in the response to Question 1 above, YRT reinsurance is exempted from the Risk Transfer Regulation. Note, however, that Appendix A-791 states that a treaty labeled as YRT will not qualify for this exemption "if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer."

Generally, a ceding company calculates the statutory credit for YRT reinsurance as the unearned statutory net premium based on the mode of the reinsurance premium.

Two specific issues related to YRT credit for reinsurance arise from the optional exemption for YRT reinsurance in the section 6.E of Regulation XXX. First, if the assuming reinsurer elects the simplified reserve calculation allowed under the optional exemption, then the ceding company's credit for reinsurance is limited to the reserve held by the assuming company for the affected policies (see section 6.E.6 of Regulation XXX). Regulation XXX does not provide further guidance on this issue. While assuming companies often elect the optional exemption, at this time there does not appear to be consistent practice regarding communication between ceding and assuming companies concerning the optional exemption. Second, if the 2001 CSO valuation basis has been elected for policies for which the optional exemption is also elected, the *Recognition of the 2001 CSO [Commissioners Standard Ordinary Task Force] Mortality Table for Use in Determining Minimum Reserve Liabilities and Nonforfeiture Benefits Model Regulation* (Model #814) applies and modifies several provisions of Regulation XXX, including requiring the use of the *ultimate* mortality rates in the 2001 CSO Mortality Table for the calculations specified in section 6.E.

Regulation XXX does not apply to policies valued under Section VM-20 of the Valuation Manual.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q10. Would the ceding company actuary usually take into account any analysis done in conjunction with setting X factors on a gross basis for Regulation XXX business when establishing credit for reinsurance?

Some actuaries believe that it is usually preferable for the actuary to take into account any X

factor analysis performed. ASOP No. 40, Section 3.4, states that "anticipated mortality should be assessed and X factor classes should be created on a gross basis." It also states that "the anticipated mortality on ceded business should not be materially different from the anticipated mortality of the X factor class from which the business is ceded. If the difference is material, the appointed actuary should consider creating separate X factor classes." Some actuaries, therefore, believe if anticipated mortality is the same for gross and ceded business and the same X factors are used for both, it is normally preferable for any X factor analysis and any resulting changes in X factors to be applied to both gross and ceded business. Alternatively, some actuaries determine that gross and ceded anticipated mortality are significantly different and create separate X factor classes, in which case such actuaries usually apply subsequent X factor analysis and changes to X factors separately to gross and ceded X factor classes.

Section C: Credit for Reinsurance Issues Related to Asset Adequacy Analysis

Note: The draft *Asset Adequacy Analysis* practice note[1] includes additional information regarding this topic.

Q11. How is credit for reinsurance treated in asset adequacy analysis?

Credit for reinsurance is an accounting matter and, as such, is not specifically mentioned in the Actuarial Opinion and Memorandum Regulation (AOMR), applicable to valuations with a year-ending date prior to Jan. 1, 2017, or Section VM-30**,** *Actuarial Opinion and Memorandum Requirements*, of the Valuation Manual, applicable to valuations with a year-ending date on or after Jan. 1 2017. However, Section 13.a.vi of VM-30 does specify that the appointed actuary must provide a regulatory asset adequacy issues summary that includes a description of "the methods used by the actuary to recognize the impact of reinsurance on the company's cash flows, including both assets and liabilities, under each of the scenarios tested." ASOP No. 11, Section 3.2 states: "When preparing, reviewing, or analyzing financial statement items that reflect reinsurance ceded or reinsurance assumed, the actuary should consider potential cash flows that may, in the actuary's professional judgment, have a material impact under the reinsurance agreement." According to the 2014 draft of the *Asset Adequacy Analysis* practice note, in a 2012 survey of appointed actuaries, 64 percent of the respondents indicated they model reinsurance in a way meant to approximate treaty terms.

Under current practice, either the cash flows are modeled in an integrated fashion (i.e., using a model that aggregates direct and reinsurance cash flows) or, especially if it is not feasible to model the direct business and the reinsurance ceded in the same model, the cash flows may be modeled separately, using consistent assumptions.

Reinsurance cash flows are not affected by the accounting status of the reinsurance agreement (i.e., whether the agreement satisfies risk transfer requirements), so many of the considerations that affect statutory accounting do not affect the asset adequacy analysis. However, according to VM-30 (applicable to valuations with year-ending dates on or after Jan. 1, 2017), Section 3.A.1.e, the appointed actuary's statement of opinion must include an opinion section expressing the appointed actuary's opinion with respect to the adequacy of the supporting assets to mature the liabilities. If the actuary elects to use the prescribed wording, the appointed actuary's opinion must include the statement that the reserves and related actuarial items "Meet the requirements of the insurance laws and regulations of the state of [state of domicile]." Thus, at least if prescribed wording is used, the appointed actuary is opining that the credit for reinsurance taken in the domiciliary state results in reserves that meet that state's requirements. With respect to reinsurance agreements that do not satisfy risk transfer requirements and are thus subject to deposit accounting, some actuaries may question whether the accounting entries reflecting such agreements are "related actuarial items." Others may believe that because including both the asset and liability impacts of such agreements would be equivalent to including the cash flows under the agreement, treating the related accounting entries as "related actuarial items" would seem to be justified and would tend to capture any interest sensitivity inherent in the cash flows. However, some states may not permit the reflection of any cash flows from reinsurance

[1] *Asset Adequacy Analysis* practice note exposure draft; Asset Adequacy Analysis Committee; American Academy of Actuaries; August 2014.

agreements that do not qualify for credit for reinsurance if such cash flows increase surplus.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q12. A company has a reinsurance agreement in place and it anticipates recapturing the agreement within the next five years. Would it be preferable for the asset adequacy analysis to assume that recapture occurs, or to assume that the agreement remains in place?

Asset adequacy analysis generally reflects management's actual strategy, but some actuaries believe it is not necessary for asset adequacy analysis to assume that management will exercise a voluntary option. In a stochastic projection, some actuaries believe it is preferable for the treatment of the potential recapture to be consistent across all scenarios. This means that the actuary may set assumptions as to when and how recapture will occur, if at all. The assumptions may vary according to conditions, but normally would not vary arbitrarily between scenarios, based on results.

Some actuaries believe it is preferable for the actuary not to assume that recapture will occur unless the reinsurance agreement specifies that a unilateral right of recapture exists and can be exercised under the conditions present at the time. These actuaries believe it is preferable for an actuary to assume that, if the reinsurance agreement requires the reinsurer's consent to a recapture, it will be withheld if the recapture is advantageous to the ceding company. If the reinsurance agreement specifies that recapture *must* occur under a given set of conditions even though no credit for reinsurance may be allowed under the reinsurance regulations, some actuaries believe it is preferable for asset adequacy analysis to reflect such recapture under scenarios that meet the given set of conditions. If the reinsurance agreement does not *require* recapture, then some actuaries believe it is not *necessary* for an actuary to assume that recapture will occur, even if that is management's intent, because management still has the right to change its mind. Some actuaries perform a sensitivity test to assess the impact of making the assumption opposite to that assumed in the analysis. Some states may not allow the company to reflect recapture in its asset adequacy analysis if exercise of that provision is subject to regulatory approval.

Q13. How does the appointed actuary take into account reinsurer counterparty risk?

ASOP No. 7, Section 3.8 states the following: "The actuary should consider whether reinsurance receivables will be collectible when due, and any terms, conditions, or other aspects that may be reasonably expected to have a material impact on the cash flow analysis."

It is often difficult to quantify the impact of a financially weak reinsurer. Current practice includes performing a sensitivity test that calculates the ceding company's exposure to this reinsurer as the amount of financial loss which is likely to occur if the reinsurer cannot pay *any* claims over an extended period of time. An emerging refinement of this practice is sometimes used: The reinsurer's financial condition is expected to vary according to economic conditions, to determine the scenarios that are expected to be most harmful and what the ceding company's exposure would be in those scenarios. In such situations, some actuaries take account of countermeasures available to mitigate this risk. For example, if suitable replacement reinsurance

is readily available, these actuaries may reflect only any increased cost of the replacement coverage plus any losses sustained from uncollectable balances during the interim before replacement coverage becomes effective.

Some actuaries believe that the counterparty risk should be modeled for all reinsurers. For example, these actuaries would assign a probability of default to all reinsurers rated below a certain credit rating. These actuaries reflect the counterparty risk by applying the default probability to the present value of cash flows projected to be received from the counterparty. One method used by some actuaries to determine the probability of default is to refer to the probability of default of a bond with the same rating as the reinsurer. Reinsurers rated above the threshold would either have no additional loss in the scenario being analyzed, or at most a very small one.

Section D: Credit for Reinsurance Issues Related to Certified Reinsurers

Q14. A company has a reinsurance agreement with a reinsurer domiciled outside the United States that is now listed as a certified reinsurer in the company's state of domicile. Before being designated as a certified reinsurer, the reinsurer held an irrevocable letter of credit equal to 100 percent of the credit for reinsurance that the company was taking. What amount of security must the reinsurer now hold for the company to take full reserve credit on this agreement?

Certified reinsurers are defined in Section 8 of the Credit for Reinsurance Model Regulation. Credit for reinsurance from a certified reinsurer only applies to reinsurance agreements entered into or renewed on or after the effective date of the certification of the reinsurer. Unless the reinsurance treaty is amended prior to the date of the financial statement, the reinsurer will be required to provide 100 percent security in order for an insurer to avoid losing credit for reinsurance. This security may still be provided via an irrevocable letter of credit. Amended reinsurance contracts may use the lower security requirements only for business losses incurred or policies written after the reinsurer is certified. The answer to Question 15 below provides further information relevant to this matter. Note that although the certified reinsurer could qualify for zero percent security on a new or amended reinsurance agreement, an insurer may request in its reinsurance agreement that the reinsurer hold a higher percentage.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Q15. What happens to a company's credit for reinsurance when a certified reinsurer has a change in rating?

According to Section 8.B(8) of the Credit for Reinsurance Model Regulation, when a certified reinsurer improves its rating, the lower security requirements apply only to agreements entered into subsequent to the change in rating. If a certified reinsurer's rating declines, all existing business is subject to the increased security requirements. If the certified reinsurer does not post additional security, the commissioner may suspend or revoke the reinsurer's certification. Upon revocation, the commissioner may require the reinsurer to post security in order for the ceding company to take credit for the reinsurance ceded to the reinsurer. Notwithstanding a downgrade or revocation of the certification of the reinsurer, the ceding company can claim full credit for reinsurance for a period of three months from the downgrade in rating, unless the reinsurance is found be the commissioner to be at a high risk of uncollectability. After the three-month period, the ceding company is no longer able to take credit for the portion of the reserves that is unsecured.

Individual states may have adopted variations in the model laws and regulations governing credit for reinsurance. Such variations are not covered in this practice note.

Section E: Credit for Reinsurance Issues Related to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

Q16. My state of domicile has recognized credit for reinsurance for certain risks my company has ceded under a reinsurance agreement. Can another state disallow credit for reinsurance for these risks?

Section 531(a) of the Dodd-Frank Act (15 USC § 8221(a)) states "If the State of domicile of a ceding insurer is an NAIC-accredited State, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then no other State may deny such credit for reinsurance."

Q17. What is a "covered agreement" under the Dodd-Frank Act and what effect could such agreement have on credit for reinsurance?

The Dodd-Frank Act authorizes the secretary of the Treasury and the U.S. trade representative, jointly, to negotiate and enter into covered agreements on behalf of the United States. The term "covered agreement" is defined in Section 313(r)(2) as "a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that—(A) is entered into between the United States and one or more foreign governments, authorities, or regulatory entities; and (B) relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation." The law requires the secretary and U.S. trade representative to consult with Congress before initiating such negotiations, during the negotiations, and before entering into the agreement, and enumerates issues to be addressed in such consultation. Section 502 of the Dodd-Frank Act provides that the covered agreement must be submitted to certain congressional committees and becomes effective 90 days thereafter.

Section 502 further establishes a Federal Insurance Office (FIO) within the U.S. Treasury Department, led by a director appointed by the secretary. Subject to procedures, conditions, and limitations on discretion specified in Section 502(f) of the Act, the FIO director may make a determination whether state insurance measures are preempted by such a covered agreement. Federal administrative procedures, potentially up to judicial review, will apply to such a determination by the FIO director.

A covered agreement could pre-empt state insurance laws and regulations, including those that impact credit for reinsurance. If a covered agreement is adopted, the amount of credit for reinsurance permitted for reinsurance agreements subject to the covered agreement could be changed.

Q18. On Jan. 13, 2017, the Treasury announced the successful completion of a covered agreement with the European Union (the "Covered Agreement") and on September 22, 2017, the Covered Agreement was signed by both parties. Which provisions of the Covered Agreement would have an impact on U.S.-based reinsurers and cedents?

The Covered Agreement imposes conditions on each of the parties in the areas of reinsurance

and group supervision (i.e., the regulatory supervision of groups of economic entities at least one of which is engage in insurance or reinsurance). The Covered Agreement defines "Home Party" as the party in whose territory the worldwide parent of the insurance or reinsurance group has its head office or is domiciled and the "Host Party" as the party in whose territory the insurance or reinsurance group has operations, but is not the territory where the worldwide parent is domiciled or has its head office.

Under the terms of Article 3 of the Covered Agreement, once the provisions of the Covered Agreement are fully in force, the following restrictions on supervision by any Host Party supervisory authority apply to any Home Party reinsurer that accepts cessions from a Host Party ceding insurer, provided that it meets the conditions listed below:

- A Party may not impose a collateral requirement or reporting equivalent as a condition to allow a Home Party assuming reinsurer to enter into a reinsurance agreement with a Host Party ceding company (Article 3, paragraph 1), nor may the Host Party impose a collateral requirement or reporting equivalent as a condition to allow the Host Party ceding insurer to take credit for the reinsurance associated with the cessions under a reinsurance agreement concluded with a Home Party assuming reinsurer (Article 3, paragraph 2), if such requirement results in less favorable treatment of the Home Party assuming reinsurer than would apply to Host Party assuming reinsurers (e.g., EU reinsurers will not be required to establish collateral requirements for U.S. cedents that are more stringent than collateral requirements applied to U.S. reinsurers, and vice versa).
- Article 3, paragraphs 1 and 2 also provide that there can be no new requirement with substantially the same regulatory impact on the Home Party assuming reinsurer as the banned collateral requirements if such requirement results in less favorable treatment of Home Party assuming reinsurers than on Host Party assuming reinsurers (e.g., state regulations may not require additional risk-based capital be held by a U.S. cedent that reinsures business with an EU-domiciled reinsurer than would be required if the reinsurance were with a U.S.-domiciled reinsurer).
- There can be no requirement for the Home Party assuming reinsurer to have a local presence to enter into a reinsurance agreement with a Host Party ceding reinsurer nor for a Host Party ceding reinsurer to take credit for the reinsurance (Article 3, paragraph 3).

Article 3, paragraph 4 specifies the conditions that must be met by the Home Party assuming reinsurer (slightly different conditions apply to associations) in order for the restrictions in Article 3, paragraphs 1 to 3, to apply:

- Capital and surplus of the reinsurer must be at least 226 million euro for EU-based reinsurers or $250 million for U.S.-based reinsurers (Article 3, paragraph 4, subparagraph (a)).
- EU-based reinsurers must maintain a solvency ratio of at least 100 percent SCR under Solvency II and U.S.-based reinsurers must maintain a solvency ratio of at least 300 percent of the authorized control level (ACL) in the territory in which the assuming reinsurer has its head office or is domiciled (Article 3, paragraph 4, subparagraph (b)).
- The Home Party supervisory authority confirms to the Host Party supervisory authority on an annual basis that the reinsurer complies with the solvency ratio requirement (Article 3, paragraph 4, subparagraph (l)).
- If its capital and surplus or the solvency ratio falls below the specified minimum levels or if regulatory action is taken against it for serious noncompliance with applicable law, the

assuming reinsurer must provide the supervisory authority in the territory of the ceding company with prompt notice of this fact (Article 3, paragraph 4, subparagraph (c)).

- Reinsurer must confirm that it consents to the jurisdiction of courts in the territory of the ceding company, but the parties may agree to use other means of dispute resolution (Article 3, paragraph 4, subparagraph (d)).
- Reinsurer must confirm it agrees to the appointment of the Host supervisory authority as its agent for service of process (Article 3, paragraph 4, subparagraph (e)).
- Reinsurer must confirm it will pay all final judgments or provide 100 percent collateral for any final judgments it resists (Article 3, paragraph 4, subparagraphs (f) and (g)).
- If requested, reinsurer must provide audited financial statements and actuarial opinions or solvency and financial condition reports, to Host supervisory authority for the two years prior to the transaction and annually thereafter, as well as information on disputed or overdue reinsurance claims and reinsurance ceded and assumed by assuming and ceding company, respectively, prior to entry into the agreement and no more than semi-annually thereafter (Article 3, paragraph 4, subparagraph (h)).
- Reinsurer must "maintain a practice of prompt payment of claims," as defined in the Article 3, paragraph 4, subparagraph (i).
- Reinsurer cannot be involved in "any solvent scheme of arrangement" (a form of "winding-up" of a block of business) that involves Host Party ceding insurers, and, if it is, it must notify the ceding company and its supervisory authority and post 100 percent collateral for the benefit of the ceding insurer (Article 3, paragraph 4, subparagraph (j)).
- If the reinsurer is in resolution, receivership or in the process of "winding up," the ceding company may obtain an order requiring reinsurer to post collateral for all outstanding ceded liabilities (Article 3, paragraph 4, subparagraph (k)).

Additional relevant provisions of the Covered Agreement include the following:

- An insurance or reinsurance group is subject to worldwide prudential supervision only by its Home supervisory authority (Article 4, subparagraph (a). (The Covered Agreement provides a good deal of detail regarding this matter—see Article 4, subparagraphs (b) through (i) and the concluding paragraph of that Article.)
- A Host supervisory authority may nevertheless exercise group supervision with respect to a group at the level of the parent entity in its territory (Article 4, subparagraph (b)).
- Nothing in the Covered Agreement prohibits parties to a reinsurance agreement agreeing to require the posting of collateral (Article 3, paragraph 7).
- In each year after the date of entry into force or provisional adoption of the Covered Agreement, the United States must encourage states to reduce the pre-existing collateral requirements by 20 percent of the amount required prior to Jan. 1, 2017 (Article 9, paragraph 3). Provided the Covered Agreement has entered into force, on a date no later than the first day of the month 42 months after the date of signature (Jan. 13, 2017), the United States shall begin the process leading to a pre-emption determination of state laws (with states prioritized by the highest volume of gross ceded reinsurance), which process must be completed by the first day of the month 60 months after the date of signature (Article 9, paragraph 4).
- The Covered Agreement may be terminated with 180 days' written notice under normal circumstances (Article 11, paragraph 1). Accelerated mandatory consultation and termination provisions apply if the financial stability of the EU or the United States is threatened (Article 10, paragraph 2, subparagraph (d)).

The Covered Agreement does not provide for "equivalence to Solvency II" (a specific provision of EU insurance regulation) for the U.S. solvency system, but exempts U.S. companies from the requirements of Solvency II as long as the Covered Agreement remains in force.

The Covered Agreement does not address equivalence of reserve standards.

Section F: Credit for Reinsurance Issues Related to Principle-Based Reserving

Note: The *Life Principle-Based Reserves Under VM-20* practice note includes additional information regarding this topic. New editions of the Valuation Manual may be issued for each calendar year. In this section, references to the Valuation Manual are to the 2018 edition.

Q19. Under what circumstances is a reinsurance agreement or amendment included in the calculation of PBR?

PBR is required for certain policies under the revised SVL. The methods to be used in calculating all life insurance, annuity, and health reserves are set forth in a Valuation Manual authorized under that law. The Valuation Manual can be revised as deemed necessary by the NAIC, following the procedures set out in the law; any changes in the Valuation Manual go into effect in all jurisdictions that have adopted the revised law simultaneously, unless a jurisdiction takes specific action. The operative date for the Valuation Manual was Jan. 1, 2017. For policies that are subject to AG 38 and AG 48, PBR calculations may be required for policies issued prior to the effective date of the Valuation Manual. Section G below covers credit for reinsurance issues related to AG 48.

Section 8 of VM-20 sets forth the procedures for reflecting reinsurance in principle-based reserves for life insurance products. Section 8.A.3 states that a company shall include the effect of a reinsurance agreement or amendment in calculating the minimum reserve if, under the terms of the APPM, the agreement or amendment qualifies for credit for reinsurance.

Q20. If a reinsurance agreement or amendment does not qualify for credit for reinsurance under the terms of the APPM, how is the minimum reserve under VM-20 affected?

According to section 8.A.4 of VM-20, "If a reinsurance agreement or amendment does not qualify for credit for reinsurance, but treating it as if it did so qualify would result in a reduction to the company's surplus, then the company shall increase the minimum reserve by the absolute value of such reduction in surplus." For agreements and amendments that do not qualify for credit for reinsurance, any reduction in the reserve is to be ignored, but any increase in the reserve must be reflected.

Q21. How is credit for reinsurance defined for life insurance policies subject to principle-based reserving?

Section 8.B of VM-20 defines credit for reinsurance to be the excess, if any, of the pre-reinsurance-ceded minimum reserve over the post-reinsurance-ceded minimum reserve. VM-20 sets forth the process for calculating the "minimum reserve," which is a post-reinsurance reserve. Calculating the minimum reserve for a group of policies requires the calculation of a net premium reserve ("NPR"), as well as, in some circumstances, a deterministic reserve ("DR") and a stochastic reserve ("SR ") for that group of policies. The NPR for a group of policies is the sum of the individual policy NPRs (as defined in Section 3 of VM-20), which are net of the SSAP 61R credits for the policies. The DR and SR are modeled reserves defined in Sections 4 and 5 of VM-20, respectively. Section 2 of VM-20 defines minimum reserves for three product groups,

further subdivided based on the two exclusion tests, the stochastic exclusion test ("SET") and the deterministic exclusion test ("DET"), defined in Section 6 of VM-20. The resulting seven "Section 2 sub-groups" and their minimum reserves are:

1.a. Term policies that passed the SET: minimum reserve equals the greater of the NPR and the DR plus any due and deferred premium asset ("DDPA") for those policies;

1.b. Term policies that did not pass the SET: minimum reserve equals the greatest of the NPR, the DR plus DDPA, and the SR plus DDPA for those policies;

2.a. ULSG policies that passed the SET: minimum reserve equals the greater of the NPR and the DR plus DDPA for those policies;

2.b. ULSG policies that did not pass the SET: minimum reserve equals the greatest of the NPR, the DR plus DDPA, and SR plus DDPA for those policies;

3.a. "All Other" policies that passed both the SET and the DET: minimum reserve equals NPR for those policies;

3.b. "All Other" policies that passed the SET but did not pass the DET: minimum reserve equals the greater of the NPR and the DR plus DDPA for those policies; and

3.c. "All Other" policies that did not pass the SET (or the DET): minimum reserve equals the greatest of the NPR, the DR plus DDPA, and SR plus DDPA for those policies.

The Valuation Manual defines ULSG policies as universal life policies meeting certain specified conditions, such as having a secondary guarantee in excess of five years. Any universal life policy that is not a ULSG policy is part of the "All Other" product group. On the other hand, variable universal life policies are ULSG policies if the specified conditions are met.

For the minimum reserve, each of the three reserve components (i.e., the SR, the DR, and the NPR), as well as the DDPA, is calculated on a post-reinsurance basis. Section 8.D of VM-20 requires that the pre-reinsurance minimum reserve be calculated on a pre-reinsurance basis (see Question 22 below) and that the SET and DET be applied for the pre- and post-reinsurance-ceded reserves separately.

Within each of the seven Section 2 sub-groups, the (post-reinsurance) minimum reserve is allocated to individual policies based on post-reinsurance policy NPRs (i.e., on the net premium reserve for an individual policy less that policy's reserve credit under SSAP 61R). Section 8.D, which describes how the (aggregate) pre-reinsurance-ceded minimum reserve is determined, does not clearly state a method for allocating this reserve to individual policies or to groups of policies. If Section 8.D.2 is read as implying that Section 2.C allocation rules apply to the pre-reinsurance-ceded minimum reserve, the allocation of the pre-reinsurance-ceded minimum reserve would be based on the <u>pre</u>-reinsurance-ceded net premium reserve. Unfortunately, using this allocation procedure for the pre-reinsurance-ceded reserve can lead to certain anomalous results, such as the pre-reinsurance-ceded minimum reserve for a block of business not involved in the resinsurance turning out to be lower than the post-reinsurance-ceded reserve. A drafting note in earlier drafts of the Valuation Manual indicated that "the allocation of the reinsurance credit to each reinsurance agreement should be reevaluated," but no change

was made in the 2017 and 2018 editions of the Valuation Manual. Some actuaries believe that an allocation of the aggregate credit for reinsurance based on the SSAP 61R reinsurance credits for each reinsured policy would be an appropriate and practical allocation method that would reduce the anomalies associated with applying Section 2.C rules to the pre-reinsurance-ceded minimum reserve. Other allocation methods have also been proposed by actuaries familiar with the issue. The NAIC Life Actuarial Task Force had not taken a position on this issue as of the date of this practice note.

Because the exclusion tests are applied separately pre- and post-reinsurance-ceded, the pre- and post-reinsurance-ceded minimum reserves for a Section 2 sub-group could consist of different policies, and which component (stochastic, deterministic, net premium) is largest for each Section 2 sub-group could be different pre- and post-reinsurance. Minimum reserves for specific group of policies, such as the product groupings that must be reported on the VM-20 Reserve Supplement, are the sums of the allocated minimum reserves for the policies in the group. Thus, the allocated pre- and post-reinsurance minimum reserves for such a group may be calculated on very different bases. Due to all these considerations, the reserve credit for a group of policies (the difference between the sum of the allocated minimum reserve on a pre- and post-reinsurance basis) may be very different from the reserve credit that would be obtained by doing the VM-20 calculations for the group on a stand-alone basis.

Q22. How is the pre-reinsurance-ceded minimum reserve calculated under VM-20?

Section 8.D.2 of VM-20 states that, if a pre-reinsurance-ceded minimum reserve is required for financial statement purposes, it shall be calculated using methods and assumptions consistent with those used to calculate the post-reinsurance-ceded minimum reserve, ignoring the effect of reinsurance ceded. Thus, the net premium reserve and, if required after performing the exclusion tests on a pre-reinsurance-ceded basis, the deterministic reserve and the stochastic reserve (as well as the DDPA) must be recalculated, ignoring the impact of reinsurance.

The pre-reinsurance net premium reserve for a group of policies is that reserve without deduction of the credit to the NPR to reflect reinsurance (the sum of the SSAP 61R credits for the policies in the group).

To calculate the DR and SR on a pre-reinsurance-ceded basis, Section 8 of the Valuation Manual requires the company to use assumptions that represent company experience in the absence of reinsurance—for example, assuming that the business was managed in a manner consistent with the manner that retained business was managed. (Assumptions may take account of specific differences in the retained and ceded business, such as different policy sizes.) In particular, the company must develop a hypothetical portfolio of starting assets and a corresponding model investment strategy. Section 8.D provides that the collar that applies to starting assets used in calculating the modeled reserves does apply when calculating the pre-reinsurance-ceded reserves.

ASOP No. 52, Section 3.5.2 states: "Possible methods for constructing the hypothetical portfolio include the following:

a. basing the portfolio on assets available at the time the cash flows were ceded;
b. assuming the portfolio consists of assets consistent with those backing the portion of the business retained for policies of the same kind; and
c. assuming the portfolio consists of a pro-rata slice of the assets of the reinsurer that back

the reserve for the segment of its business that includes the ceded policies."

In developing a model investment strategy, in view of the Section 8.D requirement that "assumptions used in calculating the pre-reinsurance-ceded reserve represent company experience in the absence of reinsurance, for example assuming that the business was managed in a manner consistent with the manner in which the retained business was managed," some actuaries have indicated that they would use the current investment strategy applied by the company to the retained business, with such modifications as are necessary to reflect any impact of the reinsurance (for example, by reflecting the impact of the reduced total amount of assets available to be invested).

Section G: Credit for Reinsurance Issues Addressed by AG 48, the 2016 Revision to the Credit for Reinsurance Model Law, and the Reserve Financing Model Regulation?

Q23. What reinsurance issues are addressed by AG 48 and the Reserve Financing Model Regulation?

AG 48 and the Reserve Financing Model Regulation were developed to address the solvency implications of life insurance "reserve financing arrangements"—i.e., arrangements in which the security or assets backing reserves are (1) issued by the ceding insurer or affiliates, (2) are not unconditionally available to satisfy general account obligations of the ceding insurer, and/or (3) create a reimbursement or indemnification obligation on the part of the ceding insurer or affiliates. Reserve financing arrangements include so-called "XXX/AXXX captive arrangements."

[The following terms are defined in the Reserve Financing Regulation and AG 48. They are capitalized there and in most references in the actuarial literature and will, accordingly, be capitalized in this section: Covered Policies, Grandfathered Policies, and Non-Covered Policies, defined in Question 25; Primary Security and Other Security, defined in Question 26; and Required Level of Primary Security and Actuarial Method, defined in Question 27. The acronyms NPR, DR, SR, SET, and DET were defined in Section F above.]

Q24. When were AG 48 and the Reserve Financing Model Regulation adopted and what are their effective dates?

The initial version of AG 48 was adopted by the NAIC with an effective date of Jan. 1, 2015. On Jan. 8, 2016, a revision of the Credit for Reinsurance Model Law was adopted, with a provision that permitted the adoption by the states of a regulation that imposes requirements on ceding insurers wishing to claim credit for reinsurance with respect to reserve financing arrangements. On Dec. 13, 2016, the NAIC adopted the Reserve Financing Model Regulation on which the state regulations regarding term and universal life with secondary guarantee reserve financing permitted by the revision to the Credit for Reinsurance Model Law could be based. As is the case with all NAIC model regulations, each state must adopt a regulation based on the Reserve Financing Model Regulation before its provisions become effective for cessions from a ceding company domiciled in that state.

The Reserve Financing Model Regulation is different in certain respects from the original version of AG 48. In order to promote uniformity among states, a new version of AG 48 was adopted on Dec. 13, 2016, with an effective date of Jan. 1, 2017. It supersedes the original version of AG 48 for valuation periods ending on or after Jan. 1, 2017. The original version applies to Covered Policies (see Question 25 below) for valuation periods ending prior to Jan. 1, 2017.

The revised version of AG 48 was conformed in most significant respects to the Reserve Financing Model Regulation and includes a sunset provision whereby the guideline will cease to apply once a regulation substantially similar to the Reserve Financing Model Regulation is adopted by a ceding company's domiciliary state. However, in view of the fact that, in a small number of states, the a regulation based on the Reserve Financing Model Regulation will need to

be adopted to apply only on a prospective basis (i.e., only for policies issued on or after the effective date of the adopted regulation), AG 48 will remain as the authority for Covered Policies to which the adopted regulation does not apply. Thus, the revised version of AG 48 is expected to continue to be used for many years to come.

[In the remainder of this Section G, the unmodified term "AG 48" will refer to the revised guideline; if reference is made to the original version of the guideline, the term "original version of AG 48" will be used.]

Q25. To which policies do the Reserve Financing Model Regulation and AG 48 apply?

The Reserve Financing Model Regulation and AG 48 apply to liabilities associated with Covered Policies, unless one of the enumerated exemptions applies (see Question 30 below). Covered Policies are defined to be policies, other than Grandfathered Policies, with guaranteed non-level gross premiums and/or guaranteed non-level benefits (i.e., term polices) or universal life policies with a secondary guarantee, subject to the enumerated exemptions listed in Question 30 (for differences in the exemptions under the original version of AG 48, see Question 30). Grandfathered Policies are policies of these same types that were (1) issued prior to Jan. 1, 2015, and (2) ceded as of Dec. 1, 2014, under a treaty that would not have met any of the enumerated exemptions (a non-exempt treaty). Non-Covered Policies are policies that do not meet the definition of Covered Policies. Some actuaries point out that a strict application of this definition would imply that Grandfathered Policies would continue to be Non-Covered Policies if the reinsurance structure under which they had been ceded as of Dec. 1, 2014, is unwound and replaced by a new structure. In this connection, as noted in Question 27 below, the Reserve Financing Model Regulation and AG 48 both include requirements related to a treaty that cedes both Covered and Non-Covered Policies.

For companies ceding Covered Policies under a non-exempt reinsurance arrangement, both AG 48 and the Reserve Financing Model Regulation require that a Required Level of Primary Security be determined using the Actuarial Method and an additional level of Other Security be determined as described therein, and state consequences for failing to hold the amounts so determined. The capitalized terms are defined identically in AG 48 and the Model Regulation. The consequences stated in AG 48 and the Model Regulation are somewhat different.

Q26. What constitutes Primary Security and Other Security?

"Primary Security" may consist of cash, securities listed by the NAIC Securities Valuation Office meeting the requirements of Section 3B of the Credit for Reinsurance Model Law (essentially, assets that would be admitted under statutory accounting), but excluding synthetic letters of credit, contingent notes, credit-linked notes, and similar securities, and, if held under a funds withheld or modified coinsurance arrangement, certain commercial loans, policy loans and certain derivatives (see Section 5F of the Model Regulation).

"Other Security" may consist of any security acceptable to the commissioner that does not qualify as Primary Security.

Q27. What are the "Required Level of Security" and the "Actuarial Method"?

The "Required Level of Primary Security" is the amount determined by applying the Actuarial Method to the ceded Covered Policies, but not more than the statutory reserve ceded.

The "Actuarial Method" is the pre-reinsurance-ceded minimum reserve (i.e., the gross reserve) calculated as described in VM-20, applied on a treaty-by-treaty basis, with the following additional requirements:

1. For term policies, the Actuarial Method is the greater of the NPR and the DR; however, if the Covered Policies do not pass the SET, the Actuarial Method is the greatest of the NPR, the DR, and the SR. Note that VM-20 defines the minimum reserve for a group of policies, such as those covered by a reinsurance agreement, as the allocation under Section 2.C of the company's aggregate minimum reserve calculated under Section 2.A. Thus, the reserve set up under AG 48 and the Reserve Financing Regulation may not match the minimum reserve for the same policies under VM-20. Moreover, under Section 2.A.1 of the Valuation Manual, the minimum reserve for term policies that do not pass the SET is the greater of the NPR and the *sum* of the DR and the due and deferred premium asset (DDPA). Some actuaries believe the reserve under the Actuarial Method was intended to reflect VM-20 and thus include the DDPA in the Actuarial Method reserve while others believe the provisions of AG 48 and the Reserve Financing Regulation should be followed as written.
2. For universal life with secondary guarantee policies, the Actuarial Method is the greatest of the NPR, the DR, and the SR—unlike for PBR, the SET cannot be utilized. The same caveats that were noted in (1) above with respect to the reserves for term policies apply to the reserves for universal life with secondary guarantee policies.
3. If both types of Covered Policies are included in the same treaty, the company can choose to apply the Actuarial Method to all Covered Policies (i.e., all three reserves are calculated, but note that the restrictions on aggregation imposed by the Valuation Manual still apply—as of the date of this practice note, this means that universal life and term policies cannot be aggregated (see Section 2 of VM-20)).
4. When ceding less than 100 percent of the Covered Policy risk,
5. If a quota share is ceded, the Required Level of Primary Security may be reduced in accordance with the percentage of risk ceded;
    - If only secondary guarantee risk is ceded, the Required Level of Primary Security is reduced by an amount determined by applying the Actuarial Method on a gross basis, but excluding the secondary guarantee, except that, where VM-20 has not been elected, the Required Level of Primary Security is reduced by the retained reserve after factoring in the impact of any YRT reinsurance ceded in an exempt arrangement. (Note that this provision appears to allow a company to cede just the secondary guarantee risk. However, many actuaries would also take into account in this regard the provisions of the Risk Transfer Regulation);
    - If a portion of the Covered Policy risk is ceded to another reinsurer on a YRT basis in an exempt arrangement, the Required Level of Primary Security is reduced by an amount determined by applying the Actuarial Method, including Section 8 (the reinsurance section) of VM-20, except that, for pre-Jan. 1, 2017, issues, the reduction is limited to cx/(2*number of reinsurance premiums per year) using the same mortality as is used for the net premium reserve; and
    - For any other treaty ceding a portion of the risk to a different reinsurer, including

stop-loss and other non-proportional reinsurance treaties, there is no reduction in the Required Level of Primary Security;
- If a combination of reinsurance forms are applicable, each method is applied in a sequence that "accurately reflects the portion of the risk ceded."

6. If a ceding company cedes Covered Policies under more than one treaty, the aggregate Required Level of Primary Security cannot be less than if all the risks were ceded under a single treaty.
7. If a treaty cedes both Covered and Non-Covered Policies, credit for reinsurance for the latter can only be taken if security is held in addition to any security used to meet the Required Level of Primary Security for the Covered Policies.
8. The asset spread tables and asset default cost tables used in conjunction with the Actuarial Method are those tables that were adopted by the NAIC's Life Actuarial Task Force no later than the Dec. 31 on or immediately prior to valuation date.

Q28. What is the impact of the Reserve Financing Model Regulation on credit for reinsurance taken relative to reinsurance of XXX/AXXX business?

Under the Reserve Financing Model Regulation, subject to the enumerated exemptions (listed in Question 30 below), credit for reinsurance is allowed on Covered Policies if and only if the following requirements are met on a treaty-by-treaty basis:

1. The ceding company's reserves for the Covered Policies are established in accordance with the SVL and related regulations and actuarial guidelines and the credit for reinsurance does not exceed the reserves.
2. The ceding company determines the Required Level of Primary Security for each treaty.
3. Funds consisting of Primary Security (see Question 26 above) at least equal to the Required Level of Primary Security are held by or on behalf of the ceding insurer on a funds withheld, trust or modified coinsurance basis.
4. Funds consisting of Other Security (see Question 26) equal to any excess of the statutory reserve over the Primary Security are held by or on behalf of the ceding company.
5. Any trust used must meet state requirements with certain exceptions (e.g., affiliate investments are not limited, except as regards Primary Security—see Section 7A(5) of the Reserve Financing Model Regulation—and the treaty must prohibit withdrawals or substitutions of trust assets that would leave the market value of Primary Security within the trust (when aggregated with Primary Security outside the trust that is held by or on behalf of the ceding insurer) below 102 percent of the level required by 3 above).
6. The reinsurance treaty is approved by the commissioner.

In addition, the ceding company cannot take or consent to actions that would result in a deficiency of either Primary Security or Other Security and must use its best efforts to eliminate any deficiency as expeditiously as possible.

Prior to the due date of each quarterly or annual statement the ceding company must perform a treaty-by-treaty analysis to determine whether the Primary Security and Other Security requirements have been satisfied and must establish a liability equal to the excess of the credit for reinsurance taken over the amount of Primary Security actually held, unless either (1) the requirements were fully satisfied by the valuation date or (2) any deficiency is eliminated before the due date of the quarterly or annual statement to which the valuation date relates.

Individual states may adopt regulations that are substantially similar to the Reserve Financing Model Regulation, but with certain variations. Such variations are beyond the scope of this practice note.

Q29. What is the impact of AG 48 on credit for reinsurance taken relative to reinsurance of XXX/AXXX business?

Unlike the Reserve Financing Model Regulation, AG 48 does not state requirements that must be met for credit for reinsurance to be taken relative to the reinsurance of Covered Policies. Instead, AG 48 requires that the appointed actuary for a ceding insurer that cedes Covered Policies in situations that are not subject to the enumerated exemptions (see Question 30 below) to: (1) determine annually, on a treaty-by-treaty basis, a "Required Level of Primary Security" by using the "Actuarial Method" defined in the guideline and (2) render a qualified opinion for the ceding company if, for any such treaty, (a) the amount of Primary Security held as of the valuation date by or on behalf of the ceding company in a funds withheld, trust or modified coinsurance arrangement is less than the Required Level of Primary Security calculated using the Actuarial Method or (b) the amount of Other Security held by or on behalf of the ceding company on the valuation date is less than the excess of the statutory reserves over the level of Primary Security actually held unless either (i) such situation is remediated by the annual statement due date or (ii) the ceding company has established a liability equal to the excess of the credit for reinsurance taken over the amount Primary Security actually held. If a trust is used, requirement (5) listed in Question 28 applies.

As may be seen, the impact of AG 48 is largely the same as the impact of the Reserve Financing Model Regulation, except that it is enforced by a qualified actuarial opinion rather than a disallowance of reserve credit. However, the means for avoiding either consequence are the same: either eliminating the deficiency by the statement due date or establishing a liability equal to the excess of the credit taken (e.g., the statutory reserve) over the amount of Primary Security actually held. Under AG 48, the verification of the adequacy of Primary Security and Other Security is the responsibility of the appointed actuary instead of the company and need only be carried out annually, instead of quarterly as is the case for the Reserve Financing Model Regulation.

Q30. To which situations involving the reinsurance of XXX/AXXX business do the Reserve Financing Model Regulation and AG 48 not apply?

The Reserve Financing Model Regulation and AG 48 do not apply to the following situations:

1. Reinsurance of
    a. Non-Covered Policies, including Grandfathered Policies.
    b. Policies that are eligible for exemption under Section 6.E (i.e., the YRT exemption has been elected) or Sections 6.F or 6G of Regulation XXX (i.e., the direct policy is an attained age YRT or the direct policy is a series of n-year renewable term insurances where the guaranteed premiums are greater than the 1980 CSO and there are no cash surrender values) and the policy is issued before the later of the effective date of the Reserve Financing Model Regulation in the cedent's domiciliary state or the date on which the ceding company begins to apply VM-20 to the ceded policies, but in no event later than Jan. 1, 2020.

c. Any universal life policy that meets all of the following requirements:

- Secondary guarantee period, if any, is five years or less;
- The specified premium for the secondary guarantee period is not less than the net level reserve premium for the secondary guarantee period based on the CSO valuation tables and valuation interest rate applicable to the issue year of the policy; and
- The initial surrender charge is not less than 100 percent of the first year annualized specified premium for the secondary guarantee period.

Note that this exempts universal life policies with secondary guarantees that are not "ULSG" policies as defined in VM-20.

d. Credit life insurance.

e. Variable life insurance policies for which the amount or duration of coverage is based upon separate account performance.

f. Group life certificates, except where the certificate provides for guaranteed maximum premiums that continue coverage in force past one year.

2. The assuming reinsurer maintains a trust in a U.S. financial institution for the benefit of U.S. ceding companies meeting the requirements of Section 2.D of the Credit for Reinsurance Model Law.

3. The reinsurer:

a.

(i) is licensed in the state in which credit for reinsurance is sought (see Section 2A of the Credit for Reinsurance Model Law); or

(ii) is admitted (see Section 2B of the Model Law) in a state where credit for reinsurance is sought; or

(iii) is domiciled in a state that employs standards regarding credit for reinsurance that are substantially similar to those of the state in which credit is sought, and meets the requirements in Section 2C of the Model Law;

b. prepares financial statements without material departure from the NAIC statutory accounting practices and procedures; and

c. is not in a Company Action Level Event, a Regulatory Action Level Event, an Authorized Control Level Event, or a Mandatory Control Level Event.

4. The reinsurer is licensed, admitted, or domiciled in the state in which credit for reinsurance is sought and meets the requirements of Sections 2A, 2B, or 2C of the Model Law and (a) is not an affiliate of the ceding company, (b) prepares its annual statement in accordance with statutory principles, (c) is licensed or accredited in at least 10 states, but not as a captive or special purpose vehicle or other similar licensing regime, and (d) is not below 500 percent of Authorized Control Level Risk-Based Capital, calculated without material deviation from NAIC statutory accounting practices and procedures.

5. The reinsurer has been certified in the domiciliary state of the cedent or, if the cedent's state has not adopted the certification process, then the reinsurer is certified in at least five states. Alternatively, the reinsurer has statutory capital and surplus equal to or greater than $250 million (calculated without regard to permitted or prescribed practices) and is

licensed in at least 26 states or licensed in 10 states and licensed or accredited in at least 35 states.

6. The commissioner, after consultation with the Financial Analysis (E) Working Group, finds that: (a) the reinsured risks are clearly outside the intent and purpose of the regulation substantially similar that was adopted by the state or AG 48, as the case may be, and (b) the risks are in scope only due to a technicality, and (c) application of the Guideline is not necessary to protect policyholders.

Q31. What are the differences between the original version of AG 48 and the Reserve Financing Model Regulation and the revised version of AG 48?

The original version of AG 48 is effective for valuation periods beginning on or after Jan. 1, 2015, and ending on or before Dec. 31, 2016. The revised version of AG 48 is effective for valuation periods beginning on or after Jan. 1, 2017. The revised version of AG 48 will cease to be effective on a state-by-state basis when a regulation substantially similar to the Reserve Financing Model Regulation is adopted to replace it.

In the original version, as in the revised version, of AG 48 the appointed actuary is required to issue a qualified opinion if the requirements regarding Primary Security and Other Security are not met and if timely remediation action is not taken. (See Question 29. The term "Other Security" is defined differently in the original version of AG 48, so the statement of the remediation options differs from that in the revised version. However, the economic effect of the remediation options is the same for the original and revised versions of AG 48.) The requirement for the issuance of a qualified actuarial opinion instead of a restriction in the credit for reinsurance is the primary difference of both versions of AG 48 from the Reserve Financing Model Regulation. The Reserve Financing Model Regulation and the revised version of AG 48 differ in several additional respects from the original version of AG 48. Some are merely technical. The more important differences include the following:

- Applicability (Scope): The provisions of the Model Regulation apply only to ceding companies domiciled in states in which regulations similar to the Model Regulation have been adopted and only on and after the effective dates of such regulations, whereas both versions of AG 48 apply in all states on and after their effective dates.

- Exemptions: The exemptions from the requirements of the Reserve Financing Model Regulation are different than the exemptions from the original version of AG 48. In the Model Regulation and the revised AG 48:
    - Exemptions for policies satisfying Section 6 E, F, and G in Regulation XXX are limited to those policies issued before the later of the effective date of the Reserve Financing Model Regulation and the date (not later than Jan. 1, 2020) on which the company first applies VM 20 to the policies (in the original version of AG 48, there was no such limitation);
    - Exemptions were added for
        - any universal life policy that meets all of the following requirements:
            - The secondary guarantee period, if any, is five years or less;
            - The specified premium for the secondary guarantee period is not less than the net level reserve premium for the secondary guarantee period based on the CSO valuation tables and valuation interest

rate applicable to the issue year of the policy; and
- The initial surrender charge is not less than 100 percent of the first year annualized specified premium for the secondary guarantee period;
- Credit life insurance;
- Variable life insurance policies for which the amount or duration of coverage is based upon separate account performance; and
- Group life certificates, except where there are guaranteed maximum premiums that are effective past one year;

- Exemptions were added for reinsurance ceded to a reinsurer that
  - Meets the requirements of Section 5.B.4.b. of the Credit for Reinsurance Model Law (as revised subsequent to the adoption of the original version of AG 48) by having $250 million in statutory capital and surplus, calculated without regard to permitted or prescribed practices and being licensed in at least 26 states or licensed in 10 states and licensed or accredited in a total of at least 35 states;
  - Meets the requirements of Sections 2A, 2B, or 2C of the Credit for Reinsurance Model Law and
    - Prepares financial statements in compliance with the APPM without material (per SSAP 1) departures pertaining to the admissibility or valuation of assets or liabilities that increase the assuming insurer's surplus, and
    - Is not in a Company Action Level Event, Regulatory Action Level Event, Authorized Control Level Event, or Mandatory Control Level Event;
  - Meets the requirements of Sections 2A, 2B, or 2C of the Credit for Reinsurance Model Law and
    - Is not an affiliate of the ceding insurer or any insurer that directly or indirectly ceded the insurance to the ceding insurer;
    - Is licensed or accredited in at least 10 states, and is not licensed in any state as a captive, special purpose reinsurer or special purpose life reinsurer, limited purpose subsidiary, or other similar licensing regime; and
    - Is not, or would not be, below 500 percent of the Authorized Control Level RBC as calculated based upon then current NAIC calculation methods without deviation and without recognition of any departures from NAIC statutory accounting practices and procedures pertaining to the admission or valuation of assets or liabilities that increase the surplus of the assuming insurer.

- Definitions:
  - "Other Security" is defined as security acceptable to the commissioner excluding Primary Security (in the original version of AG 48, Other Security was inclusive of Primary Security—this affects the description of the calculations of the restriction on credit for reinsurance if a deficiency exists but the economic result is the same);
  - The definitions of "Covered Policies" and "Grandfathered Policies" do not reference Model Regulations or Actuarial Guidelines.
  - The Required Level of Primary Security cannot exceed the total reserve ceded.

- Actuarial Method:
  - The NPR is used as a calculated and is not reduced by an "applicable percentage" as was the case for the original version of AG 48.
  - For term policies, the SET from Section 6 of VM-20 must be applied and, if not passed, the Actuarial Method reserve is the greatest of the NPR, the DR, and the SR, not just the greater of the NPR and the DR, as was the case under the original version of AG 48.
  - It is clearly stated that, when applying the Actuarial Method, the Valuation Manual's requirements regarding aggregation must be satisfied.
  - Section 6A(4) of the Reserve Financing Model Regulation and Section 5A(4) of the revised version of AG 48 regarding the treatment of reinsurance treaties that cede less than 100 percent of the risks of the Covered Policies differ in certain respects from the comparable Section 5A(4) in the original version of AG 48.
  - Section 6A(7) of the Reserve Financing Model Regulation and Section 5A(7) of the revised version of AG 48 regarding the treatment of reinsurance treaties thatcedes risks on both Covered and Non-Covered Policies were added; both sections describe the determination of the Required Level of Primary Security and prohibit the use of Primary Security that is used for Non-Covered Policies in satisfying the Required Level of Primary Security, but the Reserve Financing Model Regulation also covers the determination of reserve credit in such cases.
  - For the original version of AG 48, only changes to the Valuation Manual adopted no later than the Sept. 30 immediately prior to year-end are incorporated into the Actuarial Method. For the Reserve Financing Model Regulation and the revised version of AG 48, the Valuation Manual "as then in effect" is to be used.

- Required Analysis: The analysis by the qualified actuary that is required by both versions of AG 48 contains requirements that largely mirror requirements in the Reserve Financing Model Regulation for taking credit for reinsurance, with the following exceptions:
  - The Reserve Financing Model Regulation, unlike either version of AG 48, assigns responsibility for the required analysis to the company instead of the appointed actuary and does not require a qualified actuarial opinion in case of deficiencies in Primary Security and Other Security held;
  - The Reserve Financing Model Regulation states explicitly that statutory reserves for Covered Policies must be established in full and credit for reinsurance cannot exceed the proportionate share of ceded reserves;
  - Trust asset substitutions are only allowed if after the substitution the fair market value of the trust assets is equal to or greater than 102 percent of the required Primary Security (this requirement is found in the revised version of AG 48);
  - The reinsurance treaty must be approved by the commissioner, and
  - Under the Reserve Financing Model Regulation, Primary Security and Other Security requirements must be checked before each quarterly statement, not just the annual statement, as under the original version of AG 48. As under either version of AG 48, if the requirements are not met, a liability in the amount of the excess of the for the level of the inadequacy must be established unless the deficiency was a) eliminated by the valuation date or b) eliminated by the filing date of the statement; however the Reserve Financing Model Regulation makes clear that this provision cannot be used to maintain any deficiency of Primary or

Other Security for any longer than is reasonably necessary to eliminate it.

- Prohibition Against Avoidance. The Model Regulation explicitly prohibits any company with Covered Policies from taking any action or series of actions, or entering into any transaction or series of transactions with the purpose of avoiding the requirements, or circumventing the purpose or intent, of the Reserve Financing Model Regulation. This language is not in either version of AG 48, but both include a requirement that the appointed actuary for a company ceding Covered Policies issue a qualified opinion if the appointed actuary for any affiliated reinsurer that reinsures any of the Covered Policies issues a qualified opinion due in whole or in part to the analysis required by AG 48.

Q32. If a qualified opinion is filed due to AG 48 requirements, does that mean that a C-3 adjustment will need to be made, too?

Prior to the adoption of the original version of AG 48, the instructions for calculating the C-3 component of RBC (currently found on page LR027) stated that C-3 factors would be reduced if there was an unqualified actuarial opinion. In response to the requirement in both the original and revised versions of AG 48 that a qualified actuarial opinion be issued if required amounts of Primary Security and Other Security are not held as of the filing date of the annual statement, the instructions for C-3 RBC calculation were modified to state that if the sole reason for a qualified opinion is this AG 48 requirement, for C-3 purposes, the actuarial opinion is to be treated as unqualified for RBC purposes. RBC calculations were also modified to require that the RBC be increased to reflect the shortfall in funding Primary and Other Security.

Q33. What is meant by the phrase "securities listed by the SVO" used in the definition of Primary Security?

The phrase "securities listed by the Securities Valuation Office" is used in the Credit for Reinsurance Model Law and Regulation and in the definition of Primary Security in AG 48 and the Reserve Transfer Regulation. Several groups at the NAIC have been working on clarifying the meaning of this phrase. The process was incomplete as of the date of the practice note, and additional developments should be anticipated. The following is a summary of recent activities in this regard.

The Feb. 24, 2016, "Memorandum from the Senior Counsel of the Securities Valuation Office (SVO)"[2] includes appendices representing proposed amendments to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The purpose of these amendments is to compile a list of "investment securities" (as opposed to "regulatory securities," which are permitted due to special arrangements with certain state insurance departments) from which the Reinsurance (E) Task Force would pick sub-lists that are eligible for use as Primary Security. Thus, this listing by the SVO, itself not adopted, is preliminary to further action by the Reinsurance (E) Task Force.

In the form presented in the Memorandum, the phase "Securities Listed by the SVO" used in Section 3.B of the Credit for Reinsurance Model Law and Section 10.A(2) of the Credit for

[2] "Re: Proposal to Expand the NAIC Bank List to Include Eligible Non-Bank Financial Institutions"; National Association of Insurance Commissioners and the Center for Insurance Policy and Research; Feb. 24, 2016.

Reinsurance Model Regulation refers to a list (the "SVO List of Securities") created by aggregating sub-lists that the SVO has compiled, or caused to be compiled, from each of (1) the VOS Process (this process covers securities that are reviewed and assigned an NAIC designation by the SVO), (2) the FE Data Process (this process covers securities referred to as those "deemed exempt from filing" in the Model Law and Model Regulation due to having ratings assigned by credit rating providers), (3) the RMBS/CMBS Modeled Securities Process, (4) the U.S. Treasury Process, and (5) the Exempt U.S. Government Securities Process plus, for purposes of the Model Law (but not the Model Regulation), certain additional securities. The proposed amendment contained the following list of such additional securities, which it noted was for purposes of illustration only: (1) The money market funds on the Money Market Funds Sub-List and the exchange traded funds on the SVO's ETF Sub List, (2) any letter of credit identified in the SVO's Letter of Credit Sub-List, and (3) all U.S. Treasury securities whether or not actually owned by an insurance company.

Q34. Is a reinsurance agreement out of compliance with risk transfer requirements if it requires that all Primary Security be depleted before Other Security can be used to satisfy the obligations of the reinsurer?

Some actuaries believe the answer is yes for treaties that fall under AG 48 or the Reserve Financing Model Regulation. The rationale is that if the reinsurer does not have sufficient funds to cure a shortfall in Primary Security caused by a change in actuarial assumptions or another reason, the ceding company would suffer a reduction to its surplus due to the need to set up a liability for the excess of the credit for reinsurance over the Primary Security or due to its use of surplus funds to cure the shortfall. These actuaries believe that if the ceding company's surplus can be impacted in the event of a Primary Security shortfall, particularly when the reinsurer recognizes Other Security as an asset, the reinsurance agreement would be out of compliance with the Risk Transfer Regulation (particularly with the accounting requirement regarding the possible deprivation of surplus). These actuaries argue that some amount of Primary Security will always be required until all policy obligations have been satisfied, and therefore, Other Security may never be available to pay claims even if assumptions turn out to be more adverse than assumed in the original determination of the Primary Security requirement. These actuaries point out that the reinsurance agreement does not need to require that Other Security be used to cure a shortfall, but that its use for this purpose cannot be restricted if the shortfall cannot otherwise be cured by the reinsurer.

Some actuaries believe that the order in which assets would be liquidated to pay claims has nothing to do with meeting A-791 risk transfer requirements. The primary reason an order of use provision would be utilized is that assets held as Other Security may be less liquid than assets held as Primary Security and has no implication on the amount of funding required to be established by the reinsurer. If the Primary Security and Other Security were not fully funded, with or without the order of payment provision, then full credit for the reinsurance agreement would not be allowed. Should the reinsurer be unable to remedy the shortfall in a period "reasonably necessary to eliminate it," then risk transfer issues arise, but this occurs under all circumstances of security shortfalls and has nothing to do with order of use of securities.

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Mr. Jake Stultz
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1100 Walnut Street
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Re: Credit for Reinsurance Model Law and Regulation and the Covered Agreement between the United States and the European Union

Dear Mr. Stultz:

The American Insurance Association ("AIA") thanks you for the opportunity to submit comments with respect to the Bilateral Agreement between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance ("Covered Agreement') and its impact on amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).[1] AIA's comments are necessarily preliminary and contingent in the absence of a specific proposal regarding amending the credit for reinsurance model law and regulation. Our comments set forth a general overview of principles as the starting point for discussions. AIA looks forward to working with the NAIC and interested stakeholders to design a solution to ensure open insurance markets with financial stability and reciprocal treatment for all insurers and reinsurers.

AIA supports the Credit for Reinsurance Model Law and Regulation and continues to work for the model law's enactment in the states. The model is a success, with adoption in the overwhelming majority of the states. While the credit for reinsurance model and the concomitant reduction in collateral levels was very controversial at first, no known adverse financial results have ensued from the lowering of mandatory collateral. Reinsurance capacity for the U.S. ceding market is sufficient and the lowering of the 100% collateral requirement has not resulted in any reported financial stress for U.S. ceding insurers.

AIA likewise supports the Covered Agreement negotiated and signed by the U.S. and the EU. The Covered Agreement eliminates discriminatory measures against U.S. insurers and reinsurers, ensures a significant degree of market access, increases U.S. competitiveness, and boosts the

[1] AIA represents approximately 320 insurers that write more than $125 billion in U.S. property-casualty premiums each year. Our membership includes U.S. insurers that write insurance only within the U.S., U.S. insurers that write insurance inside and outside the U.S., and the U.S. subsidiaries of multi-national insurers.

international standing of the U.S. state-based insurance regulatory system. The Covered Agreement establishes mutual acknowledgement of prudential supervision in the EU and the U.S., effectively eliminating barriers in Europe that U.S. groups faced since the implementation of the EU Solvency II framework for insurance supervision.

• *Potential Scope of Amending the Credit for Reinsurance Model*

The Covered Agreement prohibits states from requiring EU reinsurers to post collateral only if the reinsurer meets certain financial and other requirements. These reinsurer requirements under the Covered Agreement follow the requirements for certified reinsurer status under the credit for reinsurance model law and regulation. For example, the Covered Agreement allows an EU reinsurer to benefit from zero collateral only if the reinsurer maintains a capital and surplus minimum of $250,000,000, maintains a practice of prompt payment of claims and confirms it is not presently participating in a solvent scheme of arrangement involving U.S. ceding insurers. The EU reinsurer must also submit annual financial statements and actuarial opinions, as well as a list of overdue reinsurance claims outstanding for more than 90 days. All these requirements are consistent with the requirements for certified reinsurers under the model law and regulation.

As outlined in the Notice of Public Hearing, there are three potential methods for amending the credit for reinsurance model in response to the Covered Agreement. The zero collateral option could extend to only EU reinsurers qualifying under the Covered Agreement. Zero collateral could apply to qualifying reinsurers from foreign jurisdictions covered by potential future covered agreements. Alternatively, zero collateral could extend to all qualified reinsurers domiciled in NAIC qualified jurisdictions.

• *AIA Position on Scope of Zero Collateral Option*

AIA's guiding principle for these discussions is that a zero collateral option should be potentially available for qualified reinsurers domiciled in jurisdictions providing reciprocal rights to U.S. insurers and reinsurers with mutual acknowledgement of prudential supervision. The goal is to adopt an approach that assures U.S. standards on group supervision and capital requirements are respected on a mutual basis, and U.S. state regulation of insurers is recognized internationally. The critical issue for AIA is to treat all qualified reinsurers domiciled in qualified jurisdictions in the same manner as reinsurers from EU qualified jurisdictions are treated, so long as the jurisdiction accepts and recognizes the U.S. insurance regulatory system and does not impose market restrictions on U.S. insurers and reinsurers.

Extending zero collateral to all similarly qualified reinsurers domiciled in qualified jurisdictions has the benefit of adding uniformity and clarity to credit for reinsurance laws. The financial and claims paying standards set forth in the Covered Agreement for defining qualified reinsurers offers protections recognizing that only responsible and secure reinsurers would be eligible for zero collateral. AIA can support extending zero collateral to all similarly qualified reinsurers domiciled in qualified jurisdictions provided the jurisdiction recognizes the U.S. standards on group supervision and capital requirements, and does not impose market access barriers on U.S. insurers and reinsurers that would be inconsistent with the Covered Agreement.

While extending zero collateral to all qualified reinsurers may be the ideal, the Covered Agreement did represent a *quid pro quo* negotiated agreement, where zero collateral was leveraged to obtain EU recognition of U.S. prudential measures, including group supervision standards and capital and solvency requirements. The Covered Agreement provides U.S. insurers and reinsurers with significant market access guarantees in the European Union, as well. Extending zero collateral to all qualified reinsurers domiciled in NAIC-approved qualified jurisdictions without some type of binding, international reciprocal agreement or understanding between the jurisdictions, does risk forfeiting the leverage of collateral without obtaining mutual recognition between the foreign jurisdiction and the U.S. system of insurance supervision. This leverage issue could be addressed by amending the definition of qualified jurisdictions under the credit for reinsurance model to restrict it to only those jurisdictions that recognize U.S. standards on group supervision and capital requirements, and do not impose market access barriers on U.S. insurers and reinsurers.

Potential problems surfacing from a foreign jurisdiction's treatment of U.S. insurers or reinsurers may be largely unknown now. For example, the problems U.S. group insurers faced as a result of the EU's Solvency II initiative were not known when the Covered Agreement was initially being discussed. There potentially may be future unknown issues arising between the foreign jurisdiction and the U.S. over insurance regulation.

One approach to the potential *quid pro quo* issue is to extend zero collateral only to those qualified reinsurers domiciled in qualified jurisdictions entering a covered agreement with the U.S. similar to the U.S-EU Covered Agreement that mutually acknowledges the prudential supervision of both jurisdictions' regulation of insurance. The drawback to this approach is it may not be realistic to wait for additional separate covered agreements to be negotiated and signed in the near future. Demanding a covered agreement to be negotiated and executed could also reduce the degree of uniformity in the treatment of the various qualified jurisdictions.

Another approach would allow qualified jurisdictions an opportunity to accede to the existing U.S.-EU Covered Agreement. Though the Dodd-Frank Act does not specifically reference the possibility of a country acceding to an existing covered agreement, it does give the federal government the authority to enter into covered agreements with multiple countries. We believe a third party could accede to the existing U.S.-EU Covered Agreement through all three parties signing an instrument of accession by which the third party, the U.S. and the EU agree to apply the recognition and requirements of the Covered Agreement to each other, including the mutual acknowledgement of the parties' regulatory systems that is part of the Covered Agreement.

An advantage to this approach is it would likely increase the number of foreign jurisdictions recognizing the mutual standards of the Covered Agreement, and would do so in a legally binding international agreement between sovereign entities. In addition, it would reduce the time and resources required to negotiate new covered agreements. Allowing other parties to accede to the existing Covered Agreement is consistent with the Dodd-Frank Act and international law. One potential negative implication of an accession approach is that mere accession to the standards of the U.S.-EU Covered Agreement might not address a regulatory issue unique to a specific jurisdiction.

In contrast to requiring actual accession to the U.S.-EU Covered Agreement, another approach might be to revise the definition of qualified jurisdiction in the credit for reinsurance model to require that a qualified jurisdiction must also provide mutual recognition, open markets for U.S. insurers and reinsurers, and reciprocal rights similar to those set forth in the U.S.-EU Covered Agreement. The process for certifying qualified jurisdictions would permit public comment by U.S. insurers and reinsurers regarding whether the jurisdiction creates artificial barriers to U.S. insurers and reinsurers and include regular reviews of whether the jurisdiction did provide mutual recognition, open markets and reciprocal rights. This process would grant flexibility for regulators to consider any future access problems that might develop in the jurisdiction.

• *Criteria for Evaluating Qualified Jurisdictions*

The Notice of Public Hearing also requests suggestions regarding the criteria for determining a "qualified jurisdiction" under the credit for reinsurance model. Pursuant to the current model law, a state commissioner is to evaluate "the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction and "the rights, benefits and the extent of reciprocal recognition afforded … to reinsurers licensed and domiciled in the U.S." Qualified jurisdictions must agree to share information and cooperate with the commissioner with respect to the certified reinsurer. A jurisdiction may not be a qualified jurisdiction if it does not enforce final U.S. judgments and arbitration awards.

If the model is amended to allow all qualified reinsurers domiciled in a qualified jurisdiction to post zero collateral, qualified jurisdiction status should be modified to clarify that only those jurisdictions agreeing to mutual recognition, open markets, and reciprocal rights similar to those set forth in the US-EU Covered Agreement are eligible to be qualified jurisdictions.

• *Additional Guardrails Based On Zero Collateral*

The Notice of Public Hearing further asks interested stakeholders to consider additional "guardrails" relative to U.S. ceding insurers to help address increased financial solvency risks caused by the elimination of collateral.

Additional guardrails may be unnecessary and even counter-productive. It is worth noting that lowering the collateral standard from the 100% requirement was considered controversial and risky by many when introduced by the revised credit for reinsurance model in 2011. Yet, despite the lowering of collateral, there has not been any reported evidence of financial solvency concerns with ceding insurers directly resulting from the lowering of collateral. In addition, as noted, zero collateral would apply only to those reinsurers meeting the financial and other standards set forth in the Covered Agreement. Those reinsurers would also have to be domiciled in qualified jurisdictions with effective reinsurance supervisory systems and acceding to the prudential supervisory standards of the Covered Agreement. In such a scenario, placing unnecessary "guardrails" on U.S. ceding insurers would risk lowering available capital in the market, impair open reinsurance markets, and perhaps discourage ceding insurers from purchasing reinsurance.

While there is no specific proposal outlining the nature of the "guardrails," the Covered Agreement prohibits states from adopting requirements that would have substantially the same impact on the foreign reinsurer as existing collateral requirements being eliminated pursuant to the Covered Agreement. In other words, any proposed "guardrail" proposal applied alternatively to the U.S. ceding company customers of an EU reinsurer that even indirectly results in differentiated, unfair treatment of that reinsurer would be subject to possible federal preemption.

The NAIC's Financial Condition ("E") Committee circulated a proposed Contingency Plan Regarding Consumer Protection Collateral in the fall of 2016. While the "guardrails" under current discussion have not been specified, to the extent they parallel the prior contingency plan, AIA refers to the December 14, 2016 letter it filed with the NAIC together with other joint insurance trade associations. The joint trades' letter notes the contingency plan was only in outline form and lacked specifics, making it "impossible to determine how adoption of such a plan would work in practice."

The joint trades' letter raised the following questions in reference to the contingency plan that would likewise need to be resolved prior to full consideration of a guardrails proposal:

• Status of current credit for reinsurance laws and whether financial statement credit would continue for cessions.

• Whether insurers could still negotiate for collateral and if they did, whether the insurers would receive financial statement credit for the reinsurance.

• Whether the contingency plan or the new guardrails would apply prospectively only or have retroactive application to existing reinsurance contracts.

• The scope of the guardrails. For example, whether the guardrails would apply only to those reinsurance agreements with qualifying reinsurers eligible for zero collateral or whether the guardrails would apply to all of an insurer's reinsurance agreements.

• How alternative risk transfers would be treated under the guardrail system.

•Whether federal preemption might apply if the guardrails replace collateral by adopting substantially similar requirements.

While the "guardrail" discussion in the Notice of Public Hearing mentions "additional 'guardrails' relative to U.S. ceding companies," – a suggestion that AIA would not support-- the NAIC may want to consider guidance increasing transparency and efficiency in the reinsurer transaction. If collateral is to be eliminated through the qualifying jurisdiction process, it is important that the ceding insurer has knowledge of the financial strength of the reinsurer with whom it is contracting. For example, transparency regarding the reinsurer's catastrophe program, including how it controls its exposures to catastrophe risk, its exposures to catastrophe risk, and its retrocession program could aid ceding insurers in making informed decisions.

• *Other Covered Agreement Considerations*

The Public Notice invites interested stakeholders to offer other considerations relating to states' implementation of the Covered Agreement. AIA offers the following issues for additional consideration:

1) The Covered Agreement (at Article 3 Paragraph 4) references reporting requirements permissible "if requested by the supervisory authority." It should be clarified this means a supervisory authority may exercise its discretion via its annual reporting requirements – similar to the requirements in the current certified reinsurer regulations and the certified reinsurer checklist. Regulators should not be able to make these sorts of requests on an ad hoc basis. Instead, to the extent regulators do request such reports, they should remain part of the regulatory process and framework.

2) The Covered Agreement (at Article 3 Paragraph 6) discusses the manner in which a supervisory regulator may determine that a EU reinsurer no longer qualifies for zero collateral. The language is not very specific. The model law may wish to detail the process for "de-certifying" a reinsurer previously qualified for zero collateral.

3) The Covered Agreement (at Article 4) refers to measures that a host supervisor cannot take vis-à-vis the worldwide group from the home jurisdiction. As the NAIC is well aware, AIA has a long-standing public policy principle that indicates that an insurer should only be subject to group supervision by a single jurisdiction.

AIA thanks you for the opportunity to offer preliminary comments and looks forward to continuing to work with the NAIC and all interested stakeholders during this process.

Sincerely,

Steven Bennett
Associate General Counsel
American Insurance Association

Empower Results®

DRAFT

February 5, 2018

Mr. Jake Stultz
Senior Accounting Policy Advisor
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500,
Kansas City, MO 64106

Subject: Aon Benfield recommendations on simplifying U.S. collateral requirements and the associated tracking and reporting of reinsurance recoverables

Dear Mr. Stultz,

Over the past several years, Aon Benfield has worked with U.S. ceding insurers and both U.S. and non-U.S. reinsurers in order to help clarify the statutory reporting requirements for reinsurance recoverables. We are submitting recommendations that we believe will help simplify the tracking and reporting of reinsurance recoverables while preserving most of the collateral reforms introduced by the Covered Agreement (BILATERAL AGREEMENT BETWEEN THE EUROPEAN UNION (EU) AND THE UNITED STATES OF AMERICA (U.S.) ON PRUDENTIAL MEASURES REGARDING INSURANCE AND REINSURANCE) and the Credit for Reinsurance Model Law and Regulation.

Specifically, this proposal attempts to:

1. Facilitate the tracking and reporting of reinsurance recoverables under U.S. statutory accounting

2. Preserve the state-based regulation of insurance and eliminate the need for additional agreements that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act by extending most of the terms and conditions of the Covered Agreement to other jurisdictions

3. Capitalize on the progress made by all parties with respect to collateral reform in the U.S.

4. Minimize the need for additional "guardrails" (e.g. protections) relative to U.S. ceding insurers, such as changes to risk-based capital requirements or additional regulatory approaches

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These recommendations are intended to provide a framework for moving forward with U.S. collateral reform, but not address every conceivable issue.

For purposes of clarity, we will call all reinsurers that fall under this new Covered Agreement "covered reinsurers". Thus reinsurers that would be subject to the provisions of the Covered Agreement or held to similar criteria would be known as covered reinsurers.

1. The Covered Agreement allows U.S. ceding insurers to get full credit for reinsurance ceded to EU reinsurers meeting the criteria under the agreement (e.g. minimum size, solvency ratio of 100% etc.) without providing any collateral for outstanding liabilities. We believe that this standard could be extended to large, highly rated reinsurers in certified reinsurer "qualified jurisdictions" or other domiciles with high regulatory standards.

Rationale: Since the amount of collateral is negotiable, ceding insurers can manage credit risk by their selection of reinsurers and by negotiating an amount of collateral they feel is necessary to minimize credit risk. Allowing reduced or no collateral for reinsurance credit, supports the work done towards collateral reform in the U.S. by regulators, reinsurers and ceding insurers.

We believe it makes sense to have a global approach / policy. This will alleviate the need to negotiate additional federal agreements (which could lead to different standards for reinsurers from different domiciles) and potentially conflict with existing state laws and regulations. There are reinsurers in Bermuda, Japan, Switzerland and other countries that should be able to achieve equal treatment to those in the EU. It would be preferable if the Covered Agreement could be amended at some point, so that all EU reinsurers would get equal treatment to all other reinsurers. (Please see "Thoughts on Amending the EU – U.S. Covered Agreement" on page 5.)

2. We suggest that the $250mn minimum capital requirements should be applied to all reinsurers (with the potential exception of EU reinsurers), and the minimum capital standards should be based on the reinsurer's most recently reported publicly available capital using the foreign exchange rate on the date of the reported financials.

Rationale: The size of an insurance or reinsurance company's capital base has been a key indicator of reinsurer impairment (e.g. supervision, rehabilitation, insolvency). Studies have shown that insurance and reinsurance companies with smaller capital bases have a higher probability of impairment.

This suggestion will eliminate the need for the U.S. to specify minimum capital requirements in multiple foreign currencies. The Covered Agreement specifies that EU reinsurers must possess a minimum capital of €225mn. This requirement is not onerous, but if the Covered Agreement is amended, it may make sense to apply the $250mn standard (using the exchange rate for the date of the reported capital) to EU reinsurers, so that a consistent approach can be used worldwide.

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3. We suggest that (with the possible exception of the EU reinsurers) all reinsurers that want to become covered reinsurers must have two or more public, interactive financial strength ratings of A- or A3 or higher. We suggest that this requirement be used in lieu of a Solvency II solvency ratio of 100% or greater.

Rationale: The main reasons for using ratings as opposed to a solvency ratio of 100% or greater are as follows:

a. Interactive financial strength ratings are publicly available, updated as needed, and already used by regulators, ceding insurers and reinsurers. There can be a significant lag as to the reporting of capital and capital scores for reinsurers outside the U.S. Most non-U.S. reinsurers only release financial statements publicly on an annual basis. The reports are made publicly available anytime from 3 to 8 months after year-end (or the reinsurer's fiscal year-end). There may be a similar delay or longer for solvency ratios under Solvency II to become publicly available. In an extreme case, a U.S. ceding insurer may not know the capital or solvency position of an EU reinsurer until 15 months after a major catastrophe. Consider the Japanese (Tohoku) earthquake which occurred in March 2011. U.S. ceding insurers were unable to review the capital position of non-U.S. reinsurers until 13 or more months after the event. In contrast, rating agencies can react to events more quickly and have the ability to trigger a downgrade (if warranted). Since rating agencies (through the interactive rating process) have access to non-public data, their ratings may represent a more current view of the capital position and financial strength of reinsurers. Therefore, financial strength ratings may be a better metric to measure a reinsurer's capital adequacy and the associated credit risk at any point in time.

b. Using two ratings was universally accepted by the reinsurers, their trade associations, regulators and U.S. ceding insurers when the New Credit for Reinsurance Model Law and Regulation was adopted in the fourth quarter of 2011. Also, two public, interactive financial strength ratings alleviate the dependency on a single rating agency. The A-, A3 threshold is suggested as it is the most common minimum requirement that U.S. ceding insurers use for acceptable counterparties. The A-, A3 threshold also appears to be an appropriate threshold based on the ratings scale of the Credit for Reinsurance Model Regulation. Certified reinsurers rated A-, A3 or above are only required to post 50% collateral or less, while certified reinsurers rated below A- or A3 are required to post 75% collateral or more for outstanding liabilities.

c. Certified reinsurers below A- or A3 are required to provide 75% of collateral or more under the Credit for Reinsurance Model Law and Regulation.

d. We believe the two public, interactive financial strength ratings is a higher standard than the 100% solvency ratio (which is the regulator intervention ratio). To highlight the potential downside of a using the solvency ratio, an EU reinsurer could have a solvency ratio just above the regulatory intervention level and still qualify to be a covered reinsurer.

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e. This will also alleviate the U.S. regulators from examining capital standards of every potential new jurisdiction (and reviewing these capital standards when significant changes are made).

f. Incorporating this higher standard may alleviate the need for additional "guardrails" relative to U.S. ceding insurers (such as higher risk-based capital requirements).

Overall, we feel that it is simpler and more transparent to use public, interactive financial strength ratings as opposed to solvency ratios.

4. Regulators could elect to retain the qualified jurisdiction requirement. In our view, the EU should be considered a qualified jurisdiction as well as the current certified reinsurer qualified jurisdictions.

Rationale: The qualified jurisdiction requirement encourages the exchange of information and could be withheld if U.S. reinsurers did not get similar or equal treatment in non-U.S. domiciles. Becoming a qualified jurisdiction may be easier for a non-U.S. domicile than negotiating a separate agreement similar to the Covered Agreement.

5. All lines of business reinsured by covered reinsurers would be subject to the same collateral requirements.

Rationale: Currently, certified reinsurers may only be certified for select lines of business. But this requirement is not mandated by the Covered Agreement. Rarely does the covered lines distinction come into play, and many states do not specify what lines are certified. Removing the line of business requirement eliminates the need for regulators and ceding insurers to monitor and track recoverables by line of business, without any measurable change to credit risk.

6. We suggest that all reinsurers that wish to become covered reinsurers apply for the designation and pay a small annual filing fee. We also suggest that the NAIC keep a current list of covered reinsurers on behalf of all states.

Rationale: The rationale for the above recommendations is as follows:

a. Having a list of covered reinsurers alleviates each state regulator and every ceding insurer from determining whether a reinsurer meets the capital and solvency requirements. Having a single list would also alleviate the need for groups with statutory companies in different domiciles to check the status in multiple states.

b. Having a centralized list avoids duplication of effort at the state level. It eliminates the need for each state to develop and maintain their own listing. States could simply have a link to the NAIC list.

c. This approach eliminates the need for covered reinsurers to apply in each state and pay multiple filing fees. The filing fee would be used to offset the cost of maintaining the list of covered reinsurers.

7. We suggest October 1 as the designated date for reinsurers to become covered. If a reinsurer does not appear on the NAIC list of covered reinsurers by October 1, they would be subject to normal collateral requirements. This would allow ceding insurers three months to obtain collateral from reinsurers.

Rationale: There needs to be a cutoff to ensure ceding insurers can obtain the required collateral prior to year-end. The cut-off needs to be early enough so that both ceding insurers and reinsurers are aware of the year-end collateral requirements. The October 1 date should allow ceding insurers and reinsurers to work together to meet year-end collateral requirements.

8. As far as a transition, if all of the above recommendations are implemented, we believe that certified reinsurers could be converted to covered reinsurers at some point in the future.

Rationale: Most if not all certified reinsurers would meet or exceed covered reinsurer criteria. Since the benefits of being a covered reinsurer are superior to a certified reinsurer (in almost all cases), and the requirements are essentially the same, there is little need for certified reinsurers to continue to exist. This also simplifies reporting on a go-forward basis as a reporting category can be eliminated. Therefore, all reinsurers would be in one of three categories:

1. Covered reinsurers - Meeting the requirements above and listed on the NAIC website

2. Authorized reinsurers - Meeting current licensing requirements at the state level

3. Unauthorized reinsurers – Reinsurers who are neither covered nor authorized and are required to provide 100% collateral for outstanding reinsurance recoverables.

9. These changes should be incorporated into a new Credit for Reinsurance Model Law and Regulation. In conjunction with these changes, Schedule F should be simplified.

Rationale: These recommendations, if adopted, would need to be incorporated into the relevant law and regulation. Ultimately, schedule F can be simplified as there will be no need to track recoverables from catastrophes and track rating changes for certified reinsurers.

Thoughts on Amending the EU – U.S. Covered Agreement

It took a great deal of effort to negotiate and execute the Covered Agreement. We believe the appetite to revise the agreement is low. However, we are suggesting only one material change to the agreement. Specifically, we suggest replacing the 100% solvency ratio requirement with a

requirement of two interactive, public financial strength ratings of A- or A3 or higher. As mentioned above, the ratings may provide a more up-to-date standard than the solvency ratio.

We view the other suggested changes as relatively minor. The EU could be considered a "qualified jurisdiction". For consistency, we also suggest setting the minimum capital at $250mn using the foreign exchange rate on the date of the reported financials.

Consistent with the Covered Agreement, no collateral would be required for reinsurers that meet the suggested requirements.

We suggest that no changes are made to the Covered Agreement until the new law and regulations incorporating the above suggestions are in place.

The above recommendations could be adopted without making any changes to the Covered Agreement. (EU reinsurer would be subject to different requirements.) However, it may make sense to consider amending the Covered Agreement, so that there is one approach that applies to all reinsurers globally.

We hope that all interested parties find these recommendations helpful.

Please contact me if you have any questions regarding our recommendations,

Kind Regards,

Michael McClane
Managing Director
Aon Benfield Analytics

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February 5, 2018

VIA ELECTRONIC MAIL **jstultz@naic.org**

Jake Stultz
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, Missouri 64106

SUBJECT: Bilateral Agreement between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement)

Dear Mr. Stultz:

Thank you for the opportunity to submit comments regarding how to proceed with reinsurance collateral reform in response to the Covered Agreement.

California is of the view that the *Credit for Reinsurance Model Law* (#785) and *Credit for Reinsurance Model Regulation* (#786) can be amended to accommodate the terms of the Covered Agreement. For example, the Covered Agreement relies on capital and solvency standards that are essential to the certification of reinsurers, and it allows for information sharing and documentation similar to the requirements in Models #785 and #786 for certified reinsurers. Thus, Models #785 and #786 provide an existing framework to build upon for this next evolution of reinsurance collateral reform.

As a member of the Reinsurance Task Force, California is committed to developing a plan to implement the Covered Agreement in a way that reflects the agreement that was made, and provides adequate protection for our domestic cedents and policyholders.

Sincerely,

Monica Macaluso
Attorney

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CHUBB February 6, 2018

BY E-MAIL

Superintendent Maria Vullo, Chair
Reinsurance Task Force
National Association of Insurance Commissioners

Re: Chubb Group Comments on NAIC Implementation of the Collateral Provisions of the Covered Agreement

Dear Superintendent Vullo:

Thank you for the opportunity to provide comments regarding how the collateral provisions of the US-EU Covered Agreement (Covered Agreement or Agreement) should be implemented in the state insurance regulatory system. This is an important issue requiring thoughtful, timely action.

As a fundamental principle, Chubb strongly supports open and fair insurance markets. Protectionist measures in regulation, trade and tax, both within the U.S. and around the globe, trap capital locally and impose unnecessary burdens, challenging the efficient spread of risk and company growth. We encourage cooperation and supervisory recognition between well-regulated jurisdictions, both between the states and between the U.S. and other countries. The Covered Agreement is a good example of this principle in practice.

In implementing the collateral provisions of the Covered Agreement, Chubb encourages state regulators to:

1. Utilize the Covered Agreement terms as a template to revise the Model Credit for Reinsurance Law and Regulation to treat all well-regulated jurisdictions (and companies from those jurisdictions that meet the criteria) in the same manner. This means extending the Agreement's benefits and obligations to other jurisdictions that meet the relevant criteria, including the current NAIC "Qualified Jurisdictions" Bermuda, Switzerland and Japan. This not only fulfils the NAIC's desire to minimize the need for future covered agreements, but, more importantly, it eliminates unnecessary

protectionist measures and treats similarly regulated companies the same. We also urge the NAIC to specifically deal with how the UK (which is currently a Qualified Jurisdiction) will be treated after March 2019 when it will no longer be a member of the EU subject to the terms of the Covered Agreement. The NAIC needs to minimize any potential disruption in the U.S. insurance markets as a result of this development.

CHUBB

2. Impose the same obligations on all jurisdictions that are designated to receive the reduced collateral benefits. By way of example, the EU made a formal statement of their respect for the U.S. system for (re)insurance supervision and regulation in the Agreement. The EU also made several significant commitments, including: (1) worldwide group supervision (including governance, solvency, capital and reporting) for a company operating in both jurisdictions will be conducted only by the company's group supervisor; (2) the U.S. group capital assessment will be accepted for U.S.-supervised (re)insurers; and (3) collateral and reinsurer local presence requirements in the EU will be eliminated. Other jurisdictions receiving the reduced collateral benefits should be required to make similar commitments.

Obtaining these commitments is also important in the context of other global events, including development of the International Capital Standard (ICS) at the IAIS. After state regulators complete their aggregation methodology for a group capital assessment, the U.S. will ask the IAIS to deem it an acceptable "outcome-equivalent" approach for implementing the ICS. The terms of the Covered Agreement strongly indicate that the EU should support the U.S. position. Obtaining the support of additional jurisdictions for the U.S. approach to group capital will enhance the U.S. position that the aggregation method should be accepted.

3. Evaluate existing regulatory tools and not rush to add additional "guardrails" for U.S. cedents to address some perceived increased solvency risk caused by the collateral changes. Notably, the NAIC's Property and Casualty Risk-Based Capital (RBC) framework addresses a cedent's credit risk associated with reinsurance recoverables (referred to as "R3") in a jurisdictionally agnostic way, taking into account whether the recoverables are collateralized. R3 includes several important features such as: (1) basing the capital charges on the reinsurer's financial strength rating (FSR); (2) allowing collateral to reduce the reinsurance credit risk portion for lower rated reinsurers; (3) deriving the R3 factors from historical default risk by FSR category; (4) applying the charges at the transaction level for each cedent/reinsurer relationship; and (5) providing transparent reporting of the credit

risk for each cedent's recoverables in Schedule F-Part 3. Finally, increasing burdens on cedents without regard to their financial condition and the strength of the relevant regulatory regime that supervises them would defeat the purpose of collateral reduction and also could result in other jurisdictions responding with additional protections (e.g., capital or collateral) on risks assumed by U.S.-based insurers.

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It is important that the U.S. insurance industry be well regulated, financially sound, and able to provide the financial security essential to economic growth. Towards that end, regulation should be effective and efficient, utilizing cooperation and recognition of other jurisdictions' regulation where possible, both within the U.S. and abroad to achieve the efficiency of worldwide access for well-regulated, well-capitalized (re)insurers.

Thank you for the opportunity to provide comments. We look forward to the February 20 hearing.

Respectfully submitted,

Tracey Laws
Sr. V.P. & General Counsel Global Government & Industry Affairs

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THE CINCINNATI INSURANCE COMPANIES

The Cincinnati Insurance Company ▪ The Cincinnati Indemnity Company
The Cincinnati Casualty Company ▪ The Cincinnati Specialty Underwriters Insurance Company
The Cincinnati Life Insurance Company

February 6, 2018

Superintendent Maria T. Vullo, Chair
Reinsurance (E) Task Force
National Association of Insurance Commissioners
c/o Mr. Jake Stultz
Via e-mail jstultz@naic.org

Re: NAIC Notice of Public Hearing and Request for Comments to Address Covered Agreement

Dear Superintendent Vullo:

The Cincinnati Insurance Companies (CIC) appreciate the opportunity to participate in the upcoming public hearing on February 20, 2018 in New York to address implementation of the reinsurance collateral provisions of Article 3 of the Covered Agreement. We respectfully submit these comments in conjunction with oral comments to be presented at the public hearing.

General Comments. At the 7th EU-US Insurance Symposium held on Friday, January 26, 2018 at the U.S. Chamber of Commerce, we shared our deep concerns with the covered agreement, which we view as a unilateral nullification of the McCarran Ferguson Act by the Administration without any meaningful Congressional process.[1] We strenuously opposed the signing of the covered agreement by the United States, for various reasons set forth in these three documents attached to our written comments:

- Exhibit A – Views of The Cincinnati Insurance Companies On Covered Agreements
- Exhibit B – The Process for Negotiating and Implementing a Covered Agreement In The U.S. Needs a Legislative "Check & Balance" By Congress
- Exhibit C – Cincinnati Financial Has Grave Concerns With The Covered Agreement

In our opinion, the NAIC's "sliding scale" reinsurance collateral model law and regulation[2] was working fine and was fairly and effectively giving non-US reinsurers relief from collateral to those firms worthy of relief from collateral. Approved in 35 states and well on its way to adoption in all 50 states, sliding scale model was never given a chance.[3]

[1] Unlike the EU – which has two formal approval mechanisms by the European Council and the European Parliament before ratification of a covered agreement can occur – no formal approval mechanism exists for the U.S. Congress. As we argued in Congress, the covered agreement looks like a trade agreement and smells like a trade agreement so it should be ratified by Congress like any other trade agreement.

[2] Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).

[3] See Exhibit D, attached hereto, "Implementation of 2011 Revisions to Credit for Reinsurance Model Law #785 and Model Regulation #786" [status as of September 2, 2016].

Given our longstanding opposition to the covered agreement, we will be watching the implementation process very closely to make sure there are no attempts to include provisions in the revised U.S. reinsurance collateral laws that are not authorized in the covered agreement signed by the U.S.

It is this frame of mind that we offer comments on the specific matters the NAIC has sought stakeholder input in advance of the Public Hearing on February 20.

NAIC Request for Specific Comments. The NAIC has requested specific comments on the following approaches to reinsurance collateral reform:

NAIC Request #1. Amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement.

> CIC Views. We believe the most efficient way to implement the reinsurance collateral provisions of Article 3 of the Covered Agreement is by making amendments to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786). We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #2. Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

> CIC Views. We are quite conflicted on this topic. Although we deplore covered agreements for the reasons expressed above and hope that the United States never negotiates another covered agreement, we recognize that other jurisdictions may seek collateral relief in the U.S. via a covered agreement. We also recognize the inequity of EU jurisdictions getting relief from collateral in the U.S. via the covered agreement while non-EU jurisdictions get no such relief. To address this inequity, we would suggest that the NAIC consider revisions to Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) which grant collateral relief to non-EU jurisdictions to the same extent and on the same terms that it is being extended to EU jurisdictions per the covered agreement. This would avoid the need for future covered agreements on reinsurance collateral. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #3. Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements.

> CIC Views. See our answer to NAIC Request #2. To the extent that the covered agreement creates inequities between EU jurisdictions and non-EU jurisdictions under the NAIC's Qualified Jurisdictions paradigm, the NAIC should consider how to best resolve these inequities. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #4. Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction.

> CIC Views. See our answer to NAIC Request #2. To the extent that the covered agreement creates inequities between EU jurisdictions and non-EU jurisdictions in regard to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction under the NAIC's Qualified Jurisdictions paradigm, the NAIC should consider how it might make changes to the criteria to best resolve these inequities. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #5. Considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral.

> CIC Views. As a major purchaser of reinsurance, we are generally opposed to such guardrails. If the NAIC had such concerns before the covered agreement was signed, why did the NAIC tacitly waive its opposition the covered agreement before it was signed? Instead of punishing U.S. cedants with a "covered agreement tax" the NAIC should work on making sure that the states are equipped to modify their financial surveillance paradigms to ensure that the elimination of collateral under the covered agreement does not cause increased financial solvency risks. Regarding the idea of making changes to the risk-based capital (RBC) formula to help address any increased financial solvency risks caused by the elimination of reinsurance collateral, the NAIC's recently revised Property and Casualty Risk-Based Capital (P&C RBC) framework adequately addresses credit risk associated with reinsurance amounts recoverable. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

NAIC Request #6. Any other considerations to weigh as part of the states' implementation of the Covered Agreement.

> CIC Views. The covered agreement creates a "Joint Committee" to serve as a forum for consultation and to exchange information on the administration and proper implementation of the covered agreement. CIC believes that proper implementation of the covered agreement requires appropriate transparency and engagement with stakeholders, as well as advocacy for U.S. interests. Because U.S. state regulators will be largely responsible for implementing the covered agreement, it is imperative that state regulators and state legislators be named as members of the Joint Committee to ensure that discussions in the Joint Committee will be well-informed of the views and interests of state insurance regulators. We will have additional comments on this issue when we present oral testimony at the public hearing on February 20 in New York.

Conclusion. CIC appreciates the opportunity to offer comments on implementation of the covered agreement and look forward to continuing to voice our views and concerns as the NAIC process advances. Please do not hesitate to contact us with any questions or concerns.

Sincerely,

Scott A. Gilliam
Vice President & Government Relations Officer

EXHIBIT A

VIEWS OF THE CINCINNATI INSURANCE COMPANIES ON COVERED AGREEMENTS

Statement for the Record Prepared for the Senate Banking, Housing & Urban Affairs Committee
Hearing on "Examining The U.S.-EU Covered Agreements"

[May 2, 2017]

THE U.S. SHOULD RENEGOTIATE THE PENDING COVERED AGREEMENT. The pending covered agreement should be pulled back and renegotiated since the process under which it was negotiated failed on many levels and resulted in an agreement with many procedural and substantive flaws, the terms of which could greatly damage the primacy of our state insurance regulatory system.

LACK OF TRANSPARENCY IN THE PROCESS. There was no transparency in the negotiation process. During the negotiation process there were no meaningful stakeholder process or updates for the public on the substance of what was being negotiated, and the text of the agreement was hidden from the public until it was filed with Congress on January 13, 2017.

STATE REGULATORS BARRED FROM THE NEGOTIATING TABLE. The law governing the covered agreement negotiations prohibited any meaningful participation by state regulators. State regulators were allowed to attend the negotiating sessions but were not permitted to directly or actively negotiate and were forced to sign nondisclosure agreements preventing them from revealing what they heard in those sessions. Had state regulators had real negotiating power, the outcome of the negotiation would have almost certainly been different and the terms of the covered agreement better. Instead, state regulators were put in the terrible position of being forced to watch on the sidelines as the Administration and a foreign power reshaped the landscape of state insurance regulation on reissuance collateral and group capital requirements.

THERE WAS NO NEED TO ADDRESS REINSURANCE COLLATERAL IN THE COVERED AGREEMENT. Had state regulators been allowed a meaningful role in the negotiations of the covered agreement, they would have most certainly argued against including the "zero reinsurance collateral" preemption provision in the covered agreement since the U.S. already has a state-regulated system that allows EU reinsurers to post zero collateral in the U.S. if they achieve the "Secure—1" financial strength rating under the NAIC's "sliding scale" reinsurance collateral model law. The NAIC model is well on its way to being adopted in all 50 states; 35 states have already enacted the model law and the pace for adoption by the rest of the states will now quicken since the NAIC has made enactment of the model law an accreditation requirement.[1]

THE NAIC'S "SLIDING SCALE" COLLATERAL LAW IS BETTER FOR CONSUMERS. The NAIC's "sliding scale" reinsurance collateral law is better for consumers than the provision included in the covered agreement since the NAIC model provides six different financial strength rating categories for EU reinsurers; the reinsurance collateral provision in the covered agreement only utilizes one financial strength rating for EU reinsurers. Under the NAIC sliding scale, the better the financial strength rating of the EU reinsurer, the lower the collateral requirement:

Secure—1 (0% Collateral)	Secure—4 (50% Collateral)
Secure—2 (10% Collateral)	Secure—5 (75% Collateral)
Secure—3 (20% Collateral)	Vulnerable—6 (100% Collateral)

This provides a better mechanism for U.S. insurers to judge the solvency and claims paying ability of EU reinsurers before they decide whether to do business with them, which ultimately protects consumers and policyholders who want assurance that payment of their claims will not be impacted by EU reinsurers with weak

[1] To put the issues relating to reinsurance collateral in context, it should be noted that the states have long required EU reinsurers to post collateral for their U.S. obligations given differences in EU accounting systems, differences in the rigor of insurance regulation in the EU, and difficulty with enforcement of judgments by U.S. primary insurers against EU reinsurers in their home jurisdictions, all of which make it challenging for state regulators to rate the ability and/or willingness of EU reinsurers to pay their U.S. obligations.

financial strength ratings. The NAIC sliding scale model law also protects the U.S. guaranty fund system, which relies upon U.S. insurers to do business with reinsurers with strong financial strength ratings who will honor their U.S. obligations after a ceding company becomes insolvent.

PREEMPTIVE POWER IS UNNECESSARY TO ACHIEVE MUTUAL RECOGNITION. The covered agreement creates a process for state reinsurance collateral laws to be preempted if they are not revised to comply with the terms of the covered agreement. Allowing a covered agreement to preempt state laws puts the power of dictating U.S. regulatory policy in the hands of non-regulatory federal bodies and foreign governments. The U.S. should continue to pursue mutual recognition agreements with foreign bodies which recognize the robustness of our state regulatory system and put U.S. companies on a level playing field, but they should not overwrite state laws or otherwise sacrifice state insurance regulation to achieve those objectives. As such, covered agreements should have no preemptive power and should be limited to securing mutual recognition of the U.S. system under the EU's Solvency II regulatory regime.

OTHER SUBSTANTIVE FLAWS IN THE COVERED AGREEMENT. The covered agreement has three additional substantive flaws that might have been avoided if state regulators had a voice in the process and a seat at the negotiating table:

- The covered agreement fails to grant the U.S. regulatory system full equivalency under the EU's Solvency II regulatory regime. As a result, U.S. domiciled insurers will not be permitted to operate in the EU on the same regulatory terms as insurers domiciled in the EU.
- The covered agreement requires the states to enact a group capital requirement, contrary to the desires of the NAIC (the NAIC is in the process of developing a group capital calculation which they do not want to become to become a capital requirement).
- The covered agreement creates a "Joint Committee" with considerable authority to implement the covered agreement in the U.S., but its members will not include anyone representing state insurance regulatory authorities.

NO MEANINGFUL CHECK & BALANCE BY CONGRESS. The law which governs the covered agreement negotiation process is also flawed by the absence of any meaningful check and balance by Congress. Under the current process, the Administration can unilaterally preempt state insurance laws through a covered agreement. The only Congressional check on this power is a 90 day layover requirement (a covered agreement may not be implemented until 90 days after it is filed with Congress). In contrast, the EU requires two legislative approvals before implementation. Congress needs to have check and balance power over covered agreements which is as meaningful as the EU's check and balance power over them.

CONCLUSION: RENEGOTIATE THE FLAWED COVERED AGREEMENT. The current law under which covered agreements are negotiated needs to be reformed by Congress to address the deficiencies identified above. Once that occurs, the Administration should return to the negotiating table with state insurance regulators, and, with the benefit of an open and transparent process and meaningful checks and balances, seek a covered agreement which grants mutual recognition and Solvency II equivalence to U.S. insurers doing business in the EU.

For Further Information Please Contact:

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EXHIBIT B

THE PROCESS FOR NEGOTIATING AND IMPLEMENTING A COVERED AGREEMENT IN THE U.S. NEEDS A LEGISLATIVE "CHECK & BALANCE" BY CONGRESS

- **A covered agreement cannot be implemented in the EU without legislative ratification by the Council of the European Union and the European Parliament.**

- **The United States Congress should have the same "check & balance" authority over the Administration's autonomous negotiation of a covered agreement.**

The incongruity between the EU & U.S. Approval Processes. Under the Dodd-Frank Act, Congress is not required to ratify any covered agreement negotiated by the Administration (Treasury and USTR). In contrast, any covered agreement negotiated by the European Union must be approved through two legislative processes.[1] Doesn't it seem odd that the EU requires legislative approval of covered agreements but there is no legislative approval process for covered agreements in the U.S.?

Covered agreements should be ratified like any other trade agreement. Congress must ratify trade agreements negotiated by the Administration, like the Trans-Pacific Partnership Agreement currently under consideration by Congress. Likewise, shouldn't Congress be required to ratify covered agreements, which regulate various aspects of the insurance trade between nations?

Unchecked preemption of state insurance law. Under the covered agreement process authorized under Dodd-Frank, the Administration is given carte blanch authority to negotiate away state insurance laws and regulations. I find it very unsettling that the Administration can negotiate a covered agreement with terms that can preempt state insurance regulation without approval by Congress. Shouldn't there be a legislative check and balance on this unbridled power to eviscerate state insurance law? Shouldn't Congress have a voice in the Administration's use of covered agreements to engage in piecemeal repeal of the McCarran-Ferguson Act?

Lack of transparency. Thus far the EU and U.S. negotiators have not presented the public with any details on the substance of their negotiations. In fact, it appears that all parties to the negotiations have signed nondisclosure agreements. Doesn't this lack of transparency make it incumbent on Congress to debate the terms of a covered agreement and have a vote on whether to ratify a covered agreement before it becomes law in the United States?

Trojan horse for international insurance standards. Congress has spent a considerable amount of time this year on the need for greater transparency and congressional oversight of international insurance standards setting processes, which culminated in the full Committee's passage of H.R. 5143 (Chairman Luetkemeyer's bill). We are concerned that a covered agreement could include terms which import international insurance standards into the U.S. without any Congressional review, debate or approval. Doesn't this make it imperative for Congress to debate and ratify any covered agreement negotiated by the Administration?

Prepared by The Cincinnati Insurance Companies
Key Contact: Scott A. Gilliam, Vice President & Government Relations Officer
6200 S. Gilmore Road | Fairfield, OH 45014 | Phone: 513-607-5717
Email: scott_gilliam@cinfin.com

[1] First, the Council of the European Union, a body made up of representatives from each of the 28 EU member states, must approve the covered agreement by qualified majority voting. Second, the European Parliament, a legislative body composed of 751 members, with seats allocated on the basis of the population of each member state (much like our U.S. Congress), must ratify the covered agreement by a majority vote. The European Parliament may accept or reject the proposed text of the agreement but cannot amend it. If the European Parliament does not give its consent, the covered agreement cannot be adopted.

EXHIBIT C

CINCINNATI FINANCIAL HAS GRAVE CONCERNS WITH THE COVERED AGREEMENT

QUICK SUMMARY – A NEGOTIATED ATTACK ON STATE INSURANCE REGULATION

STATE INSURANCE REGULATION UNDER ATTACK. Our concerns with the covered agreement are grounded in our support of our time-tested state insurance regulatory system. The covered agreement is a negotiated attack on state regulation which imposes federally-negotiated regulatory standards on the states in regard to ***reinsurance collateral*** and ***group capital***.

THE NEGOTIATION WAS FLAWED. The regulators whose system is being involuntarily altered under the covered agreement had no meaningful voice or leverage during the negotiations. State regulators were allowed to attend the negotiating sessions but they were not entitled to negotiate. The state regulators were also required to sign nondisclosure agreements after every negotiation session. Had state regulators had a meaningful voice in the negotiation the outcome on ***reinsurance collatera***l and ***group capital*** would have been much different.

REGULATORY POKER GAME. Given the terms of the covered agreement, it appears that federal negotiators were willing to gamble away state insurance regulatory authority over ***reinsurance collateral*** and ***group capital*** in exchange for making it easier for certain U.S. firms to do business in the EU under relaxed Solvency II requirements. That's unconscionable. If U.S. firms want to play in the EU sandbox they should comply with Solvency II like several other U.S. firms doing business in the EU have already done.

AMBIGUITIES NECESSITATE A PAUSE FOR PUBLIC COMMENT. In an April 7, 2017 letter to the Treasury Secretary Mnuchin and the Acting U.S. Trade Representative, 24 members of Congress expressed their bipartisan concern with the numerous ambiguities in the covered agreement and asked that it not be signed until they can be clarified and resolved. Proponents say just sign the agreement and we'll figure out the ambiguities later. That is not an option. Instead, the Administration should notice a 90 day public comment period for interested parties to flush out the ambiguities and determine if they were actually intended by the negotiators.

FOREIGN GIVEAWAY. EU reinsurers are already bragging about the $40 billion in collateral relief they will obtain under the agreement. In exchange, the states get new regulatory edicts on reinsurance collateral and group capital that they had no ability to shape or protest. These are the same EU reinsurers who begged the NAIC to adopt a sliding scale reinsurance collateral law under which required collateral would range from zero to 100% based on solvency and claims paying ability. Now they get zero collateral without any metrics to test solvency or claims paying ability.

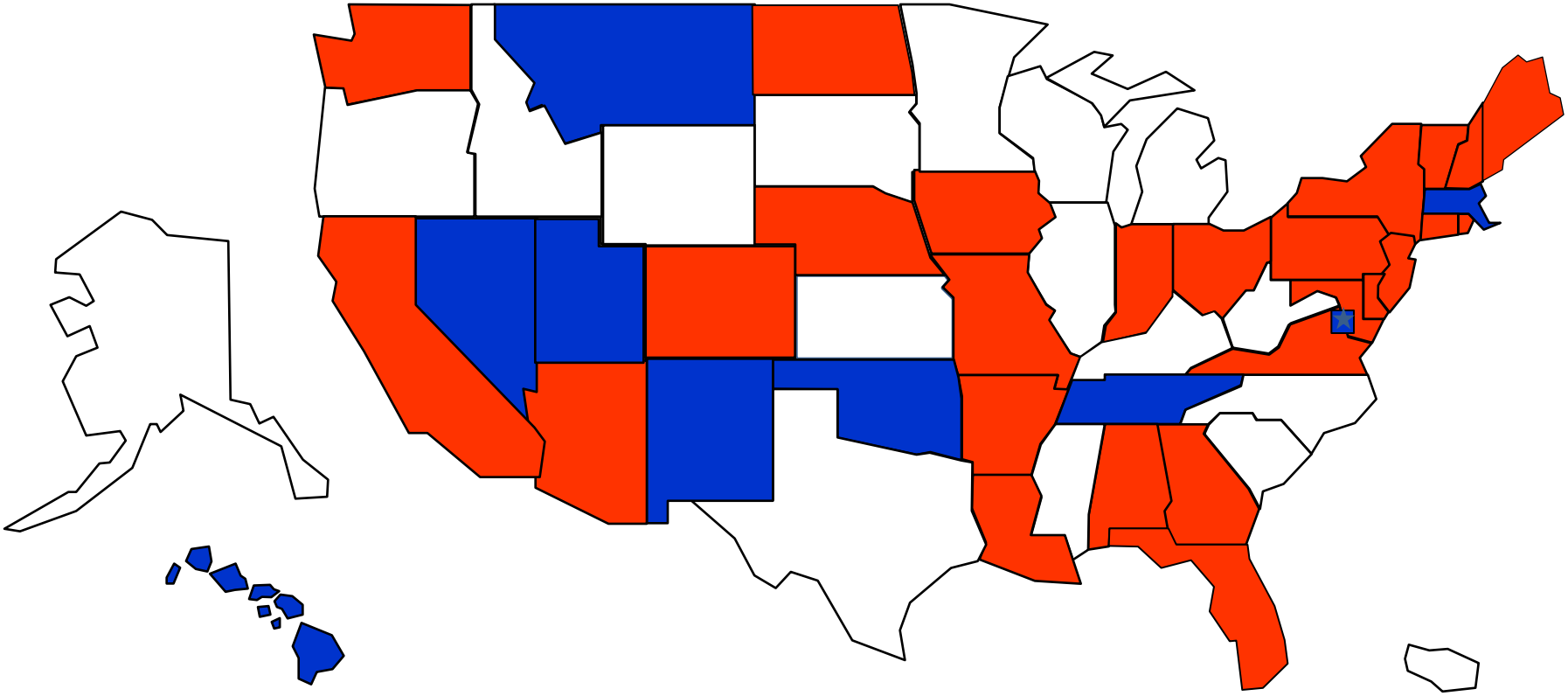
NO CHECK & BALANCE BY CONGRESS. Unlike the EU – which has two formal approval mechanisms by the European Council and the European Parliament before ratification can occur – no formal approval mechanism exists for the U.S. Congress. The covered agreement looks like a trade agreement and smells like a trade agreement so it should be ratified by Congress like any other trade agreement.

TROJAN HORSE. Our greatest fear, that covered agreements would become a Trojan horse for the importation of European bank-centric international standards on the U.S., has been realized. Under Art. 4 of the agreement the states have to adopt a European style group capital requirement. The Europeans are hoping the new Administration doesn't figure out the terrible consequences of the group capital requirement before it is signed.

RENEGOTIATE THE COVERED AGREEMENT. Clarifications and exchange of letters will not solve the dilemma posed by the ambiguities in the covered agreement. The negotiations must be reopened with state insurance regulators at the table and with real negotiating power and with federal negotiators who seek to preserve state regulation rather than destroy it.

EXHIBIT D

Implementation of 2011 Revisions to Credit for Reinsurance Models
Model Law #785
Model Regulation #786
[status as of September 2, 2016]



Adopted both 785 & 786
(26: AL, AZ, AR CA, CO, CT, DE, FL, GA, IA, IN, LA, MD, ME, MO, ND, NE, NH, NJ, NY, OH, PA, RI, VA, VT, WA)

Adopted 785
(9: DC, HI, MA, MT, NM, NV, OK, TN, UT)

No Action to Date

Disclaimer: This map represents state action or pending state action regarding NAIC amendments to the model(s). This map does not reflect a determination as to whether the pending or enacted legislation contains all elements of NAIC amendments to the model(s) or whether a state meets any applicable accreditation standards.

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February 6, 2018

National Association of Insurance Commissioners
NAIC Central Office
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Reinsurance collateral provisions of Article 3 of the Covered Agreement

To members of the Reinsurance Task Force,

CNA Financial Corporation (referred to in this letter as CNA, the Company, we, our, and us) appreciates the opportunity to provide written comments regarding how the NAIC will implement the U.S./E.U. Covered Agreement (Covered Agreement or Agreement). Our response is formatted in the manner requested and answers the questions as follows:

1. Amending the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement.

In order to ensure consistent adoption and application nationwide, the NAIC should modify and adopt the Credit for Reinsurance Model Law and regulation to incorporate the provisions of the Covered Agreement. These modifications should include adding a separate category of reinsurer, similar to the six existing categories found in the current model law. This new category would eliminate the need for U.S. cedents to hold collateral in order to take statutory reserve credit for amounts recoverable from E.U. reinsurers. We also believe it is critical to add a provision to this category that removes such reserve credit without collateral if any provision of the Covered Agreement falls into non-compliance. This would ensure prompt response to non-compliance without having to change state law. Finally, we believe that the NAIC should establish a committee with the U.S. Treasury to evaluate and determine E.U. compliance of the Covered Agreement going forward. The decisions of this committee could be used as the trigger for rolling back collateral relief for this class of reinsurer in the event of non-compliance.

2. Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Covered Agreement does much more than provide collateral relief to E.U. reinsurers; it provides recognition of the U.S. regulatory framework for U.S. insurance groups operating in the E.U. This recognition removes the threat that U.S. groups conducting business in the EU could be subject to Solvency II Group Supervision in the event that the U.S. is not deemed equivalent under Solvency II. It is important to note that CNA has always favored state based regulation of insurance and opposes any action that could jeopardize the McCarran-Ferguson Act of 1945. We do believe that the Federal involvement in the execution of the Covered Agreement actually preserves the states' ability to regulate

U.S. groups doing business in the EU; however, we do acknowledge Federal pre-emption is a possibility if certain terms of the Covered Agreement fall into non-compliance due to the failure of states to adopt required changes in reinsurance laws.

Another important point to consider when evaluating the expansion of the Agreement's collateral relief to Qualified Jurisdictions is the recent Kuala Lumpur Agreement (KL Agreement) regarding the Insurance Capital Standard (ICS), which we view as yet another threat to the U.S. state-based regulatory system from an international standard setter. As described in the KL Agreement and beginning in 2020, all Internationally Active Insurance Groups (IAIG), including CNA, would be subject to mandatory reporting of the ICS on a Market Adjusted Valuation (MAV) basis. The results would be provided to both a firm's group supervisor and the IAIS for an official five year monitoring period. During this monitoring period the group supervisor can also direct firms to provide additional data to the IAIS under an aggregation approach which will be evaluated to determine comparability with the ICS on a MAV basis. If successful, the aggregation approach could become an optionally accepted approach beginning in 2025, which would follow five years of MAV reporting by the IAIGs to Group Supervisors and Supervisory Colleges.

While CNA is supportive of the "Team USA" efforts regarding the aggregation approach, reporting the ICS on a MAV basis for five years is a line too far to cross. In our opinion, once MAV is required to be prepared in a robust and reportable fashion to insurance regulators the proverbial "valuation war" has been lost and MAV will become the ultimate and only ICS valuation standard.

In response to the KL Agreement, the NAIC should take a hard line regarding expanding collateral relief to qualified jurisdictions and only grant it to jurisdictions that provide mutual recognition for the U.S. Group Supervisory Framework in return. Access to the world's largest market on a cost effective collateral free basis is a very attractive asset to market participates world-wide and its value must not be squandered when the future of statutory accounting and the current U.S. regulatory system is at stake. It is our view that obtaining concrete mutual recognition agreements with the world's largest markets would significantly reduce the drumbeat for a global capital standard modeled after Solvency II. This mutual recognition can be accomplished by entering into a separate covered agreement with key jurisdictions, or if legally supportable, a Multi-lateral Memorandum of Mutual Understanding (MMOU).

3. Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements.

See our comments in the prior sections

4. Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction.

No comment

5. Considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral.

Prior to looking at the additional "guardrails" for U.S. ceding companies, we believe it is imperative that the NAIC first get the statutory balance sheet correct with an updated reinsurance credit analysis to replace the outdated Schedule F penalty process. A Schedule F penalty approach was a reasonable and conservative approach when the consideration was whether a reinsurer was authorized or provided

collateral. Now that collateral is not going to be required for a significant number of unauthorized reinsurers, we recommend that the NAIC adopt a bad debt valuation allowance approach similar to U.S. GAAP. This would provide for a robust credit assessment of reinsurance receivables ensuring the accuracy of U.S. Statutory Financial Statements which is the basis for determining an insurer's ordinary dividend capacity. Once the balance sheet is correct, we believe the recently adopted RBC charges for reinsurance recoverables is an appropriate approach even in a world without regulatory required collateral.

6. Any other considerations to weigh as part of the states' implementation of the Covered Agreement.

No Comment

As always, CNA appreciates the opportunity to respond to these very important issues and requests the opportunity to testify during the February 20th hearing.

Sincerely,

Jeffery C. Alton

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GDV
DIE DEUTSCHEN VERSICHERER

Jake Stultz
National Association of Insurance Commissioners
1100 Walnut Street
Suite 1500
Kansas City, MO 64106-2197
USA

Ref
V 3

Phone extension
-5435

Date
2018-02-06

NAIC public hearing to address reinsurance collateral provisions of Article 3 of the Covered Agreement

Dear Mr. Stultz,

Thank you for the opportunity to provide written comments in advance of the public hearing. The Covered Agreement which is due for ratification soon constitutes a tremendous step forward in the relationship between the United States and the European Union as it is built on mutual trust and regulatory cooperation/recognition between the parties. Both the European and German authorities have already demonstrated their full commitment to the Agreement, and we are confident that the U.S.-side will do so either.

Considering the issues identified in the notice of the public hearing, we would like to respectfully offer the following comments:

1) Impact on the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation

The Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation require an assuming insurer to be licensed and domiciled in a "Qualified Jurisdiction" in order to be eligible for certification by a state as a certified reinsurer for reinsurance collateral reduction purposes. We understand that, as a result of the Covered Agreement, this condition does not apply to EU-domiciled reinsurers fully compliant with Article 3 (4) of the Agreement anymore. Furthermore, we understand that the Agreement shall, pursuant to its Article 10 (2) (a), be provisionally applied as from 7 November 2017. Therefore, we kindly ask the NAIC

- to encourage each U.S. State to reduce the amount of collateral required by each State to allow full credit for reinsurance by 20 percent

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as of the January 1 before signature of the Agreement, Article 9 (3) (a),
- continue the gradual reduction for the 60 months implementation period, and
- encourage each U.S. State to abstain from requiring EU reinsurers to produce reporting formats that are not subject to the Agreement.

Apart from that, we would appreciate the clarification that EU jurisdictions are not subject to the process for developing and maintaining the NAIC List of Qualified Jurisdictions any longer.

2) Treatment of U.S. ceding (re-) insurers

The Preamble of the Agreement states that *"prudential measures applicable in the European Union, together with the requirements and undertakings provided for in this Agreement, achieve a level of protection for policyholders and other consumers with respect to reinsurance cessions and group supervision consistent with the requirements of the Federal Insurance Office Act of 2010".*

We understand that the U.S. confirmed that there are no increased financial solvency risks associated with EU reinsurers which qualify for the Agreement due to the elimination of collateral requirements. Therefore, we kindly ask the NAIC to consider additional "guardrails" for U.S. ceding companies with restraint, as they may be inconsistent with the spirit of the Agreement and may prevent U.S. insurers from utilizing its benefits.

We strongly believe that it is in the best interest of the parties to fully implement the Agreement, which will help to facilitate prosperity and economic growth on both sides. Thus, we count on the NAIC's professional expertise and support to path the way to a successful implementation.

Yours sincerely,

Dr. Axel Wehling

Karen Bartel

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February 6, 2018

Superintendent Maria T. Vullo
New York State Department of Financial Services
Chair, NAIC Reinsurance (E) Task Force
Via email to jstultz@naic.org

Re: NAIC request for comments on reinsurance collateral reform

Dear Superintendent Vullo,

The General Insurance Association of Japan (GIAJ)[1] appreciates the opportunity to comment as the NAIC initiates discussions on how to proceed with collateral elimination under the Covered Agreement.

The GIAJ believes that the NAIC's collateral reform should take due account of the following principles: consistency with existing rules, fair treatment among reinsurers, efficiency of supervision, and removal of duplicative regulations. We believe these principles support the objectives of the NAIC to promote competitive markets and policyholder protection.

Our specific comments on the "approaches to reinsurance collateral reform" build on these principles.

Request for Comments.

- *Amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement.*
- *Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.*
- *Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements*

Collateral elimination should be achieved by amending the existing Model Law/Regulation.

We support the NAIC's moves to achieve collateral elimination by amending the existing Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786). As part of efforts to modernize reinsurance regulation, #785 and #786 were amended in 2011 to allow reinsurance collateral reduction for non-U.S. based reinsurers. Collateral elimination under the Covered Agreement and collateral reduction under

[1] GIAJ is an industry organization whose 26 member companies account for about 95 percent of the total general insurance premiums in Japan which is one of seven jurisdictions listed in the NAIC List of Qualified Jurisdictions. Some of our members or their affiliates are certified reinsurers.

#785 and #786 for Certified Reinsurers in Qualified Jurisdictions are technically similar in that reinsurance regulations of foreign jurisdictions are evaluated to allow credit for reinsurance. Therefore, it is consistent and efficient to achieve reinsurance collateral reform by amending #785 and #786.

EU-based reinsurers, reinsurers from other jurisdictions covered by potential future covered agreement(s) and reinsurers domiciled in NAIC Qualified Jurisdictions should be provided with consistent reinsurance collateral requirements.

Regarding the three approaches to the Model Law/Regulation amendment listed in the Notice, we support "Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements". We support neither the first approach, "Amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement", nor the second approach, "Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act."

With regard to the first and second approaches in which the effect of collateral elimination is limited to the EU and/or jurisdictions covered by potential future covered agreements, we fear that they could potentially be arbitrary and inconsistent with the existing framework. Theoretically, it is possible that a jurisdiction under the scope of a covered agreement could fail to be recognized as a Qualified Jurisdiction. If this proves to be the case, while reinsurers domiciled in such jurisdictions will still be preferentially treated and granted reinsurance collateral elimination, reinsurers domiciled in Qualified Jurisdictions without a covered agreement will only be granted collateral reduction. The NAIC should avoid such a situation as it goes against the principle of fair treatment for reinsurers.

Moreover, these approaches require #785 and #786 to incorporate additional categories such as "the European Union (EU)" or "jurisdictions under the scope of covered agreement(s)". This makes the framework unnecessarily complex, and should be avoided.

In addition, according to the Dodd-Frank Act, a covered agreement could potentially deal with a wide range of issues related to prudential measures of insurance or reinsurance. Furthermore, it is far from certain how future covered agreements are to be negotiated with foreign government(s). The NAIC should avoid subjecting the Model Law/Regulation to such externalities and uncertainties.

Contrary to these two approaches, the NAIC can avoid the above-mentioned unfair treatment, regulatory complexities and uncertainties under the third approach, "Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements". The NAIC can leverage the current framework under #785 and #786 concerning Certified Reinsurers and Qualified Jurisdictions by revising the existing provisions on reinsurance collateral reduction (#785 Section 2E and #786 Section 8) to achieve reinsurance collateral elimination, and also apply them to Certified Reinsurers in every Qualified Jurisdiction regardless of EU membership status.

As for any EU jurisdiction not yet recognized as a Qualified Jurisdiction, a provision could be added, for example, to #785 Section 2E (3) and #786 Section 8C, to allow such jurisdictions to acquire Qualified Jurisdiction status. These revisions would secure efficiency and promote regulatory consistency between EU and non-EU Qualified Jurisdictions by making the best use of the NAIC's existing scheme.

Requirements on individual reinsurers should also be consistent between reinsurers domiciled in EU and non-EU Qualified Jurisdictions.

If the conditions for reinsurance collateral elimination stipulated in Article 3 Paragraph 4 of the Covered Agreement apply to EU reinsurers, the same conditions must apply to reinsurers domiciled in non-EU Qualified Jurisdictions. Otherwise, there exists the risk of arbitrage (i.e. reinsurers domiciled in jurisdictions which could fail to be recognized as a Qualified Jurisdiction enjoy an advantage over reinsurers domiciled in non-EU Qualified Jurisdictions).

We also suggest amending the existing requirements on Certified Reinsurers with regard to (i) minimum capital/surplus and (ii) financial strength ratings as follows, and applying them consistently to reinsurers domiciled in both EU and non-EU Qualified Jurisdictions:

(i) Allowing the use of audited financial statements submitted to the home supervisor.

(ii) Replacing the financial strength rating requirements with requirements to maintain on an ongoing basis the domestic (home jurisdiction's) SCR.

These revisions would help reduce the burden on state insurance regulators, the NAIC and relevant reinsurers, while maintaining the existing framework.

Request for Comments.

- *Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction.*

Criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction need no change.

The existing "Process for Developing and Maintaining the NAIC List of Qualified Jurisdictions" is comprehensive and specific enough to provide the information necessary to evaluate reinsurance regulations of foreign jurisdictions, and to determine credit for reinsurance. For both the reinsurance collateral reduction currently allowed and collateral elimination under the Covered Agreement, reinsurance regulations of foreign jurisdictions are evaluated to allow credit for reinsurance. Therefore, it is unnecessary to make the criteria any stricter.

In particular, the re-evaluations that Qualified Jurisdictions are subject to every five years should be conducted in an efficient manner with a focus on material changes to the applicable reinsurance supervisory system that may affect the status of the Qualified Jurisdiction.

Request for Comments.

- *Considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral.*

No need to consider additional "guardrails".

We do not believe additional "guardrails" need to be considered. Ceded reinsurance credit risk is appropriately captured, and consistently examined through the NAIC Property/Casualty Risk-Based Capital (RBC). The reliability of the current RBC to provide sufficient guardrails is supported by the fact that no collateral or additional guardrails are required for licensed reinsurers or accredited reinsurers (#785 Section 2AB and Section 3). At the same time, both the Qualified Jurisdictions and the Covered Agreement frameworks evaluate and recognize reinsurance regulations of foreign jurisdictions. These layers of measures provide sufficient policyholder protection. Additional requirements go against facilitation of fair competition and appropriate risk diversification. The credit risk of assuming reinsurers and whether or not to require collateral should ultimately be determined by the individual ceding insurers.

Article 3 Paragraph 1 (b) of the Covered Agreement stipulates that, regarding any new requirements on reinsurers, Home (EU) and Host (US) Party Assuming Reinsurers should be treated equally. From the standpoint of consistency, #785 and #786 should also secure the same treatment of assuming reinsurers domiciled in EU and non-EU Qualified Jurisdictions. Such treatment would also be beneficial in avoiding any risk of arbitrage (i.e. reinsurers domiciled in jurisdictions which could fail to be recognized as a Qualified Jurisdiction enjoy an advantage over reinsurers domiciled in non-EU Qualified Jurisdictions).

Sincerely,

Mamoru Otsubo
General Manager,
International Policy Planning Department
The General Insurance Association of Japan

FROM THE CHIEF EXECUTIVE

IUA OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION

2 February 2018

Via Email

National Association of Insurance Commissioners
Reinsurance Task Force

Attn: Jake Stultz

Dear Commissioners,

The International Underwriting Association of London (the "IUA") is pleased to provide these comments concerning implementation of the collateral reform provisions (Article 3 and Article 9) of the Bilateral Agreement between the European Union and the United States of America on Prudential Matters Regarding Insurance and Reinsurance (the "Covered Agreement"). These comments do not address any other provisions of the Covered Agreement.

We believe that the Covered Agreement is a significant event in the evolution of EU and US regulatory cooperation. It demonstrates a remarkable level of understanding and recognition of two different regulatory systems. With it, these two important and largest of the global insurance markets demonstrate how regulators can responsibly rely on each other in certain critical areas, thus avoiding unnecessary duplication of regulation and more efficient regulatory operations. Of course, the Covered Agreement makes important strides in ensuring the smooth functioning of two key reinsurance markets, and that is the focus of these comments. The Covered Agreement recognizes the strength of the US state-based system of regulation. But, it also places some immediate demands on US regulators to take prompt action to reform state laws and regulations. This public hearing is an important step in that reform process, and we strongly support your efforts to hold this meeting and are pleased to be a participant in it.

THE WORLD OF INSURANCE

In a further effort to help you advance your work, we have attached to these comments discussion drafts of proposed amendments to the NAIC Credit For Reinsurance Model Law and Credit For Reinsurance Model Regulation. We have prepared these proposals after consultation with a number of market participants, but we will allow individual companies express support or provide other comments on them, as they wish.

By way of brief explanation of the drafts we would note:

1. We have proposed a new stand-alone section of the Model Law and the Model Regulation to apply to reinsurers who are domiciled in countries covered by the Covered Agreement – or by a future Covered Agreement. It would also apply to those reinsurers which are domiciled in a Qualified Jurisdiction to whom you wish to grant similar credit for reinsurance treatment.

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2. This structure will allow you to maintain the current Qualified Jurisdiction/Certified Reinsurer approach for other countries/reinsurers.

3. Accordingly, with this structure there will be 3 categories of non-US reinsurers trading with US ceding insurers: reinsurers with no qualification or certification who post 100% collateral; reinsurers who are domiciled in Qualified Jurisdictions and are certified reinsurers and post variable collateral; and reinsurers who are domiciled in a Covered Agreement jurisdiction or in a jurisdiction to which regulators grant similar rights.

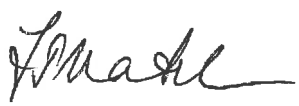
4. The most basic components are provided in the proposed new section of the Model Law. Most of the detailed qualification and other requirements have been placed in the Model Regulation. We believe this will make it easier to explain the changes in the state legislative process and will allow greater flexibility for future changes, as they can be made by regulation, rather than legislation. It would be easy to move provisions from the regulation to the law, if you wished.

Finally, we believe it is important to define specific rules for the transition period from being a NAIC certified reinsurer (and complying with this system) to being a EU-reinsurer under the Covered Agreement and complying with the new rules established by it. The same will be needed for other reinsurers to whom regulators grant similar status. In this regard, it will be important to ensure that today's certified reinsurers do not end up in complying with both systems at the same time. To this end, we recommend that State regulators start to allow a 20% reduction of current collateral amounts (per Article 9(3)(a) of the Covered Agreement) for reinsurers maintaining a NAIC certified reinsurer status and that those reinsurers should immediately be allowed to follow the qualification requirements under the Covered Agreement and no longer be subject to the NAIC Checklist and no certified reinsurer renewal process would be required.

As part of this process we recommend that regulators use the resources of the Financial Analysis(E) Working Group [or other designated NAIC entity] to make required decisions and take appropriate action. We also suggest that the concept of a lead state regulator for reinsurers qualifying under the proposed new section of the Model Law be considered. This will help ensure a unified and efficient process of transition and implementation.

We hope that these proposals assist you in developing your new policy. We are pleased to address any questions or comments you have regarding them and to working with you to finalize and adopt these important revisions.

Yours sincerely,



David Matcham
Chief Executive

IUA OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION

New Section 4, Credit For Reinsurance Model Law

Section 4. Credit Allowed for Cessions Governed by International Regulatory Agreements

A. Notwithstanding any other provisions of this law, credit for reinsurance shall be allowed a domestic ceding insurer as either an asset of reduction from liability when the reinsurer is:

1. Domiciled in a country which has a binding bilateral agreement in place with the United States or any State thereof, which provides preemptive credit for reinsurance rules for such reinsurers (a "Covered Agreement"), or

2. Domiciled in a jurisdiction approved by the NAIC or [this state] as qualifying under this Section, and which reinsurer meets the requirements for a certified reinsurer under section 2(E)1&2 of this law.*

[*drafting note: the jurisdictional approval process will follow the process for Qualified Jurisdictions under Section 2(E)3 of this law, but with the additional decision to be made on granting qualification under this Section.]

B. Credit shall be allowed provided the Covered Agreement remains fully enforceable and the reinsurer meets all applicable reporting and performance requirements.

C. To the extent that any Covered Agreement provides for the phasing out of current reinsurance collateral requirements, credit for reinsurance will be subject to those collateral requirements.

D. The provisions of this Section 4 shall apply only to reinsurance agreements entered into, amended, or renewed on or after the date on which a measure that reduces collateral pursuant to this Article takes effect, and only with respect to losses incurred and reserves reported from and after the later of (i) the date of the measure, or (ii) the effective date of such new reinsurance agreement, amendment, or renewal. Nothing in this law shall limit or in any way alter the capacity of parties to any reinsurance agreement to renegotiate such reinsurance agreement or to limit or in any way alter the capacity of parties to a reinsurance agreement to agree on requirements for collateral or other terms in that agreement.

E. The Commissioner shall have the authority to adopt regulations to implement the provisions of any Covered Agreement or to implement the requirements of this Section 4.

Credit for Reinsurance Model Regulation

[New] Section 9. **Credit Allowed for Cessions Governed by International Regulatory Agreements**

A. Notwithstanding any other provisions of this law, credit for reinsurance shall be allowed a domestic ceding insurer as either an asset of reduction from liability when the reinsurer is:

   1. Domiciled in a country which has a binding bilateral agreement in place with the United States or any State thereof, which provides preemptive credit for reinsurance rules for such reinsurers (a "Covered Agreement"), or

   2. Domiciled in a jurisdiction approved by the NAIC or [this state] as qualifying under this Section, and which reinsurer meets the requirements for a certified reinsurer under section 2(E)1&2 of the Credit For Reinsurance Model Law.*

   [*drafting note: the jurisdictional approval process will follow the process for Qualified Jurisdictions under Section 2(E)3 of the Credit For Reinsurance Model Law, but with the additional decision to be made on granting qualification under this Section.]

B. Credit shall be allowed provided the Covered Agreement remains fully enforceable and the reinsurer meets all applicable reporting and performance requirements.

C. For reinsurers who qualify under Section A(1) and (2) of this Section and who are currently required to post collateral in order for U.S. ceding insurers to take annual statement credit for that reinsurance, the collateral required will be reduced as required by any relevant Covered Agreement.

D. To qualify for credit under this the reinsurer must:

   1. Have own funds or capital and surplus of at least €226m, if domiciled in the EU or $250m if domiciled in the United States (or an equivalent amount calculated according to the methodology applicable in and in the currency of the country in which the reinsurer is domiciled).

   2. Have a solvency ratio of 100% SCR under solvency II of RBC of 300% of Action Control Level (or the equivalent solvency margin under its domestic solvency regime).

   3. Agree to provide written notice to the domiciliary regulator of each of its ceding insurers in the event it falls below the required solvency margin.

4. Consent to the jurisdiction of U.S. courts for the resolution of disputes. However, nothing in this regulation shall limit or in any way alter the capacity of parties to a reinsurance agreement to agree to alternative dispute resolution mechanism.

5. Agree to designate an agent for service of process, including designating the insurance supervisor of the domiciliary regulator of its U.S. ceding insurer as agent for service of process.

6. Consent in writing to pay all final non-appealable judgements, wherever sought, obtained by a ceding insurer, that have been declared enforceable in the territory where the judgment was obtained.

7. Agree in each reinsurance agreement subject to this regulation that it will provide collateral for 100% of the assuming reinsurer's liabilities attributable to reinsurance ceded pursuant to that agreement if the assuming reinsurer resists enforcement of a final judgment that is enforceable under the law of the territory in which it was obtained or a properly enforceable arbitration award, whether obtained by the ceding insurer or by its resolution estate, if applicable.

8. If requested, agree to provide to the NAIC Reinsurance Financial Analysis(E) Working Group [or other designated Committee, Task Force or Working Group]:

    a. Audited annual statements, including external audit report
    b. Financial condition and actuarial reports provided to domestic regulator
    c. List of disputed/ overdue reinsurance claims
    d. Details on assumed ceded business.

9. Maintain a practice of prompt payment of claims. The lack of prompt payment will be evidenced if any of the following criteria is met:

    (i) More than 15 percent of the reinsurance recoverables are overdue and in dispute as reported to the supervisor;

    (ii) More than 15 percent of the reinsurer's ceding insurers or reinsurers have overdue reinsurance recoverables on paid losses of 90 days or more which are not in dispute and which exceed for each ceding insurer 90,400 Euro, where the assuming reinsurer has its head office in the EU, or 100,000 U.S. dollars, where the assuming reinsurer is domiciled in the United States; or

    (iii) The aggregate amount of reinsurance recoverables on paid losses which are not in dispute, but are overdue by 90 days

or more, exceeds 45,200,000 Euro, where the assuming reinsurer has its head office in the EU, or 50,000,000 U.S. dollars, where the assuming reinsurer is domiciled in the United States or an equivalent amount in the currency of the country in which the reinsurer is domiciled.

10. Confirm that it is not presently participating in any solvent scheme of arrangement, which involves U.S. domiciled insurers, and agrees to notify the ceding insurer and its supervisory authority and to provide 100 percent collateral to the ceding insurer consistent with the terms of the scheme should the assuming reinsurer enter into such an arrangement.

11. Commit that in the event it becomes subject to a legal process of resolution, receivership, or winding-up proceedings as applicable, the ceding insurer, or its representative, may seek and, if determined appropriate by the court in which the resolution, receivership, or winding-up proceedings is pending, may obtain an order requiring that the assuming reinsurer post collateral for all outstanding ceded liabilities.

12. Have its domestic regulator confirm on an annual basis that the reinsurer meets the solvency margins noted in Section (D) 2 above.

13. Subject to applicable law and the terms of this Agreement, nothing in this Article shall limit or in any way alter the capacity of parties to a reinsurance agreement to agree on requirements for collateral or other terms in that reinsurance agreement.

E. The provisions of this regulation shall apply only to reinsurance agreements entered into, amended, or renewed on or after the date on which a measure that reduces collateral pursuant to this Article takes effect, and only with respect to losses incurred and reserves reported from and after the later of (i) the date of the measure, or (ii) the effective date of such new reinsurance agreement, amendment, or renewal. Nothing in this Agreement shall limit or in any way alter the capacity of parties to any reinsurance agreement to renegotiate such reinsurance agreement.

Edmund C. Kenealy
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February 13, 2018

(Via E-mail to Mr. Jake Stultz: jstultz@naic.org)

Superintendent Maria Vullo, Chair
Reinsurance (E) Task Force
National Association of Insurance Commissioners

Dear Superintendent Vullo:

Liberty Mutual Insurance appreciates the opportunity to provide comments regarding the implementation of the collateral provisions of the Bilateral Agreement between the United States of America ("US") and the European Union ("EU") on Prudential Measures Regarding Insurance and Reinsurance ("Covered Agreement"). While our comments are filed after the February 6, 2018, date reflected in the notice, we respectfully request that they be made part of the record as the Reinsurance (E) Task Force undertakes its important work of evaluating how best to proceed with reinsurance collateral reform.

Because of its extra-territorial impact, Solvency II can have significant negative consequences for non-EU-based insurance groups with EU operations, including those based here in the US. As a result, a Covered Agreement negotiation that likely could have been focused solely on the issue of reinsurance collateral expanded to address group level governance, solvency and capital and reporting. From the time agreement on the Covered Agreement's terms was announced in January 2017, Liberty Mutual Insurance articulated the need to clarify certain of its potentially ambiguous provisions. The Statement of the US on the Covered Agreement with the EU issued on September 22, 2017 ("Policy Statement") was an important step in ensuring that the all interested parties – insurance regulators and industry participants alike - understand the approach the US will take with respect to the Covered Agreement's implementation. As a result, Liberty Mutual Insurance believes that the Covered Agreement – as clarified by the Policy Statement – represents an important development in international insurance regulatory cooperation. The Covered Agreement – as clarified by the Policy Statement - also acknowledges the US group supervisory system and provides a way forward for the group capital calculation the NAIC is developing to be recognized by the EU as an effective means to assess group-wide capital. And, to the extent that a covered agreement or similar bilateral commitment with other jurisdictions should be negotiated and concluded in the future, we strongly urge that the clarifications in the Policy Statement be specifically incorporated in any final agreement to ensure clarity of intent between the parties.

However, while we support the Covered Agreement's goals, three points are worth emphasizing:

- First, Liberty Mutual Insurance does not believe that a Covered Agreement was the only, or necessarily the best, means to accomplish the goals of reinsurance collateral reform and recognition of the US' approach to group insurance supervision. In the US, insurance regulation is squarely within the purview of the several states. While the Dodd-Frank Act gave the federal government the authority to preempt state law in certain cases, we believe that such authority should be used sparingly, if ever. The issue of reduction of collateral and EU recognition of the US approach to group supervision could have been addressed by the states through amendments to their substantive law. That said, the treatment of these issues in the Covered Agreement – as clarified by the Policy Statement - may well provide a template for a state-based approach to addressing the same matters with other jurisdictions. An amendment to the Credit for Reinsurance Model Law could be made to apply standards similar to those reflected in the Covered Agreement for reduced collateral by reinsurers in other jurisdictions; *provided, however*, that those jurisdictions recognize the US system of group supervision and its group capital regime. This would put to rest – at least with respect to those jurisdictions - the purely manufactured issue of "equivalence" of the US' insurance regulatory system.

- Second, no part of the Covered Agreement should be read or implemented in isolation from the other parts of the document. In particular, the agreement by the US to reduce reinsurance collateral in Article 3 was the result of a negotiated bargain that is tied to the EU's commitment in Article 4 to recognize the validity of the US system of group supervision, including its assessment of group capital. The integrity of this commitment by the EU has been called into serious question by release of the IAIS Q&A document on January 26, 2018, regarding implementation of ICS 2.0, and by the comments of certain EU representatives at the EU-US Insurance Symposium in Washington, DC, held on the same day. Therefore, whatever approach the NAIC takes to implement Article 3 of the Covered Agreement must be expressly tied to the EU's compliance with Article 4, as clarified by the Policy Statement. If Article 4 is breached by the EU or an EU Member State and/or the Covered Agreement is terminated, then any reduced collateral standards for qualified EU reinsurers should automatically be immediately rescinded.

- Finally, Liberty Mutual Insurance opposes the creation of any new "guardrails" on US ceding companies. This is unnecessary given that any EU reinsurer must meet significant criteria to qualify for a reduction in collateral under the Covered Agreement. The imposition of such requirements would serve only to increase the costs and burdens imposed on US cedants. At a minimum, they would seem to frustrate the purpose of the Covered Agreement. At worst, conditions imposed on US insurers ceding to EU reinsurers that are not also imposed when they cede to US reinsurers would seem to violate Article 3.1. of the Covered Agreement.

Thank you for your consideration of our comments. We look forward to continued engagement with the NAIC, policymakers and industry colleagues on the important issues surrounding implementation of the Covered Agreement.

Very truly yours,

Edmund C. Kenealy

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SABRINA MIESOWITZ
Associate General Counsel

LLOYD'S

February 6, 2018

VIA Email

Superintendent Maria Vullo
New York Department of Financial Services
Chair, NAIC Reinsurance Task Force

Re: Request for Comments Regarding Implementation of the Covered Agreement

Dear Superintendent Vullo,

This comment letter is submitted on behalf of Underwriters at Lloyd's, London ("Lloyd's") in response to the above referenced request for comments. Lloyd's also plans to attend the Reinsurance Task Force's ("RTF") hearing on this issue on February 20. We appreciate the attention the RTF is giving to this issue. Lloyd's believes that implementation of the covered agreement will be the final step in fully modernizing credit for reinsurance in the US.

Lloyd's is one of the largest providers of reinsurance capacity to the US. In 2017, Lloyd's assumed $5.5 billion in premium from US ceding insurers.

There are a number of ways that the RTF could approach implementation of the covered agreement. Lloyd's believes that the best option would be to revise the requirements of the certified reinsurer regime to align with the covered agreement provisions. This will produce the clearest outcome: one standard that applies to all reinsurers that meet the qualifications.

As Lloyd's has stated in comments to the RTF over its last several meetings, we believe that the reinsurance collateral-related provisions of the covered agreement should be applied to all Qualified Jurisdictions. The Qualified Jurisdictions Working Group put significant effort into developing its framework and conducting reviews. The results of that work evidenced that the jurisdictions which have been qualified have robust regulatory systems and have established good working relationships with US state insurance regulators. Thus, Lloyd's believes that reinsurers from Qualified Jurisdictions should be on the same footing as reinsurers from jurisdictions that have secured a covered agreement. Such equitable treatment will avoid an un-level playing field in the reinsurance arena. The simplest way to recognize this equal standing would be for jurisdictions that maintain a covered agreement with the US to simply be deemed to be Qualified Jurisdictions.

Lloyd's has prepared the attached mark-up's of the NAIC Model Credit for Reinsurance Law and Regulation which show the changes that would need to be made to: (i) deem jurisdictions with a covered agreement to be Qualified Jurisdictions, and (ii) amend the requirements of the certified reinsurer regime to align with the covered agreement.

We look forward to discussing this proposal with RTF members in more detail at the hearing.

Regards,

LLOYD'S AMERICA, INC. The Museum Office Building 42 West 54th Street 14th Floor New York NY 10019 www.Lloyds.com/America
Telephone +1 212 382 4081 Fax +1 212 382 4070 Email: Sabrina.Miesowitz@lloyds.com

Model 785 Section 2 - Credit allowed a domestic ceding insurer

…

E. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the commissioner as a reinsurer in this state ~~and secures its obligations in accordance with the requirements of this subsection~~.

(1) In order to be eligible for certification, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner pursuant to Paragraph (3) of this subsection;

(b) The assuming insurer must maintain minimum capital and surplus, or its equivalent, in an amount to be determined by the commissioner pursuant to regulation;

~~(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner pursuant to regulation;~~

(c~~d~~) The assuming insurer must agree to submit to the jurisdiction of this state, appoint the commissioner as its agent for service of process in this state, and agree to provide security for 100 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment;

(d~~e~~) The assuming insurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis~~; and~~

~~(f) The assuming insurer must satisfy any other requirements for certification deemed relevant by the commissioner~~.

(2) An association including incorporated and individual unincorporated underwriters may be a certified reinsurer. In order to be eligible for certification, in addition to satisfying requirements of Paragraph (1):

(a) The association shall satisfy its minimum capital and surplus requirements through the capital and surplus equivalents (net of liabilities) of the association and its members, which shall include a joint central fund that may be applied to any unsatisfied obligation of the association or any of its members, in an amount determined by the commissioner to provide adequate protection;

(b) The incorporated members of the association shall not be engaged in any business other than underwriting as a member of the association and shall be subject to the same level of regulation and solvency control by the association's domiciliary regulator as are the unincorporated members; and

(c) Within ninety (90) days after its financial statements are due to be filed with the association's domiciliary regulator, the association shall provide to the commissioner an annual certification by the association's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.

(3) The commissioner shall create and publish a list of qualified jurisdictions, under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be considered for certification by the commissioner as a certified reinsurer.

(a) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. A jurisdiction may not be recognized as a qualified jurisdiction if the commissioner has determined that the jurisdiction does not adequately and promptly enforce final U.S. judgments and arbitration awards. Additional factors may be considered in the discretion of the commissioner.

(b) A list of qualified jurisdictions shall be published through the NAIC Committee Process. The commissioner shall consider this list in determining qualified jurisdictions. If the commissioner approves a jurisdiction as qualified that does not appear on the list of qualified jurisdictions, the commissioner shall provide thoroughly documented justification in accordance with criteria to be developed under regulations.

(c) U.S. jurisdictions that meet the requirement for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.

(d) Non-U.S. jurisdictions maintaining in-force binding bilateral agreements regarding reinsurance collateral with the United States shall be recognized as qualified jurisdictions.

(~~d~~e) If a certified reinsurer's domiciliary jurisdiction ceases to be a qualified jurisdiction, the commissioner has the discretion to suspend the reinsurer's certification indefinitely, in lieu of revocation.

(4) ~~The commissioner shall assign a rating to each certified reinsurer, giving due consideration to the financial strength ratings that have been assigned by rating agencies deemed acceptable to the commissioner pursuant to regulation.~~ The commissioner shall publish a list of all certified reinsurers ~~and their ratings~~.

~~(5) A certified reinsurer shall secure obligations assumed from U.S. ceding insurers under this subsection at a level consistent with its rating, as specified in regulations promulgated by the commissioner.~~

~~(a) In order for a domestic ceding insurer to qualify for full financial statement credit for reinsurance ceded to a certified reinsurer, the certified reinsurer shall maintain security in a form acceptable to the commissioner and consistent with the provisions of Section 3, or in a multibeneficiary trust in accordance with Subsection D of this section, except as otherwise provided in this subsection.~~

~~(b) If a certified reinsurer maintains a trust to fully secure its obligations subject to Subsection D of this section, and chooses to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer shall maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security as permitted by this subsection or comparable laws of other U.S. jurisdictions and for its obligations subject to Subsection D of this section. It shall be a condition to the grant of certification under Subsection E of this section that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust~~

~~account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.~~

~~(c) The minimum trusteed surplus requirements provided in Subsection D are not applicable with respect to a multibeneficiary trust maintained by a certified reinsurer for the purpose of securing obligations incurred under this subsection, except that such trust shall maintain a minimum trusteed surplus of $10,000,000.~~

~~(d) With respect to obligations incurred by a certified reinsurer under this subsection, if the security is insufficient, the commissioner shall reduce the allowable credit by an amount proportionate to the deficiency, and has the discretion to impose further reductions in allowable credit upon finding that there is a material risk that the certified reinsurer's obligations will not be paid in full when due.~~

(5~~e~~) ~~For purposes of this subsection,~~ a certified reinsurer whose certification has been terminated for any reason shall be ~~treated as a certified reinsurer~~ required to secure 100 percent of its obligations.

(i) As used in this subsection, the term "terminated" refers to revocation, suspension, voluntary surrender and inactive status.

~~(ii) If the commissioner continues to assign a higher rating as permitted by other provisions of this section, this requirement does not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended.~~

(6) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction's certification, ~~and has the discretion to defer to the rating assigned by that jurisdiction,~~ and such assuming insurer shall be considered to be a certified reinsurer in this state.

(7) A certified reinsurer that ceases to assume new business in this state may request to maintain its certification in inactive status in order to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer shall continue to comply with all applicable requirements of this subsection~~, and the commissioner shall assign a rating that takes into account, if relevant, the reasons why the reinsurer is not assuming new business~~.

…

H. If the assuming insurer does not meet the requirements of Subsections A, B or C, the credit permitted by Subsection D ~~or E~~ of this section shall not be allowed unless the assuming insurer agrees in the trust agreements to the following conditions:

(1) Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by Subsection D(3) of this section, or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund.

(2) The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic insurance companies.

(3) If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. ceding insurers of the grantor of the trust, the assets or part thereof shall be returned by the commissioner with regulatory oversight to the trustee for distribution in accordance with the trust agreement.

(4) The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

I. If an accredited ~~or certified~~ reinsurer ceases to meet the requirements for accreditation ~~or certification~~, the commissioner may suspend or revoke the reinsurer's accreditation ~~or certification~~.

(1) The commissioner must give the reinsurer notice and opportunity for hearing. The suspension or revocation may not take effect until after the commissioner's order on hearing, unless:

(a) The reinsurer waives its right to hearing;

(b) The commissioner's order is based on regulatory action by the reinsurer's domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer's eligibility to transact insurance or reinsurance business in its domiciliary jurisdiction ~~or in the primary certifying state of the reinsurer under Subparagraph E(6) of this section~~; or

(c) The commissioner finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the commissioner's action.

(2) While a reinsurer's accreditation ~~or certification~~ is suspended, no reinsurance contract issued or renewed after the effective date of the suspension qualifies for credit except to the extent that the reinsurer's obligations under the contract are secured in accordance with Section 3. If a reinsurer's accreditation ~~or certification~~ is revoked, no credit for reinsurance may be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured in accordance with ~~Subsection E(5) or~~ Section 3.

J. If a certified reinsurer ceases to meet the requirements for certification, the commissioner may suspend or revoke the reinsurer's accreditation. The commissioner must provide written notice of the suspension or revocation and the reasons for it to the certified reinsurer and its domiciliary regulator.

(1) Prior to suspension or revocation, the commissioner shall communicate with the certified reinsurer and, except for exceptional circumstances in which a shorter period is necessary for policyholder or other consumer protection, provide the certified reinsurer with 30 days from the initial communication to submit a plan to remedy the defect. The certified reinsurer must remedy the defect within 90 days from the initial communication.

(2) While a reinsurer's certification is suspended, no reinsurance contract issued or renewed after the effective date of the suspension qualifies for credit except to the extent that the reinsurer's obligations under the contract are secured in accordance with Section 3. If a reinsurer's certification is revoked, no credit for reinsurance may be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured in accordance with Section 3.

~~J~~K. Concentration Risk.

Model 786 Section 8

Credit for reinsurance—certified reinsurers

A. Pursuant to [cite state law equivalent of Section 2E of the Credit for Reinsurance Model Law], the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that has been certified as a reinsurer in this state at all times for which statutory financial statement credit for reinsurance is claimed under this section. ~~The credit allowed shall be based upon the security held by or on behalf of the ceding insurer in accordance with a rating assigned to the certified reinsurer by the commissioner. The security shall be in a form consistent with the provisions of [cite state law equivalent of Section 2E and Section 3 of the Credit for Reinsurance Model Law] and 11, 12 or 13 of this Regulation. The amount of security required in order for full credit to be allowed shall correspond with the following requirements:~~

~~(1) **Ratings**~~	~~**Security Required**~~
~~Secure - 1~~	~~0%~~
~~Secure - 2~~	~~10%~~
~~Secure - 3~~	~~20%~~
~~Secure - 4~~	~~50%~~
~~Secure - 5~~	~~75%~~
~~Vulnerable - 6~~	~~100%~~

(2) Affiliated reinsurance transactions shall be treated the same ~~receive the same opportunity for reduced security requirements~~ as all other reinsurance transactions.

(3) ~~The commissioner shall require the certified reinsurer to post one hundred percent (100%), for the benefit of the ceding insurer or its estate, security upon the entry of~~ If an order of rehabilitation, liquidation or conservation is entered against the ceding insurer, the ceding insurer, or its representative, may seek a court order requiring that the assuming reinsurer post one hundred percent collateral for all outstanding ceded liabilities.

(4) In order to facilitate the prompt payment of claims, a certified reinsurer shall not be required to post security for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the certified reinsurer continuing to pay claims in a timely manner. Reinsurance recoverables for only 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:

Line 1: Fire

(a) Line 2: Allied Lines

(b) Line 3: Farmowners multiple peril

(c) Line 4: Homeowners multiple peril

(d) Line 5: Commercial multiple peril

(e) Line 9: Inland Marine

(f) Line 12: Earthquake

(g) Line 21: Auto physical damage

(5) Credit for reinsurance under this section shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer. Any reinsurance contract entered into prior to the effective date of the certification of the assuming insurer that is subsequently amended after the effective date of the certification of the assuming insurer, or a new reinsurance contract, covering any risk for which collateral was provided previously, shall only be subject to this section with respect to losses incurred and reserves reported from and after the effective date of the amendment or new contract.

(6) Nothing in this section shall prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for certified reinsurers under this section.

B. Certification Procedure.

(1) The commissioner shall post notice on the insurance department's website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The commissioner may not take final action on the application until at least thirty (30) days after posting the notice required by this paragraph.

> **Drafting Note:** States that do not wish to make the internet the required mechanism for providing public notice should modify this provision accordingly. This provision was intended to provide a less formal notice requirement than is typically called for under state Administrative Procedure Acts.

(2) The commissioner shall issue written notice to an assuming insurer that has made application and been approved as a certified reinsurer. ~~Included in such notice shall be the rating assigned the certified reinsurer in accordance with Subsection A of this section.~~ The commissioner shall publish a list of all certified reinsurers ~~and their ratings~~.

(3) In order to be eligible for certification, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a Qualified Jurisdiction, as determined by the commissioner pursuant to Subsection C of this section.

(b) The assuming insurer must maintain capital and surplus, or its equivalent, of no less than $250,000,000 calculated in accordance with the methodology applicable in its jurisdiction of domicile ~~Subparagraph (4)(h) of this subsection~~. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least $250,000,000 and a central fund containing a balance of at least $250,000,000.

(c) The assuming insurer must maintain on an ongoing basis a solvency ratio of: (i) 100% SCR under Solvency II if domiciled in the EU, or (ii) an RBC of 300% Authorized Control Level if domiciled in the US, or (iii) a level determined by the Commissioner to be equivalent under the measure of solvency applied in the assuming insurer's jurisdiction of domicile. This requirement may be satisfied by an association including incorporated and individual unincorporated underwriters maintaining a solvency ratio of 100% SCR under Solvency II.

~~(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. These ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. These financial strength ratings will be one factor used by the commissioner in~~

~~determining the rating that is assigned to the assuming insurer. Acceptable rating agencies include the following:~~

~~(i) Standard & Poor's;~~

~~(ii) Moody's Investors Service;~~

~~(iii) Fitch Ratings;~~

~~(iv) A.M. Best Company; or~~

~~(v) Any other Nationally Recognized Statistical Rating Organization.~~

~~(d) The certified reinsurer must comply with any other requirements reasonably imposed by the commissioner.~~

(4) ~~Each certified reinsurer shall be rated on a legal entity basis, with due consideration being given to the group rating where appropriate, except that an association including incorporated and individual unincorporated underwriters that has been approved to do business as a single certified reinsurer may be evaluated on the basis of its group rating.~~ Factors that may be considered as part of the evaluation process include, but are not limited to, the following:

~~(a) The certified reinsurer's financial strength rating from an acceptable rating agency. The maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as outlined in the table below. The commissioner shall use the lowest financial strength rating received from an approved rating agency in establishing the maximum rating of a certified reinsurer. A failure to obtain or maintain at least two financial strength ratings from acceptable rating agencies will result in loss of eligibility for certification:~~

~~Ratings~~	~~Best~~	~~S&P~~	~~Moody's~~	~~Fitch~~
~~Secure - 1~~	~~A++~~	~~AAA~~	~~Aaa~~	~~AAA~~
~~Secure - 2~~	~~A+~~	~~AA+, AA, AA-~~	~~Aa1, Aa2, Aa3~~	~~AA+, AA, AA-~~
~~Secure - 3~~	~~A~~	~~A+, A~~	~~A1, A2~~	~~A+, A~~
~~Secure - 4~~	~~A-~~	~~A-~~	~~A3~~	~~A-~~
~~Secure - 5~~	~~B++, B+~~	~~BBB+, BBB, BBB-~~	~~Baa1, Baa2, Baa3~~	~~BBB+, BBB, BBB-~~
~~Vulnerable - 6~~	~~B, B-C++, C+, C, C-, D, E, F~~	~~BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R~~	~~Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C~~	~~BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD~~

~~(b) The business practices of the certified reinsurer in dealing with its ceding insurers, including its record of compliance with reinsurance contractual terms and obligations;~~

(c) For certified reinsurers domiciled in the U.S., a review of the most recent applicable NAIC Annual Statement Blank, either Schedule F (for property/casualty reinsurers) or Schedule S (for life and health reinsurers);

(d) For certified reinsurers not domiciled in the U.S., a review annually of Form CR-F (for property/casualty reinsurers) or Form CR-S (for life and health reinsurers) (attached as exhibits to this regulation);

(e) The reputation of the certified reinsurer for prompt payment of claims under reinsurance agreements. Lack of prompt payment will be evidenced by the criteria set forth in Subparagraph (5) below ~~, based on an analysis of ceding insurers' Schedule F reporting of overdue reinsurance recoverables, including the proportion of obligations that are more than ninety (90) days past due or are in dispute, with specific attention given to obligations payable to companies that are in administrative supervision or receivership~~;

(f) Regulatory actions taken against the certified reinsurer for serious noncompliance;

~~(g) The report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in paragraph (h) below;~~

(h) For certified reinsurers not domiciled in the U.S., audited financial statements (in accordance with the applicable law of its domiciliary jurisdiction ~~audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings~~, and solvency or financial condition report or actuarial opinion (~~as~~ if filed with the non-U.S. jurisdiction supervisor). Upon the initial application for certification, the commissioner will consider audited financial statements for the last two ~~three~~ (2~~3~~) years filed with its non-U.S. jurisdiction supervisor;

~~(i) The liquidation priority of obligations to a ceding insurer in the certified reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding;~~

(j) A certified reinsurer's participation in any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers. The certified reinsurer shall agree to notify the commissioner and all impacted ceding insurers and to provide 100 percent collateral to ceding insurers consistent with the terms of the scheme should the certified reinsurer enter into ~~shall receive prior notice from a certified reinsurer that proposes participation by the certified reinsurer in~~ a solvent scheme of arrangement.~~; and~~

~~(k) Any other information deemed relevant by the commissioner~~.

(5) ~~Based on the analysis conducted under Subparagraph (4)(e) of certified reinsurer's reputation for prompt payment of claims, the commissioner may make appropriate adjustments in the security the certified reinsurer is required to post to protect its liabilities to U.S. ceding insurers, provided that the commissioner shall, at a minimum, increase the security the certified reinsurer is required to post by one rating level under Subparagraph (4)(a) if the commissioner finds that~~ An assuming reinsurer will not be eligible to be a certified reinsurer if it does not maintain prompt payment of claims under reinsurance contracts. The lack of prompt payment will be evidenced if any of the following criteria is met:

(a) More than fifteen percent (15%) of the certified reinsurer’s reinsurance recoverables are overdue and in dispute as reported to its domiciliary supervisor;

(b) More than fifteen percent (15%) of the certified reinsurer's ceding insurance clients have overdue reinsurance recoverables on paid losses of ninety (90) days or more which are not in dispute and which exceed $100,000 for each cedent (or 90,400 Euro where the certified reinsurer has its head office in the EU); or

~~(b)~~ (c) The aggregate amount of reinsurance recoverables on paid losses which are not in dispute, but ~~that~~ are overdue by ninety (90) days or more exceeds $50,000,000 (or 45,200,00 Euro where the certified reinsurer has its head office in the EU).

(6) The assuming insurer must submit a properly executed Form CR-1 (attached as an exhibit to this regulation) as evidence of: (i) its submission to the jurisdiction of this state, (ii) appointment of the commissioner as an agent for service of process in this state, (iii) agreement to pay all final judgments obtained by a ceding insurer, and agreement to provide security for one hundred percent (100%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment or a properly enforceable arbitration award. The commissioner shall not certify any assuming insurer that is domiciled in a jurisdiction that the commissioner has determined does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(7) The certified reinsurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis. All information submitted by certified reinsurers which are not otherwise public information subject to disclosure shall be exempted from disclosure under [cite state law equivalent of Freedom of Information Act] and shall be withheld from public disclosure. The applicable information filing requirements are, as follows:

(a) Notification within ten (10) days: (i) if the certified reinsurer falls below the minimum capital and surplus specified in Subparagraph 3(b) or the solvency ratio specified in Subparagraph 3(c); (ii) of any regulatory actions taken against the certified reinsurer for serious noncompliance ~~any change in the provisions of its domiciliary license or any change in rating by an approved rating agency, including a statement describing such changes and the reasons therefore~~;

(b) Annually, Form CR-F or CR-S, as applicable [per the instructions to be developed as an exhibit to this model];

~~(c) Annually, the report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in Subsection (d) below;~~

(c~~d~~) Annually, audited financial statements (in accordance with the applicable law of its domiciliary jurisdiction ~~audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings,~~ and solvency or financial condition report or actuarial opinion (~~as~~ if filed with the certified reinsurer's supervisor). Upon the initial certification, audited financial statements for the last two ~~three~~ (2~~3~~) years filed with the certified reinsurer's supervisor;

(d~~e~~) At least annually, an updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers;

(e~~f~~) A certification from the certified reinsurer's domestic regulator that the certified reinsurer meets the requirements of Subparagraphs (3)(b) and (3)(c). ~~is in good standing and maintains capital in excess of the jurisdiction's highest regulatory action level; and~~

~~(g) Any other information that the commissioner may reasonably require.~~

(8) ~~Change in Rating or~~ Revocation of Certification.

(a) ~~In the case of a downgrade by a rating agency or other disqualifying circumstance, the commissioner shall upon written notice assign a new rating to the certified reinsurer in accordance with the requirements of Subparagraph (4)(a).~~

~~(b)~~ The commissioner shall have the authority to suspend, revoke, or otherwise modify a certified reinsurer's certification at any time if the certified reinsurer fails to meet its obligations ~~or security requirements~~ under this section, or if other financial or operating results of the certified reinsurer, or documented significant delays in payment by the certified reinsurer, lead the commissioner to reconsider the certified reinsurer's ability or willingness to meet its contractual obligations. The commissioner must provide written notice of the suspension or revocation and the reasons for it to the certified reinsurer and its domiciliary regulator.

(b) Prior to suspension or revocation, the commissioner shall communicate with the certified reinsurer and, except for exceptional circumstances in which a shorter period is necessary for policyholder or other consumer protection, provide the certified reinsurer with 30 days from the initial communication to submit a plan to remedy the defect. The certified reinsurer must remedy the defect within 90 days from the initial communication.

~~(c) If the rating of a certified reinsurer is upgraded by the commissioner, the certified reinsurer may meet the security requirements applicable to its new rating on a prospective basis, but the commissioner shall require the certified reinsurer to post security under the previously applicable security requirements as to all contracts in force on or before the effective date of the upgraded rating. If the rating of a certified reinsurer is downgraded by the commissioner, the commissioner shall require the certified reinsurer to meet the security requirements applicable to its new rating for all business it has assumed as a certified reinsurer.~~

(c~~d~~) Upon revocation of the certification of a certified reinsurer by the commissioner, the assuming insurer shall be required to post security in accordance with Section 10 in order for the ceding insurer to continue to take credit for reinsurance ceded to the assuming insurer. ~~If funds continue to be held in trust in accordance with Section 7, the commissioner may allow additional credit equal to the ceding insurer's *pro rata* share of such funds, discounted to reflect the risk of uncollectibility and anticipated expenses of trust administration.~~ Notwithstanding the ~~change of a certified reinsurer's rating or~~ revocation of the reinsurer's ~~its~~ certification, a domestic insurer that has ceded reinsurance to that certified reinsurer may not be denied credit for reinsurance for a period of three (3) months for all reinsurance ceded to that certified reinsurer, unless the reinsurance is found by the commissioner to be at high risk of uncollectibility.

C. Qualified Jurisdictions.

(1) If, upon conducting an evaluation under this section with respect to the reinsurance supervisory system of any non-U.S. assuming insurer, the commissioner determines that the jurisdiction qualifies to be recognized as a qualified jurisdiction, the commissioner shall publish notice and evidence of such recognition in an appropriate manner. The commissioner may establish a procedure to withdraw recognition of those jurisdictions that are no longer qualified.

(2) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the reinsurance supervisory system of the non-U.S. jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. The commissioner shall determine the appropriate approach for evaluating the qualifications of such jurisdictions, and create and publish a list of jurisdictions whose reinsurers may be approved by the commissioner as eligible for certification. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. Additional factors to be considered in determining whether to recognize a qualified jurisdiction, in the discretion of the commissioner, include but are not limited to the following:

(a) The framework under which the assuming insurer is regulated.

(b) The structure and authority of the domiciliary regulator with regard to solvency regulation requirements and financial surveillance.

(c) The substance of financial and operating standards for assuming insurers in the domiciliary jurisdiction.

(d) The form and substance of financial reports required to be filed or made publicly available by reinsurers in the domiciliary jurisdiction and the accounting principles used.

(e) The domiciliary regulator's willingness to cooperate with U.S. regulators in general and the commissioner in particular.

(f) The history of performance by assuming insurers in the domiciliary jurisdiction.

(g) Any documented evidence of substantial problems with the enforcement of final U.S. judgments in the domiciliary jurisdiction. A jurisdiction will not be considered to be a qualified jurisdiction if the commissioner has determined that it does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(h) Any relevant international standards or guidance with respect to mutual recognition of reinsurance supervision adopted by the International Association of Insurance Supervisors or successor organization.

(i) Any other matters deemed relevant by the commissioner.

(3) A list of qualified jurisdictions shall be published through the NAIC Committee Process. The commissioner shall consider this list in determining qualified jurisdictions. If the commissioner approves a jurisdiction as qualified that does not appear on the list of qualified jurisdictions, the commissioner shall provide thoroughly documented justification with respect to the criteria provided under Subsections 8.C(2)(a) to (i).

(4) U.S. jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.

(5) Non-U.S. jurisdictions maintaining in-force binding bilateral agreements regarding reinsurance collateral with the United States shall be recognized as qualified jurisdictions.

D. Recognition of Certification Issued by an NAIC Accredited Jurisdiction.

(1) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction's certification, and to defer to the rating assigned by that jurisdiction, if the assuming insurer submits a properly executed Form CR-1 and such additional information as the commissioner requires. The assuming insurer shall be considered to be a certified reinsurer in this state.

(2) Any change in the certified reinsurer's status ~~or rating~~ in the other jurisdiction shall apply automatically in this state as of the date it takes effect in the other jurisdiction. The certified reinsurer shall notify the commissioner of any change in its status ~~or rating~~ within 10 days after receiving notice of the change.

(3) ~~The commissioner may withdraw recognition of the other jurisdiction's rating at any time and assign a new rating in accordance with Subsection B(8) of this section.~~

~~(4)~~ The commissioner may withdraw recognition of the other jurisdiction's certification at any time, with written notice to the certified reinsurer. Unless the commissioner suspends or revokes the certified reinsurer's certification in accordance with Subsection B(8) of this section, the certified reinsurer's certification shall remain in good standing in this state for a period of three (3) months, which shall be extended if additional time is necessary to consider the assuming insurer's application for certification in this state.

E. Mandatory ~~Funding~~ Clauses. In addition to the clauses required under Section 14, reinsurance contracts entered into or renewed under this section shall include: (i) a clause appointing the commissioner as an agent for service of process in this state; and (ii) a clause stating that the assuming insurer will provide security for one hundred percent (100%) of its liabilities under the reinsurance contract if it resists enforcement of a final U.S. judgment or a properly enforceable arbitration award ~~a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer under this section for reinsurance ceded to the certified reinsurer~~.

F. The commissioner shall comply with all reporting and notification requirements that may be established by the NAIC with respect to certified reinsurers and qualified jurisdictions.

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February 6, 2018

Reinsurance Task Force Chair Maria T. Vullo
National Association of Insurance Commissioners
VIA Email Transmission: Jake Stultz (jstultz@naic.org),

RE: NAMIC Comments – Bilateral Agreement Between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement)

Dear Ms. Vullo:

The following comments are submitted on behalf of the member companies of the National Association of Mutual Insurance Companies regarding the NAIC implementation of the EU-U.S. Covered Agreement. Thank you for your interest in NAMIC members' thoughts on this issue. We will be present at the hearing and look forward to the opportunity to share our thoughts and comments.

NAMIC is the largest property/casualty insurance trade association in the country, with more than 1,400 member companies representing 39 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC member companies serve more than 170 million policyholders and write more than $230 billion in annual premiums. Our members account for 54 percent of homeowners, 43 percent of automobile, and 32 percent of the business insurance markets. Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

In the request for comment for the February 20 hearing you seek responses to possible approaches to the implementation of the Reinsurance Section of the Covered Agreement. In addition, you requested other ideas that may be useful in arriving at a solution to the issues. NAMIC's general thoughts include the following:

- The Covered Agreement has been signed by both the U.S. and the EU and is in effect for insurance regulatory authorities only in the U.S. and the EU. It is not in effect for any other jurisdiction. Any approach to include other jurisdictions should include a commitment to mutual recognition of the U.S. group supervision and group capital regime.
- Both parties to the Covered Agreement have obligations that must be met in by September 2022. The time for implementing the Covered Agreement in all states began to run in September 2017 and revision

of the collateral requirements of European Union reinsurers meeting the Covered Agreement criteria must be completed in all states by September 2022. This time frame is more aggressive than a typical accreditation standard at the NAIC.[1]

- NAMIC is adamantly opposed to federal pre-emption of state law to implement the Covered Agreement.
- The U.S. obligations under the Covered Agreement are significantly more challenging to implement by the end of the five-year period and significantly more difficult to undo if there are compliance issues with the EU. EIOPA has already shown little support for mutual recognition of the U.S. group supervision and group capital approach at the IAIS. Any revisions to collateral requirements should include a provision for immediate reciprocal action on the part of the states if the EU breaches the agreement at some point in the future.

The NAMIC response to the questions posed includes suggestions and options for discussion and consideration. Each option may require further revision or improvement. Ultimately, we are all striving to address an issue of "first impression" – one that we have not addressed in other regulatory endeavors. We hope these ideas can help the debate and further the path to implementation. Our responses to the proposals set forth in the materials provided for the meetings are as follows:

1. Amending the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786) to eliminate reinsurance collateral requirements for EU-based reinsurers meeting the conditions of the Covered Agreement.

   NAMIC favors an approach amending the model law and regulation to create a provision for specific treatment of EU-based reinsurers consistent with the terms of the Covered Agreement. We also agree with the concept advanced by CNA that the language added to the Credit for Reinsurance Model Law and Regulation should include automatic reversion to the standard collateral approach in the event there is any EU or EU member state breach of the Covered Agreement.

   Changing the model law and regulation will take a significant amount of time and enacting the new models in all states will likely require more time than the 60 months provided in the Covered Agreement. In the interest of avoiding possible pre-emption actions at the federal level, we suggest that the NAIC explore possible regulatory means to expedite the elimination of collateral requirements to avoid future pre-emption of state law. NAMIC offers optional language for a regulation or bulletin (see Attachment) that could be shared with states to address the implementation of the Covered Agreement prior to the adoption of a formal model law and regulation by the NAIC.

[1] Even if 1) the language is agreed upon for changes to the model law and the model regulation; 2) all required NAIC committee approvals and Executive/Plenary adoption occurs; and 3) all significant elements are exposed and completed in 2018, the Financial Regulation Standards and Accreditation(F) Committee requires a 30-day comment period in the first year after approval (2019), a one-year comment period during the second year after approval (2020), discussion and adoption during the third year after approval (2021) and two years thereafter for the states to pass in their legislatures the revisions to the model law and regulation (2023).

2. **Extending similar treatment to reinsurers from other jurisdictions covered by potential future covered agreement(s) that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.**
   NAMIC would not support the pursuit of additional Covered Agreements with other jurisdictions. Any additional international negotiations conducted at the Federal level would continue to erode the primacy of state regulation of insurance. There are other means to achieve the same goals without engaging in protracted negotiations and building joint committee structures that will attempt to leverage their position over U.S. state regulation of insurance. If there is a need to extend the exemption from collateral requirements beyond the reinsurers in the EU, we prefer an approach that is incorporated within the model law and regulation as set forth in question 3.

3. **Providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements.**
   NAMIC could support extension of the elimination of collateral requirements to other Qualified Jurisdictions, but only if the jurisdiction meets all requirements for qualified jurisdictions as well as agreeing to all of the other terms and conditions that the EU agreed upon under the Covered Agreement as interpreted by the U.S. Treasury Policy Statement. Importantly, this includes mutual recognition of the U.S. group supervision and group capital regime.

   There are several interesting ways to achieve this goal including the creation of a separate and distinct group of Qualified Jurisdictions that have agreed to the terms of the Covered Agreement including the policy statement interpreting the agreement from the U.S. Treasury.

   Another option is to revise the definition of a qualified jurisdiction to include one that has mutually recognized and agreed that the U.S. approach to group supervision and group capital is acceptable. By clearly revising the definition of Qualified Jurisdiction, the U.S. could then accomplish the goal of expanding mutual recognition of the U.S. group capital and supervision regime while also simplifying the collateral system.

   Revised language to the qualified jurisdiction definition could include something like the following:

   "Section 2 (E)(3)(a) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming reinsurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on an on-going basis, and consider the rights benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to (re)insurers licensed and domiciled in the U.S. including but not limited to mutually recognizing the U.S. insurance group supervision and group capital system as compliant with international standards and as the only group supervision and capital system applicable to

insurance groups with an ultimate controlling parent domiciled in the United States. A qualified jurisdiction must agree to share information and cooperate with the commissioner . . ."

Nonetheless, an extension of the elimination of collateral requirements for jurisdictions not included in the Covered Agreement should not be effective until a revised model law including the critical mutual recognition conditions for Qualified Jurisdictions could be adopted in all states.

4. **Considering changes to the criteria for evaluating whether a jurisdiction should be a Qualified Jurisdiction.**
   See proposal set forth in section 3.

5. **Considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to help address the increased financial solvency risks caused by the elimination of reinsurance collateral.**
   NAMIC does not support the automatic addition of new capital requirements for U.S. ceding companies using an EU-based reinsurer. In fact, NAMIC argues that such action would run afoul of the Covered Agreement prohibition against other, "new requirements with substantially the same regulatory impact . . .or any reporting requirement attributable to such removed collateral." Covered Agreement Article 3(2)(b).

   In addition, the only thing that will be accomplished by the changes in the model law and regulation will be elimination of "required" collateral. Ceding companies will still negotiate for collateral when it is in their best interest, especially with companies that have less than "aa" credit ratings. The consideration of collateral can still be weighed to assess whether any changes need to be made. We do not support an automatic shift of the collateral requirement over to a ceding company capital requirement until a proper assessment of the practices following the implementation of the Covered Agreement have been assessed.

6. **Any other considerations to weigh as part of the states' implementation of the Covered Agreement.**
   Nothing further to add.

Thank you for your consideration of these comments on this matter of importance to NAMIC, its member companies and their policyholders. If there are any questions, please feel free to contact me at 317-876-4270.

Sincerely,

Michelle Rogers
Assistant Vice President, International and Regulatory Affairs
National Association of Mutual Insurance Companies

[Attachment]

ATTACHMENT: MODEL REGULATION OR BULLETIN

The United States and the European Union have entered into a Bilateral Agreement Between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (the "Covered Agreement") that dictates changes in U.S. state law and regulation concerning the treatment of reinsurers from the EU. In the event that states fail to enact the changes described in Article 3 of the Covered Agreement by September 23, 2022, the federal government has agreed to take action to pre-empt state law.

The development of revisions to the Credit for Reinsurance Law [state statutory citation] and Credit for Reinsurance Regulation [insurance regulatory citation] are currently underway for enactment by all states on a uniform basis. As an interim measure, until the uniform language for the Credit for Reinsurance Law and Regulation has been finalized, in order to comply with the terms of the Covered Agreement promptly, and avoid federal pre-emption of [state] law and regulation, the following will apply to the [state] department of insurance efforts to implement the Credit for Reinsurance regulation [citation] pertaining to reinsurers domiciled in a member state of the EU:

In implementing the [state] Credit for Reinsurance regulation [citation] until an NAIC Credit for Reinsurance model law and regulation are available for adoption, all EU reinsurers meeting the conditions set forth in the Covered Agreement, Article 3 Paragraph 4[2] shall be deemed compliant with the requirements of the security rating under section [section 8 of the model regulation] of Secure-1 resulting in 0% security or collateral required.

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[2] Covered Agreement Conditions for EU Reinsurers to be Entitled to No Required Collateral

"4(a) the assuming reinsurer has and maintains on an ongoing basis,

(i) at least 226 million Euro, where the ceding insurer has its head office in the EU, or 250 million U.S. dollars, where the ceding insurer is domiciled in the United States, of own funds or capital and surplus, calculated according to the methodology of its home jurisdiction; or

(ii) if the assuming reinsurer is an association including incorporated and individual unincorporated underwriters:

(A) minimum capital and surplus equivalents (net of liabilities) or own funds, calculated according to the methodology applicable in its home jurisdiction, of at least 226 million Euro, where the ceding insurer has its head office in the EU, or 250 million U.S. dollars, where the ceding insurer is domiciled in the United States; and

(B) a central fund containing a balance of at least 226 million Euro, where the ceding insurer has its head office in the EU, or 250 million U.S. dollars, where the ceding insurer is domiciled in the United States;

(b) the assuming reinsurer has and maintains on an ongoing basis:

(i) a solvency ratio of 100 percent SCR under Solvency II or an RBC of 300 percent Authorized Control Level, as applicable in the territory in which the assuming reinsurer has its head office or is domiciled; or

(ii) if the assuming reinsurer is an association including incorporated and individual unincorporated underwriters, a solvency ratio of 100 percent SCR under Solvency II or an RBC of 300 percent Authorized Control Level, as applicable in the territory in which the assuming reinsurer has its head office or is domiciled;

(c) the assuming reinsurer agrees to provide prompt written notice and explanation to the supervisory authority in the territory of the ceding insurer if:

(i) it falls below the minimum capital and surplus or own funds, as applicable, specified in subparagraph (a), or the solvency or capital ratio, as applicable, specified in subparagraph (b); or

(ii) any regulatory action is taken against it for serious noncompliance with applicable law;

(d) the assuming reinsurer provides written confirmation to the Host supervisory authority of consent to the jurisdiction of the courts of the territory in which the ceding insurer has its head office or is domiciled, in accordance with applicable requirements of that territory for providing such consent. Nothing in this Agreement shall limit or in any way alter the capacity of parties to a reinsurance agreement to agree to alternative dispute resolution mechanisms;

(e) where applicable for "service of process" purposes, the assuming reinsurer provides written confirmation to the Host supervisory authority of consent to the appointment of that supervisory authority as agent for service of process. The Host supervisory authority may require that such consent be provided to it and included in each reinsurance agreement under its jurisdiction;

(f) the assuming reinsurer consents in writing to pay all final judgments, wherever enforcement is sought, obtained by a ceding insurer, that have been declared enforceable in the territory where the judgment was obtained;

(g) the assuming reinsurer agrees in each reinsurance agreement subject to this Agreement that it will provide collateral for 100 percent of the assuming reinsurer's liabilities attributable to reinsurance ceded pursuant to that agreement if the assuming reinsurer resists enforcement of a final judgment that is enforceable under the law of the territory in which it was obtained or a properly enforceable arbitration award, whether obtained by the ceding insurer or by its resolution estate, if applicable;

(h) The assuming reinsurer or its legal predecessor or successor, where applicable, provides the following documentation to the Host supervisory authority, if requested by that supervisory authority:

(i) with respect to the two years preceding entry into the reinsurance agreement and on an annual basis thereafter, its annual audited financial statements, in accordance with the applicable law of the territory of its head office, including the external audit report

(ii) with respect to the two years preceding entry into the reinsurance agreement, solvency and financial condition report or actuarial opinion, if filed with the assuming reinsurer's supervisor;

(iii) prior to entry into the reinsurance agreement and not more than semiannually thereafter, an updated list of all disputed and overdue reinsurance claims outstanding for 90 days or more, regarding reinsurance assumed from ceding insurers of the jurisdiction of the ceding insurer; and

(iv) prior to entry into the reinsurance agreement and not more than semiannually thereafter, information regarding the assuming reinsurer's assumed reinsurance by ceding company, ceded reinsurance by the assuming reinsurer, and reinsurance recoverable on paid and unpaid losses by the assuming reinsurer, to allow for the evaluation of the criteria set forth in subparagraph (i) of paragraph 4;

(i) the assuming reinsurer maintains a practice of prompt payment of claims under reinsurance agreements. The lack of prompt payment will be evidenced if any of the following criteria is met:

(i) more than 15 percent of the reinsurance recoverables are overdue and in dispute as reported to the supervisor;

(ii) more than 15 percent of the reinsurer's ceding insurers or reinsurers have overdue reinsurance recoverables on paid losses of 90 days or more which are not in dispute and which exceed for each ceding insurer 90,400 Euro, where the assuming reinsurer has its head office in the EU, or 100,000 U.S. dollars, where the assuming reinsurer is domiciled in the United States; or

(iii) the aggregate amount of reinsurance recoverables on paid losses which are not in dispute, but are overdue by 90 days or more, exceeds 45,200,000 Euro, where the assuming reinsurer has its head office in the EU, or 50,000,000 U.S. dollars, where the assuming reinsurer is domiciled in the United States;

(j) the assuming reinsurer confirms that it is not presently participating in any solvent scheme of arrangement, which involves Host Party Ceding Insurers, and agrees to notify the ceding insurer and its supervisory authority and to provide 100 percent collateral to the ceding insurer consistent with the terms of the scheme should the assuming reinsurer enter into such an arrangement;

(k) if subject to a legal process of resolution, receivership, or winding-up proceedings as applicable, the ceding insurer, or its representative, may seek and, if determined appropriate by the court in which the resolution, receivership, or winding-up proceedings is pending, may obtain an order requiring that the assuming reinsurer post collateral for all outstanding ceded liabilities; and

(l) the assuming reinsurer's Home supervisory authority confirms to the Host Party supervisory authority on an annual basis that the assuming reinsurer complies with subparagraph (b)."

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February 2, 2018

Superintendent Vullo, Chair
Reinsurance (E) Task Force
National Association of Insurance Commissioner
c/o Mr. Jake Stultz
Via e-mail jstultz@naic.org

Re: NAIC Notice of Public Hearing and Request for Comments to Address Covered Agreement

Dear Superintendent Vullo:

The Reinsurance Association of America (RAA) appreciates the opportunity to participate in the upcoming public hearing on February 20, 2018 in New York to address implementation of the reinsurance collateral provisions of Article 3 of the Covered Agreement. The Reinsurance Association of America is a national trade association representing reinsurance companies doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross border basis. The RAA also has life reinsurance company affiliates. We respectfully submit these comments in conjunction with oral comments to be presented at the public hearing.

As an overall matter, the RAA's comments are guided by the following general principles, which we urge the NAIC to follow as it addresses implementation of the Covered Agreement:

- Amendments to the *Credit for Reinsurance Model Law* #785 and the *Credit for Reinsurance Model Regulation* #786 should be as streamlined and uncomplicated as possible, to maintain clarity and prevent confusion in the state implementation process.

- Any amendments that extend similar treatment to jurisdictions other than the E.U. should: (a) require recognition of U.S. group supervision authority, including solvency and capital, governance and reporting requirements; and (b) eliminate any collateral requirements or requirements that U.S. reinsurers maintain a local presence in such jurisdictions. Such amendments should also ensure that U.S. reinsurers otherwise receive the same treatment as non-U.S. reinsurers under the NAIC framework.

- The NAIC should be cautious in its evaluation of whether additional "guardrails" are needed, as many regulatory protections already exist. Any proposed regulatory changes should be tailored to a specific regulatory gap that is not otherwise addressed. For example, the NAIC's Property and Casualty Risk-Based Capital (P&C RBC) framework adequately addresses credit risk associated with reinsurance amounts recoverable. The current

framework is also well-suited to address U.S. regulatory concerns arising from the Covered Agreement.

Consistent with these general principles, the RAA believes that implementation of the Covered Agreement can best be achieved through modifications to the current Credit for Reinsurance Model Law and Regulation that: (1) effectively implement the Covered Agreement with respect to qualified reinsurers based in the E.U.; and (2) allow for similar treatment to be extended to similarly qualified reinsurers based in other jurisdictions, such as those jurisdictions that have already been granted Qualified Jurisdiction status in the U.S., subject to commitments to the obligations and requirements contained in the Covered Agreement. Such commitments should be effectuated through appropriate agreements or Memoranda of Understanding, and enforced through the threat of disruption of the jurisdiction's status. We also urge the NAIC to determine how the UK will be treated in a post-Brexit environment, given the importance of the UK as an insurance center in Europe and as an insurance market, and to take action to prevent any disruption with respect to the UK.

The RAA proposes modifications to the both the Model Law and Regulation (attached) that would achieve these objectives. In brief, the proposed modifications would maintain the existing Qualified Jurisdiction framework but add a new category of "Designated Jurisdiction" (and, correspondingly, "Designated Reinsurer") to reflect necessary modifications to implement the Covered Agreement. The same provisions would apply to those jurisdictions that meet the requirements to be a Designated Jurisdiction, which would include recognizing the U.S. system of insurance supervision. This approach is necessary given the prospective nature of the Covered Agreement, although we anticipate that all of the current Qualified Jurisdictions could meet the requirements to be deemed Designated Jurisdictions under this approach on a prospective basis.

The RAA's proposal would reduce the likelihood that future covered agreements to address the collateral issue with other jurisdictions would be necessary. It also would streamline the state implementation process because it would avoid the necessity of repeated changes to the Credit for Reinsurance Model Law and Regulation to reflect new agreements with additional jurisdictions.

<u>Overview of Proposed Modifications to Model Law/Regulation</u>

As noted above, we have attached proposed revisions to the current Credit for Reinsurance Model Law and Regulation to bring them into compliance with the conditions of the Covered Agreement with respect to the E.U. and to create a mechanism to extend the same benefits granted under the Covered Agreement to reinsurers domiciled in jurisdictions that make enforceable commitments to be subject to those terms and conditions.

To make the process as clear as possible, we have inserted new sections in the attached proposal to revise the current Section D in the Model Law and Section 8 in the Model Regulation. The revisions include a new category of reinsurers called a "Designated Reinsurer", along with a new category of jurisdiction called a "Designated Jurisdiction". In our view, these new categories are necessary to distinguish those designations from the current Qualified Jurisdiction framework, which we think should be maintained, at least initially. As noted above, maintaining the existing Certified Reinsurer designations is necessary at least with respect to existing contracts, as the Designated Reinsurer

category will only apply prospectively. Under this new category, any Designated Jurisdiction would be required to recognize U.S. group supervision authority, including solvency and capital, governance and reporting requirements, and eliminate any requirements that U.S. reinsurers maintain a local presence or post collateral in order to do business in such jurisdictions.

Under the Designated Jurisdictions category, we have eliminated any references to credit ratings to comply with the Covered Agreement. As an alternative to the ability to rely upon ratings as part of the evaluation criteria and to justify zero collateral treatment for a Designated Reinsurer, we have added two additional requirements to the determination of whether a jurisdiction qualifies as a Designated Jurisdiction to reflect the requirements of the Covered Agreement. First, the jurisdiction must agree to eliminate any local presence or collateral requirements for reinsurers. Second, the jurisdiction must recognize U.S. group supervision authority, including solvency and capital, governance and reporting requirements. All other criteria to determine a Designated Jurisdiction remain unchanged from the Qualified Jurisdiction framework. The RAA proposed modifications also include a requirement for the NAIC to maintain a list of Designated Jurisdictions and the effective date of the corresponding Designated Jurisdiction agreement.

Designated Jurisdictions: Enforcement and Resulting Benefits

In the current model law Section 2(E)(3)(a) and regulation Section 8(C)(2), the qualified jurisdiction rules provide that the reinsurance supervisory system of the non-U.S. jurisdiction will be evaluated, "both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S." A jurisdiction currently must submit to this ongoing review to maintain its status as a Qualified Jurisdiction. To ensure that any Designated Jurisdiction complies with its obligations as required by the designation on an ongoing basis, we believe that the NAIC must: (1) require appropriate agreement or Memoranda of Understanding with any Designated Jurisdiction (other than the E.U.); and (2) develop a more robust and immediate system to deal with non-compliance.

The NAIC Qualified Jurisdiction (E) Working Group has a Process document that sets forth the rules for developing and maintaining the qualified jurisdiction list. These rules provide that "[i]f the Qualified Jurisdiction Working Group finds the jurisdiction to be out of compliance at any time with the requirements to be a Qualified Jurisdiction, the specific reasons will be documented in a report to the jurisdiction under review, and the status as a Qualified Jurisdiction may be placed on probation, suspended or revoked." The NAIC process should include timely review and enforcement of Qualified Jurisdiction and new Designated Jurisdiction rules.

The consequences to a Designated Jurisdiction that fails to comply with the terms of its status must be immediate and objective. When formulating the rules for Designated Jurisdictions, the NAIC should include a requirement that a jurisdiction's status will be immediately suspended for prospective business upon a showing of material differential treatment of a U.S.-based reinsurer. Additionally, similar rules and procedures should be created for when a Designated Reinsurer violates any condition necessary to qualify for zero collateral. We have added revisions in the attached model regulation Section 9(A)(8) to detail procedures to follow in these circumstances. These procedures mirror the requirements of the Covered Agreement.

Consideration of Additional Guardrails

As noted above, the NAIC should exercise caution when considering additional "guardrails" relative to U.S. ceding companies, such as changes to the risk-based capital (RBC) formula or new regulatory approaches to address any perceived increased financial solvency risks caused by the elimination of reinsurance collateral. As detailed below, many regulatory protections already exist in the current solvency regime. The NAIC should identify a regulatory gap that needs to be addressed before considering what protections are necessary to address it. The NAIC's recently revised Property and Casualty Risk-Based Capital (P&C RBC) framework adequately addresses credit risk associated with reinsurance amounts recoverable. The current framework is jurisdictionally agnostic and thus well-suited to address U.S. regulatory concerns arising from implementation of the Covered Agreement. To the extent that the NAIC considers any additional guardrails, they should apply equally to both U.S. and non-U.S. reinsurers.

The credit risk component of P&C RBC, known as "R3", includes a risk-based charge on reinsurance amounts recoverable of U.S. ceding companies. This recently revised charge already contemplates whether the reinsurance amounts recoverable are collateralized or not, and adjusts the R3 charge accordingly. R3 is based on the current Credit for Reinsurance Model Law and Regulation requirements, and would require only slight modification to reflect the new requirements of the Covered Agreement. Specifically, we recommend the creation of a new category of Designated Reinsurer to add to the other categories of Authorized, Unauthorizes and Certified Reinsurer.

R3 includes the following major features:

- The capital charges are based on the Financial Strength Ratings (FSR) of the reinsurer;
- The R3 factors are derived from historical default risk by FSR category plus an additional .03 factor for operational and other non-credit risk;
- Reinsurance collateral can reduce the reinsurance credit risk portion of R3 for lower-rated reinsurers (NAIC-4 through NAIC-7 reinsurer designation equivalents);
- R3 is jurisdictionally agnostic as to the domicile of the reinsurer;
- The charges are applied at the transaction level for each cedent/reinsurer relationship; and
- As of 2018 year-end, Schedule F—Part 3 of the NAIC's Annual Statement will detail the R3 calculation; providing robust reporting and transparency of the credit risk associated with each ceding company's reinsurance recoverable portfolio.

We understand that C-10 addresses similar risks in the life-based RBC formula.

Other Considerations for States' Implementation of Covered Agreement

As an immediate indication that the NAIC and states will be implementing the Covered Agreement terms in good faith, the NAIC and the states should consider relaxing the collateral and designated reinsurer application requirements in accordance with the Covered Agreement. E.U. supervisors already have begun to provide benefits to U.S. reinsurers that are consistent with the terms of the Covered Agreement. For example, immediately after the parties signed the Covered Agreement, the German supervisor agreed to forbear from enforcing local presence requirements against U.S.

reinsurers.

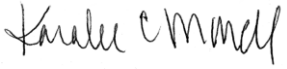
The NAIC and states should consider similar actions. For example, the Covered Agreement suggests reducing the collateral requirements to 0 over 5 years by reducing the requirements by 20% each year. Another suggestion is that the state regulators, NAIC and the NAIC's Reinsurance Financial Analysis Working Group (REFAWG) can relax the requirement that designated reinsurers provide reconciled financial statements or relieve designated reinsurers from providing actuarial opinions when they are not required to provide actuarial opinions to their non-U.S. based supervisor.

The RAA has also proposed specific language for NAIC consideration that would extend the same collateral treatment to reinsurers domiciled and licensed in an NAIC accredited state. We strongly believe that U.S. domiciled reinsurers should have the same efficient access to U.S. markets that is afforded to reinsurers subject to the Covered Agreement or the proposed Designated Reinsurer category.

* * * *

The RAA appreciates the opportunity to offer comments and work with the NAIC to effectively implement the Covered Agreement. We look forward to continued collaboration as the NAIC process advances. Please do not hesitate to contact us with any questions or concerns.

Sincerely,



Frank Nutter
President

Karalee Morell
Vice President & Assistant General Counsel

CREDIT FOR REINSURANCE MODEL LAW

Preface to Credit for Reinsurance Models

The amendments to the NAIC Credit for Reinsurance Model Law (#785) & Regulation (#786) are part of a larger effort to modernize reinsurance regulation in the United States. The NAIC initially adopted the Reinsurance Regulatory Modernization Framework Proposal during its 2008 Winter National Meeting. The NAIC recommended that this framework be implemented through federal legislation in order to best preserve and improve state-based regulation of reinsurance, ensure timely and uniform implementation throughout all NAIC member jurisdictions, and as a more comprehensive alternative to related federal legislation. In addition to this proposed federal legislation, the framework also provided that changes to state insurance laws should be considered. For example, state laws to establish requirements under which states would regulate qualified reinsurers, and also to consider reinsurance risk diversification and notice requirements for ceding insurers.

On July 21, 2010, Congress passed and the President signed related federal legislation, the Nonadmitted and Reinsurance Reform Act, which became effective July 21, 2011. While this act does not implement the NAIC framework, it does preempt the extraterritorial application of state credit for reinsurance law and permits states of domicile to proceed forward with reinsurance collateral reforms on an individual basis if they are accredited. This federal legislation also does not prohibit the states from acting together, through the NAIC, to achieve the reinsurance modernization framework goals. In addition to the current work on the credit for reinsurance models, the NAIC will continue its efforts to implement other aspects of the framework. These efforts will continue both through work conducted by the Reinsurance Task Force and through referrals to the appropriate groups within the NAIC. In addition, the NAIC will consider a proposal to form a new group to provide advisory support and assistance to states in the review of reinsurance collateral reduction applications. Such a process with respect to the review of applications for reinsurance collateral reduction and qualified jurisdictions should strengthen state regulation and prevent regulatory arbitrage. Such an effort would be supported by NAIC staff with substantial expertise to support the functions of such a group.

Finally, the NAIC will continue to work on requirements for NAIC review and approval of qualified jurisdictions, and will undertake a re-examination of the collateral amounts within two years from the effective date of the revisions to the models.

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CREDIT FOR REINSURANCE MODEL LAW

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Section 1. Purpose

The purpose of this Act is to protect the interest of insureds, claimants, ceding insurers, assuming insurers and the public generally. The legislature hereby declares its intent is to ensure adequate regulation of insurers and reinsurers and adequate protection for those to whom they owe obligations. In furtherance of that state interest, the legislature hereby provides a mandate that upon the insolvency of a non-U.S. insurer or reinsurer that provides security to fund its U.S. obligations in accordance with this Act, the assets representing the security shall be maintained in the United States and claims shall be filed with and valued by the state insurance commissioner with regulatory oversight, and the assets shall be distributed, in accordance with the insurance laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic U.S. insurance companies. The legislature declares that the matters contained in this Act are fundamental to the business of insurance in accordance with 15 U.S.C. §§ 1011-1012.

Section 2. Credit Allowed a Domestic Ceding Insurer

Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of Subsections A, B, C, D, E or F of this section; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

Drafting Note: This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

Credit shall be allowed under Subsections A, B or C of this section only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under Subsections C or D of this section only if the applicable requirements of Subsection G have been satisfied.

A. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is licensed to transact insurance or reinsurance in this state.

Drafting Note: A state that provides for licensing of reinsurance by line, for consistency should adopt an amended version of Subsection A requiring the assuming insurer to be "licensed to transact reinsurance in this state."

B. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is accredited by the commissioner as a reinsurer in this state. In order to be eligible for accreditation, a reinsurer must:

(1) File with the commissioner evidence of its submission to this state's jurisdiction;

(2) Submit to this state's authority to examine its books and records;

(3) Be licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, be entered through and licensed to transact insurance or reinsurance in at least one state;

(4) File annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; and

(5) Demonstrate to the satisfaction of the commissioner that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer is deemed to meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than $20,000,000 and its accreditation has not been denied by the commissioner within ninety (90) days after submission of its application.

Drafting Note: To qualify as an accredited reinsurer, an assuming insurer must meet all of the requirements and the standards set forth in Subsection B. If the commissioner of insurance determines that the assuming insurer has failed to continue to meet any of these qualifications, the commissioner may, upon written notice and hearing, revoke accreditation.

C. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is domiciled in, or in the case of a U.S. branch of an alien assuming insurer is entered through, a state that employs standards regarding credit for reinsurance substantially similar to those applicable under this statute and the assuming insurer or U.S. branch of an alien assuming insurer:

(a) Maintains a surplus as regards policyholders in an amount not less than $20,000,000; and

(b) Submits to the authority of this state to examine its books and records.

(2) The requirement of Section 2 C(1)(a) does not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system.

Drafting Note: The term "substantially similar" means standards that equal or exceed the standards of the enacting state, as determined by the commissioner of the enacting state. It is expected that the NAIC will maintain a list of states whose laws establish standards that equal or exceed the standards of this model act.

D. (1) Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution, as defined in Section 4B, for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. To enable the commissioner to determine the sufficiency of the trust fund, the assuming insurer shall report annually to the commissioner information substantially the same as that required to be reported on the NAIC Annual Statement form by licensed

insurers. The assuming insurer shall submit to examination of its books and records by the commissioner and bear the expense of examination.

(2) (a) Credit for reinsurance shall not be granted under this subsection unless the form of the trust and any amendments to the trust have been approved by:

(i) The commissioner of the state where the trust is domiciled; or

(ii) The commissioner of another state who, pursuant to the terms of the trust instrument, has accepted principal regulatory oversight of the trust.

(b) The form of the trust and any trust amendments also shall be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the United States. The trust shall vest legal title to its assets in its trustees for the benefit of the assuming insurer's U.S. ceding insurers, their assigns and successors in interest. The trust and the assuming insurer shall be subject to examination as determined by the commissioner.

(c) The trust shall remain in effect for as long as the assuming insurer has outstanding obligations due under the reinsurance agreements subject to the trust. No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing the balance of the trust and listing the trust's investments at the preceding year-end and shall certify the date of termination of the trust, if so planned, or certify that the trust will not expire prior to the following December 31.

(3) The following requirements apply to the following categories of assuming insurer:

(a) The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers, and, in addition, the assuming insurer shall maintain a trusteed surplus of not less than $20,000,000, except as provided in Paragraph 3(b) of this subsection.

(b) At any time after the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner with principal regulatory oversight of the trust may authorize a reduction in the required trusteed surplus, but only after a finding, based on an assessment of the risk, that the new required surplus level is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. The risk assessment may involve an actuarial review, including an independent analysis of reserves and cash flows, and shall consider all material risk factors, including when applicable the lines of business involved, the stability of the incurred loss estimates and the effect of the surplus requirements on the

assuming insurer's liquidity or solvency. The minimum required trusteed surplus may not be reduced to an amount less than thirty percent (30%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers covered by the trust.

(c) (i) In the case of a group including incorporated and individual unincorporated underwriters:

(I) For reinsurance ceded under reinsurance agreements with an inception, amendment or renewal date on or after January 1, 1993, the trust shall consist of a trusteed account in an amount not less than the respective underwriters' several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any underwriter of the group;

(II) For reinsurance ceded under reinsurance agreements with an inception date on or before December 31, 1992, and not amended or renewed after that date, notwithstanding the other provisions of this Act, the trust shall consist of a trusteed account in an amount not less than the respective underwriters' several insurance and reinsurance liabilities attributable to business written in the United States; and

(III) In addition to these trusts, the group shall maintain in trust a trusteed surplus of which $100,000,000 shall be held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account; and

(ii) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be subject to the same level of regulation and solvency control by the group's domiciliary regulator as are the unincorporated members.

(iii) Within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, the group shall provide to the commissioner an annual certification by the group's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the group.

(d) In the case of a group of incorporated underwriters under common administration, the group shall:

(i) Have continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to making application for accreditation;

(ii) Maintain aggregate policyholders' surplus of at least $10,000,000,000;

(iii) Maintain a trust fund in an amount not less than the group's several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group pursuant to reinsurance contracts issued in the name of the group;

(iv) In addition, maintain a joint trusteed surplus of which $100,000,000 shall be held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group as additional security for these liabilities; and

(v) Within ninety (90) days after its financial statements are due to be filed with the group's domiciliary regulator, make available to the commissioner an annual certification of each underwriter member's solvency by the member's domiciliary regulator and financial statements of each underwriter member of the group prepared by its independent public accountant.

Drafting Note: Unless otherwise stated, "commissioner" refers to the commissioner of insurance in the state where credit or a reduction from liability is taken.

Drafting Note: Consideration was given to deferring to state capital and surplus requirements as a threshold for the trusteed surplus, but it was concluded that, on the basis of risk exposure and current industry security practices, the standards for credit should be higher under Subsection D. The $100,000,000 trusteed surplus requirement for a group including incorporated and individual unincorporated underwriters reflects the higher financial standards currently found among the states for a group of this type. The $20,000,000 trusteed surplus requirement is an option available to assuming insurers that do not satisfy both the licensing and financial standards of Subsection B or C.

E. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that has been certified by the commissioner as a reinsurer in this state and secures its obligations in accordance with the requirements of this subsection.

(1) In order to be eligible for certification, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner pursuant to Paragraph (3) of this subsection;

(b) The assuming insurer must maintain minimum capital and surplus, or its equivalent, in an amount to be determined by the commissioner pursuant to regulation;

(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner pursuant to regulation;

(d) The assuming insurer must agree to submit to the jurisdiction of this state, appoint the commissioner as its agent for service of process in this state, and agree to provide security for 100 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment;

(e) The assuming insurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis; and

(f) The assuming insurer must satisfy any other requirements for certification deemed relevant by the commissioner.

(2) An association including incorporated and individual unincorporated underwriters may be a certified reinsurer. In order to be eligible for certification, in addition to satisfying requirements of Paragraph (1):

(a) The association shall satisfy its minimum capital and surplus requirements through the capital and surplus equivalents (net of liabilities) of the association and its members, which shall include a joint central fund that may be applied to any unsatisfied obligation of the association or any of its members, in an amount determined by the commissioner to provide adequate protection;

(b) The incorporated members of the association shall not be engaged in any business other than underwriting as a member of the association and shall be subject to the same level of regulation and solvency control by the association's domiciliary regulator as are the unincorporated members; and

(c) Within ninety (90) days after its financial statements are due to be filed with the association's domiciliary regulator, the association shall provide to the commissioner an annual certification by the association's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.

(3) The commissioner shall create and publish a list of qualified jurisdictions, under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be considered for certification by the commissioner as a certified reinsurer.

(a) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. A jurisdiction may not be recognized as a qualified jurisdiction if the commissioner has determined that the jurisdiction does not adequately and promptly enforce final U.S. judgments and arbitration awards. Additional factors may be considered in the discretion of the commissioner.

(b) A list of qualified jurisdictions shall be published through the NAIC Committee Process. The commissioner shall consider this list in determining qualified jurisdictions. If the commissioner approves a jurisdiction as qualified that does not appear on the list of qualified jurisdictions, the commissioner shall provide thoroughly documented justification in accordance with criteria to be developed under regulations.

(c) U.S. jurisdictions that meet the requirement for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.

(d) If a certified reinsurer's domiciliary jurisdiction ceases to be a qualified jurisdiction, the commissioner has the discretion to suspend the reinsurer's certification indefinitely, in lieu of revocation.

(4) The commissioner shall assign a rating to each certified reinsurer, giving due consideration to the financial strength ratings that have been assigned by rating agencies deemed acceptable to the commissioner pursuant to regulation. The commissioner shall publish a list of all certified reinsurers and their ratings.

(5) A certified reinsurer shall secure obligations assumed from U.S. ceding insurers under this subsection at a level consistent with its rating, as specified in regulations promulgated by the commissioner.

(a) In order for a domestic ceding insurer to qualify for full financial statement credit for reinsurance ceded to a certified reinsurer, the certified reinsurer shall maintain security in a form acceptable to the commissioner and consistent with the provisions of Section 3, or in a multibeneficiary trust in accordance with Subsection D of this section, except as otherwise provided in this subsection.

(b) If a certified reinsurer maintains a trust to fully secure its obligations subject to Subsection D of this section, and chooses to secure its obligations incurred as a certified reinsurer in the form of a multibeneficiary trust, the certified reinsurer shall maintain separate trust accounts for its obligations incurred under reinsurance agreements issued or renewed as a certified reinsurer with reduced security as permitted by this subsection or comparable laws of other U.S. jurisdictions and for its obligations subject to Subsection D of this section. It shall be a condition to the grant of certification under Subsection E of this section that the certified reinsurer shall have bound itself, by the language of the trust and agreement with the commissioner with principal regulatory oversight of each such trust account, to fund, upon termination of any such trust account, out of the remaining surplus of such trust any deficiency of any other such trust account.

(c) The minimum trusteed surplus requirements provided in Subsection D are not applicable with respect to a multibeneficiary trust maintained by a certified reinsurer for the purpose of securing

obligations incurred under this subsection, except that such trust shall maintain a minimum trusteed surplus of $10,000,000.

(d) With respect to obligations incurred by a certified reinsurer under this subsection, if the security is insufficient, the commissioner shall reduce the allowable credit by an amount proportionate to the deficiency, and has the discretion to impose further reductions in allowable credit upon finding that there is a material risk that the certified reinsurer's obligations will not be paid in full when due.

(e) For purposes of this subsection, a certified reinsurer whose certification has been terminated for any reason shall be treated as a certified reinsurer required to secure 100 percent of its obligations.

(i) As used in this subsection, the term "terminated" refers to revocation, suspension, voluntary surrender and inactive status.

(ii) If the commissioner continues to assign a higher rating as permitted by other provisions of this section, this requirement does not apply to a certified reinsurer in inactive status or to a reinsurer whose certification has been suspended.

(6) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction's certification, and has the discretion to defer to the rating assigned by that jurisdiction, and such assuming insurer shall be considered to be a certified reinsurer in this state.

(7) A certified reinsurer that ceases to assume new business in this state may request to maintain its certification in inactive status in order to continue to qualify for a reduction in security for its in-force business. An inactive certified reinsurer shall continue to comply with all applicable requirements of this subsection, and the commissioner shall assign a rating that takes into account, if relevant, the reasons why the reinsurer is not assuming new business.

F. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that has its head office or is domiciled in a designated jurisdiction and secures its obligations in accordance with the requirements of this subsection (hereinafter a "designated reinsurer").

(1) In order to be eligible, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must have its head office or be domiciled and licensed to transact insurance or reinsurance in a designated jurisdiction, as determined by the commissioner pursuant to Paragraph (3) of this subsection;

(b) The assuming insurer must maintain minimum capital and surplus, or its equivalent, in an amount to be determined by the commissioner pursuant to regulation;

(c) The assuming insurer must maintain an RBC or its equivalent, to be determined by the commissioner pursuant to regulation;

(d) The assuming insurer must confirm that it is not presently participating in any solvent scheme of arrangement, which involves any domestic ceding insurers, and agrees to notify the ceding insurer and the commissioner and to provide 100 percent security to the ceding insurer consistent with the terms of the scheme should the assuming insurer enter into such an arrangement;

(d) The assuming insurer must agree to submit to the jurisdiction of this state, appoint the commissioner as its agent for service of process in this state, and agree to provide security for 100 percent of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment;

(e) The assuming insurer must agree to meet applicable information filing requirements as determined by the commissioner; and

(f) The assuming insurer must satisfy any other requirements for certification deemed relevant by the commissioner.

(2) An association including incorporated and individual unincorporated underwriters may be a designated reinsurer. In order to be eligible, in addition to satisfying requirements of Paragraph (1):

(a) The association shall satisfy its minimum capital and surplus requirements through the capital and surplus equivalents (net of liabilities) of the association and its members, which shall include a joint central fund that may be applied to any unsatisfied obligation of the association or any of its members, in an amount determined by the commissioner to provide adequate protection;

(b) The incorporated members of the association shall not be engaged in any business other than underwriting as a member of the association and shall be subject to the same level of regulation and solvency control by the association's domiciliary regulator as are the unincorporated members; and

(c) Within ninety (90) days after its financial statements are due to be filed with the association's domiciliary regulator, the association shall provide to the commissioner an annual certification by the association's domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the association.

(3) The commissioner shall create and publish a list of designated jurisdictions, under which an assuming insurer licensed and domiciled in such jurisdiction is eligible to be considered a designated reinsurer by the commissioner.

(a) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a designated

jurisdiction, the commissioner shall consider applicable agreements, evaluate the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. A designated jurisdiction must agree to share information and cooperate with the commissioner with respect to all designated reinsurers domiciled within that jurisdiction. A jurisdiction may not be recognized as a designated jurisdiction if the commissioner has determined that the jurisdiction does not adequately and promptly enforce final U.S. judgments and arbitration awards.

~~(a)~~(b) Eligible non-U.S. jurisdictions must be subject to or enter into an agreement or memorandum of understanding (MOU) acknowledged by the commissioner that, subject to the terms and conditions in the agreement or MOU:

(i) Provides market access rights for U.S. domiciled insurers at least equivalent to those provided hereunder;

(ii) Eliminates any requirement for a U.S. domiciled assuming insurer to post collateral in such non-U.S. jurisdiction or on behalf of insurers subject to the regulation of such non-U.S. jurisdiction and provides accounting or other regulatory treatment for reinsurance assumed by a U.S. domiciled assuming insurer similar to the treatment afforded to reinsurance assumed by insurers domiciled in such non-U.S. jurisdiction;

(iii) Eliminates any requirement for a U.S. domiciled assuming insurer to establish or maintain a local presence as a condition for entering into a reinsurance agreement with any ceding insurer subject to regulation by the non-U.S. jurisdiction or as a condition to allow the ceding insurer to recognize credit for such reinsurance or credit for risk mitigation effect of such reinsurance;

(iv) Agrees to publicly acknowledge and recognize the U.S. state based regulatory system as a competent regulatory structure that is deserving of international mutual recognition on prudential solvency, group capital, corporate governance, financial reporting, and group supervision matters for insurance groups that are domiciled or maintain their headquarters in this state or another state accredited by the National Association of Insurance Commissioners; and

(v) Such additional factors may be considered in the discretion of the commissioner.

(c) A list of designated jurisdictions shall be published through the NAIC Committee Process. Such list shall indicate the respective effective date of each such DJ Agreement. The commissioner shall consider this list in determining designated jurisdictions. If the commissioner approves a jurisdiction as designated that does not appear on the list of designated jurisdictions, the commissioner shall provide thoroughly

documented justification in accordance with criteria to be developed under regulations.

(d) U.S. jurisdictions that meet the requirement for accreditation under the NAIC financial standards and accreditation program shall be recognized as designated jurisdictions.

(6) If a non-U.S. jurisdiction has been deemed a designated jurisdiction by an NAIC accredited jurisdiction, the commissioner has the discretion to defer to and accept that jurisdiction's designation. Upon such acceptance by the commissioner, the non-U.S. jurisdiction shall be considered a designated jurisdiction in this state.

(7) Provided that it continues to comply with all applicable requirements of this subsection, a designated reinsurer that ceases to assume new business in this state will maintain its status and be eligible for applicable credit for reinsurance accounting treatment for its in-force business. .

~~F.~~G. Credit shall be allowed when the reinsurance is ceded to an assuming insurer not meeting the requirements of Subsections A, B, C, D or E of this section, but only as to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

Drafting Note: For purposes of this subsection, "jurisdiction" refers to those jurisdictions other than the United States and also to any state, district or territory of the United States. Subsection E allows credit to ceding insurers that are mandated by these jurisdictions to cede to state-owned or controlled insurance or reinsurance companies or to participate in pools, guaranty associations or residual market mechanisms.

~~G~~H. If the assuming insurer is not licensed, accredited or certified to transact insurance or reinsurance in this state, the credit permitted by Subsections C and D of this section shall not be allowed unless the assuming insurer agrees in the reinsurance agreements:

(1) (a) That in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance agreement, the assuming insurer, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, will comply with all requirements necessary to give the court jurisdiction, and will abide by the final decision of the court or of any appellate court in the event of an appeal; and

(b) To designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the ceding insurer.

(2) This subsection is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if this obligation is created in the agreement.

~~H~~I. If the assuming insurer does not meet the requirements of Subsections A, B or C, the credit permitted by Subsection D or E of this section shall not be allowed unless the assuming insurer agrees in the trust agreements to the following conditions:

(1) Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by Subsection D(3) of this section, or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund.

(2) The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic insurance companies.

(3) If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. ceding insurers of the grantor of the trust, the assets or part thereof shall be returned by the commissioner with regulatory oversight to the trustee for distribution in accordance with the trust agreement.

(4) The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

~~I.~~ J. If an accredited or certified reinsurer ceases to meet the requirements for accreditation or certification, the commissioner may suspend or revoke the reinsurer's accreditation or certification.

(1) The commissioner must give the reinsurer notice and opportunity for hearing. The suspension or revocation may not take effect until after the commissioner's order on hearing, unless:

(a) The reinsurer waives its right to hearing;

(b) The commissioner's order is based on regulatory action by the reinsurer's domiciliary jurisdiction or the voluntary surrender or termination of the reinsurer's eligibility to transact insurance or reinsurance business in its domiciliary jurisdiction or in the primary certifying state of the reinsurer under Subparagraph E(6) of this section; or

(c) The commissioner finds that an emergency requires immediate action and a court of competent jurisdiction has not stayed the commissioner's action.

(2) While a reinsurer's accreditation or certification is suspended, no reinsurance contract issued or renewed after the effective date of the suspension qualifies for credit except to the extent that the reinsurer's obligations under the contract are secured in accordance with Section 3. If a reinsurer's accreditation or certification is revoked, no credit for reinsurance may be granted after the effective date of the revocation except to the extent that the reinsurer's obligations under the contract are secured in accordance with Subsection E(5) or Section 3.

~~J~~K. Concentration Risk.

(1) A ceding insurer shall take steps to manage its reinsurance recoverables proportionate to its own book of business. A domestic ceding insurer shall notify the commissioner within thirty (30) days after reinsurance recoverables from any single assuming insurer, or group of affiliated assuming insurers, exceeds fifty percent (50%) of the domestic ceding insurer's last reported surplus to policyholders, or after it is determined that reinsurance recoverables from any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the domestic ceding insurer.

(2) A ceding insurer shall take steps to diversify its reinsurance program. A domestic ceding insurer shall notify the commissioner within thirty (30) days after ceding to any single assuming insurer, or group of affiliated assuming insurers, more than twenty percent (20%) of the ceding insurer's gross written premium in the prior calendar year, or after it has determined that the reinsurance ceded to any single assuming insurer, or group of affiliated assuming insurers, is likely to exceed this limit. The notification shall demonstrate that the exposure is safely managed by the domestic ceding insurer.

Section 3. Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements of Section 2

An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements of Section 2 shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer; provided further, that the commissioner may adopt by regulation pursuant to Section 5B specific additional requirements relating to or setting forth: (1) the valuation of assets or reserve credits; (2) the amount and forms of security supporting reinsurance arrangements described in Section 5B; and/or (3) the circumstances pursuant to which credit will be reduced or eliminated.

Drafting Note: This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such reinsurance arrangements.

The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined in Section 4B. This security may be in the form of:

A. Cash;

B. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners, including those deemed exempt from filing as defined by the Purposes and Procedures Manual of the Securities Valuation Office, and qualifying as admitted assets;

C. (1) Clean, irrevocable, unconditional letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in Section 4A, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding insurer on or before the filing date of its annual statement;

(2) Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs; or

Drafting Note: Providing for the continuing acceptability of letters of credit whose issuers were acceptable when the credit support facility was first obtained is intended to avoid abrupt interruptions in the acceptability of credit support arrangements that run for specific periods of time, and thus unnecessary disruptions in the marketplace, on account of the issuing (or confirming) institution's subsequent failure to meet applicable standards of issuer acceptability (whether by virtue of a change in the issuing institution's ability to qualify under the original standards or as a result of revisions to the applicable standards). The provision stipulates that letters of credit acceptable when first obtained will, in the event of the subsequent nonqualification of the issuing (or confirming) institution, continue to be acceptable as security until the account party and beneficiary would first have, in the normal course of business, an opportunity to replace the credit support facility.

D. Any other form of security acceptable to the commissioner.

Drafting Note: There is no implication in the requirement that the security for the payment of obligations must be held under the exclusive control of the ceding insurer that either the reserve liability or the assets held in relation to the reserve liability have not been transferred for the purposes of statutory accounting by the ceding insurer to the reinsurer.

Section 4. Qualified U.S. Financial Institutions

A. For purposes of Section 3C, a "qualified U.S. financial institution" means an institution that:

(1) Is organized or (in the case of a U.S. office of a foreign banking organization) licensed, under the laws of the United States or any state thereof;

(2) Is regulated, supervised and examined by U.S. federal or state authorities having regulatory authority over banks and trust companies; and

(3) Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.

Drafting Note: The NAIC's Securities Valuation Office (SVO) maintains, on a current basis, a list of all U.S. financial institutions that have, upon application to the SVO, been determined to meet the eligibility standards of its *Purposes and Procedures Manual*. These standards, developed by the NAIC's Letter of Credit (EX4) Study Group, make use of nationally recognized ratings services, and are more rigorous in the case of foreign banking organizations (whose standby letters of credit must be issued or confirmed by a qualified U.S. financial institution) than those that are applicable to domestic financial institutions whose standby letters of credit would be considered acceptable.

B. A "qualified U.S. financial institution" means, for purposes of those provisions of this law specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:

(1) Is organized, or, in the case of a U.S. branch or agency office of a foreign banking organization, licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and

(2) Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.

Drafting Note: Because assets held in a fiduciary capacity are not subject to the claims of the trustee's creditors, and because the trust departments of all U.S. financial institutions (including U.S. branch or agency offices of foreign banking organizations having fiduciary powers in the U.S.) are regulated, supervised and examined by the institution's primary U.S. bank regulatory authority (federal or state), there is no need to apply additional standards measuring the financial condition or standing of the institution, as in the case of determining those institutions whose standby letter of credit obligations will be considered acceptable.

Section 5. Rules and Regulations

A. The commissioner may adopt rules and regulations implementing the provisions of this law.

Drafting Note: It is recognized that credit for reinsurance also can be affected by other sections of the enacting state's code, e.g., a statutory insolvency clause or an intermediary clause. It is recommended that states that do not have a statutory insolvency clause or an intermediary clause consider incorporating such clauses in their legislation.

B. The commissioner is further authorized to adopt rules and regulations applicable to reinsurance arrangements described in Paragraph (1) of this Section 5B.

Drafting Note: This new regulatory authority is being added in response to reinsurance arrangements entered into, directly or indirectly, with life/health insurer-affiliated captives, special purpose vehicles or similar entities that may not have the same statutory accounting requirements or solvency requirements as US-based multi-state life/health insurers. To assist in achieving national uniformity, commissioners are asked to strongly consider adopting regulations that are substantially similar in all material respects to NAIC adopted model regulations in the handling and treatment of such policies and reinsurance arrangements.

(1) A regulation adopted pursuant to this Section 5B, may apply only to reinsurance relating to:

(a) Life insurance policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits;

(b) Universal life insurance policies with provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period;

(c) Variable annuities with guaranteed death or living benefits;

(d) Long-term care insurance policies; or

(e) Such other life and health insurance and annuity products as to which the NAIC adopts model regulatory requirements with respect to credit for reinsurance.

(2) A regulation adopted pursuant to Paragraph 1(a) or 1(b) of this Section 5B, may apply to any treaty containing (i) policies issued on or after January 1, 2015, and/or (ii) policies issued prior to January 1, 2015, if risk pertaining to such pre-2015 policies is ceded in connection with the treaty, in whole or in part, on or after January 1, 2015.

Drafting Note: The NAIC's Actuarial Guideline XLVIII (AG 48) became effective January 1, 2015, and covers policies ceded on or after this date unless they were ceded as part of a reserve financing arrangement as of December 31, 2014. One regulation contemplated by this revision to the NAIC Credit for Reinsurance Model Law is intended to substantially replicate the requirements for the amounts and forms of security held under the rules provided in AG 48. AG 48 was written to sunset upon a state's adoption (pursuant to the enabling authority of the preceding paragraph) of a regulation with terms substantially similar to AG 48. The preceding paragraph is intended to provide continuity of rules applicable to those policies and reinsurance arrangements, including continuity as to the policies covered by such rules. The preceding paragraph is not intended to change the scope of, or collateral requirements for policies and treaties covered under AG 48.

(3) A regulation adopted pursuant to this Section 5B may require the ceding insurer, in calculating the amounts or forms of security required to be held under regulations promulgated under this authority, to use the Valuation Manual adopted by the NAIC under Section 11B(1) of the NAIC Standard Valuation Law, including all amendments adopted by the NAIC and in effect on the date as of which the calculation is made, to the extent applicable.

(4) A regulation adopted pursuant to this Section 5B shall not apply to cessions to an assuming insurer that:

(a) Is certified in this state or, if this state has not adopted provisions substantially equivalent to Section 2E of the Credit for Reinsurance Model Law, certified in a minimum of five (5) other states; or

(b) Maintains at least $250 million in capital and surplus when determined in accordance with the NAIC *Accounting Practices and Procedures Manual*, including all amendments thereto adopted by the NAIC, excluding the impact of any permitted or prescribed practices; and is

(i) licensed in at least 26 states; or

(ii) licensed in at least 10 states, and licensed or accredited in a total of at least 35 states.

(5) The authority to adopt regulations pursuant to this Section 5B does not limit the commissioner's general authority to adopt regulations pursuant to Section 5A of this law.

Section 6. Reinsurance Agreements Affected

This Act shall apply to all cessions after the effective date of this Act under reinsurance agreements that have an inception, anniversary or renewal date not less than six (6) months after the effective date of this Act.

Drafting Note: The enacting state may wish to provide a delay in the applicability greater than six (6) months to allow time for the insurance commissioner to promulgate regulations and to allow reinsurers to prepare and submit qualifying data.

Chronological Summary of Actions (All references are to the Proceedings of the NAIC).

1984 Proc. II 9, 29, 822, 836, 837-839 (adopted).
1986 Proc. I 9-10, 24, 799, 811, 812 (corrected).
1987 Proc. II 15, 24, 444-448, 832, 854, 856 (amended and reprinted).
1990 Proc. I 12-14, 851, 857-861 (amended at special plenary session September 1989 and reprinted).
1990 Proc. I 6, 30, 840, 872, 875-878 (technical amendments adopted at winter plenary and reprinted).

1990 Proc. II 7, 18, 748, 766, 780-783 (amended).
1993 Proc. 4th Quarter 6, 31, 835-836, 874, 891 (amended).
1996 Proc. 2nd Quarter 12, 12-17, 24, 862 (amended and reprinted).
2011 Proc. 3rd Quarter 113-114, 131-137, 222-236, 289-298 (amended).
2016 Proc. 1st Quarter Vol. I 111, 131, 138, 141, 145, 150-171 (amended).

Section 8. Credit for Reinsurance—Certified Reinsurers

A. Pursuant to [cite state law equivalent of Section 2E of the Credit for Reinsurance Model Law], the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that has been certified as a reinsurer in this state at all times for which statutory financial statement credit for reinsurance is claimed under this section. The credit allowed shall be based upon the security held by or on behalf of the ceding insurer in accordance with a rating assigned to the certified reinsurer by the commissioner. The security shall be in a form consistent with the provisions of [cite state law equivalent of Section 2E and Section 3 of the Credit for Reinsurance Model Law] and 11, 12 or 13 of this Regulation. The amount of security required in order for full credit to be allowed shall correspond with the following requirements:

(1)

Ratings	**Security Required**
Secure – 1	0%
Secure – 2	10%
Secure – 3	20%
Secure – 4	50%
Secure – 5	75%
Vulnerable – 6	100%

(2) Affiliated reinsurance transactions shall receive the same opportunity for reduced security requirements as all other reinsurance transactions.

(3) The commissioner shall require the certified reinsurer to post one hundred percent (100%), for the benefit of the ceding insurer or its estate, security upon the entry of an order of rehabilitation, liquidation or conservation against the ceding insurer.

(4) In order to facilitate the prompt payment of claims, a certified reinsurer shall not be required to post security for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the certified reinsurer continuing to pay claims in a timely manner. Reinsurance recoverables for only 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

(5) Credit for reinsurance under this section shall apply only to reinsurance contracts entered into or renewed on or after the effective date of the certification of the assuming insurer. Any reinsurance contract entered into prior to the effective date of the certification of the assuming insurer that is subsequently amended after the effective date of the certification of the assuming insurer, or a new reinsurance contract, covering any risk for which collateral was provided previously, shall only be subject to this section with respect to losses incurred and reserves reported from and after the effective date of the amendment or new contract.

(6) Nothing in this section shall prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for certified reinsurers under this section.

B. Certification Procedure.

(1) The commissioner shall post notice on the insurance department's website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The commissioner may not take final action on the application until at least thirty (30) days after posting the notice required by this paragraph.

Drafting Note: States that do not wish to make the internet the required mechanism for providing public notice should modify this provision accordingly. This provision was intended to provide a less formal notice requirement than is typically called for under state Administrative Procedure Acts.

(2) The commissioner shall issue written notice to an assuming insurer that has made application and been approved as a certified reinsurer. Included in such notice shall be the rating assigned the certified reinsurer in accordance with Subsection A of this section. The commissioner shall publish a list of all certified reinsurers and their ratings.

(3) In order to be eligible for certification, the assuming insurer shall meet the following requirements:

(a) The assuming insurer must be domiciled and licensed to transact insurance or reinsurance in a Qualified Jurisdiction, as determined by the commissioner pursuant to Subsection C of this section.

(b) The assuming insurer must maintain capital and surplus, or its equivalent, of no less than $250,000,000 calculated in accordance with Subparagraph (4)(h) of this subsection. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least $250,000,000 and a central fund containing a balance of at least $250,000,000.

(c) The assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. These ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. These financial strength ratings will be one factor used by the commissioner in determining the

rating that is assigned to the assuming insurer. Acceptable rating agencies include the following:

(i) Standard & Poor's;
(ii) Moody's Investors Service;
(iii) Fitch Ratings;
(iv) A.M. Best Company; or
(v) Any other Nationally Recognized Statistical Rating Organization.

(d) The certified reinsurer must comply with any other requirements reasonably imposed by the commissioner.

(4) Each certified reinsurer shall be rated on a legal entity basis, with due consideration being given to the group rating where appropriate, except that an association including incorporated and individual unincorporated underwriters that has been approved to do business as a single certified reinsurer may be evaluated on the basis of its group rating. Factors that may be considered as part of the evaluation process include, but are not limited to, the following:

(a) The certified reinsurer's financial strength rating from an acceptable rating agency. The maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as outlined in the table below. The commissioner shall use the lowest financial strength rating received from an approved rating agency in establishing the maximum rating of a certified reinsurer. A failure to obtain or maintain at least two financial strength ratings from acceptable rating agencies will result in loss of eligibility for certification:

Ratings	Best	S&P	Moody's	Fitch
Secure – 1	A++	AAA	Aaa	AAA
Secure – 2	A+	AA+, AA, AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure – 3	A	A+, A	A1, A2	A+, A
Secure – 4	A-	A-	A3	A-
Secure – 5	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable – 6	B, B-C++, C+, C, C-, D, E, F	BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD

(b) The business practices of the certified reinsurer in dealing with its ceding insurers, including its record of compliance with reinsurance contractual terms and obligations;

(c) For certified reinsurers domiciled in the U.S., a review of the most recent applicable NAIC Annual Statement Blank, either Schedule F (for property/casualty reinsurers) or Schedule S (for life and health reinsurers);

(d) For certified reinsurers not domiciled in the U.S., a review annually of Form CR-F (for property/casualty reinsurers) or Form CR-S (for life and health reinsurers) (attached as exhibits to this regulation);

(e) The reputation of the certified reinsurer for prompt payment of claims under reinsurance agreements, based on an analysis of ceding insurers' Schedule F reporting of overdue reinsurance recoverables, including the proportion of obligations that are more than ninety (90) days past due or are in dispute, with specific attention given to obligations payable to companies that are in administrative supervision or receivership;

(f) Regulatory actions against the certified reinsurer;

(g) The report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in paragraph (h) below;

(h) For certified reinsurers not domiciled in the U.S., audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the non-U.S. jurisdiction supervisor). Upon the initial application for certification, the commissioner will consider audited financial statements for the last three (3) years filed with its non-U.S. jurisdiction supervisor;

(i) The liquidation priority of obligations to a ceding insurer in the certified reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding;

(j) A certified reinsurer's participation in any solvent scheme of arrangement, or similar procedure, which involves U.S. ceding insurers. The commissioner shall receive prior notice from a certified reinsurer that proposes participation by the certified reinsurer in a solvent scheme of arrangement; and

(k) Any other information deemed relevant by the commissioner.

(5) Based on the analysis conducted under Subparagraph (4)(e) of a certified reinsurer's reputation for prompt payment of claims, the commissioner may make appropriate adjustments in the security the certified reinsurer is required to post to protect its liabilities to U.S. ceding insurers, provided that the commissioner shall, at a minimum, increase the security the certified reinsurer is required to post by one rating level under Subparagraph (4)(a) if the commissioner finds that:

(a) More than fifteen percent (15%) of the certified reinsurer's ceding insurance clients have overdue reinsurance recoverables on paid losses of ninety (90) days or more which are not in dispute and which exceed $100,000 for each cedent; or

(b) The aggregate amount of reinsurance recoverables on paid losses which are not in dispute that are overdue by ninety (90) days or more exceeds $50,000,000.

(6) The assuming insurer must submit a properly executed Form CR-1 (attached as an exhibit to this regulation) as evidence of its submission to the jurisdiction of this state, appointment of the commissioner as an agent for service of process in this state, and agreement to provide security for one hundred percent (100%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment. The commissioner shall not certify any assuming insurer that is domiciled in a jurisdiction that the commissioner has determined does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(7) The certified reinsurer must agree to meet applicable information filing requirements as determined by the commissioner, both with respect to an initial application for certification and on an ongoing basis. All information submitted by certified reinsurers which are not otherwise public information subject to disclosure shall be exempted from disclosure under [cite state law equivalent of Freedom of Information Act] and shall be withheld from public disclosure. The applicable information filing requirements are, as follows:

(a) Notification within ten (10) days of any regulatory actions taken against the certified reinsurer, any change in the provisions of its domiciliary license or any change in rating by an approved rating agency, including a statement describing such changes and the reasons therefore;

(b) Annually, Form CR-F or CR-S, as applicable [per the instructions to be developed as an exhibit to this model];

(c) Annually, the report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in Subsection (d) below;

(d) Annually, audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the certified reinsurer's supervisor). Upon the initial certification, audited financial statements for the last three (3) years filed with the certified reinsurer's supervisor;

(e) At least annually, an updated list of all disputed and overdue reinsurance claims regarding reinsurance assumed from U.S. domestic ceding insurers;

(f) A certification from the certified reinsurer's domestic regulator that the certified reinsurer is in good standing and maintains capital in excess of the jurisdiction's highest regulatory action level; and

(g) Any other information that the commissioner may reasonably require.

(8) Change in Rating or Revocation of Certification.

(a) In the case of a downgrade by a rating agency or other disqualifying circumstance, the commissioner shall upon written notice assign a new rating to the certified reinsurer in accordance with the requirements of Subparagraph (4)(a).

(b) The commissioner shall have the authority to suspend, revoke, or otherwise modify a certified reinsurer's certification at any time if the certified reinsurer fails to meet its obligations or security requirements under this section, or if other financial or operating results of the certified reinsurer, or documented significant delays in payment by the certified reinsurer, lead the commissioner to reconsider the certified reinsurer's ability or willingness to meet its contractual obligations.

(c) If the rating of a certified reinsurer is upgraded by the commissioner, the certified reinsurer may meet the security requirements applicable to its new rating on a prospective basis, but the commissioner shall require the certified reinsurer to post security under the previously applicable security requirements as to all contracts in force on or before the effective date of the upgraded rating. If the rating of a certified reinsurer is downgraded by the commissioner, the commissioner shall require the certified reinsurer to meet the security requirements applicable to its new rating for all business it has assumed as a certified reinsurer.

(d) Upon revocation of the certification of a certified reinsurer by the commissioner, the assuming insurer shall be required to post security in accordance with Section 10 in order for the ceding insurer to continue to take credit for reinsurance ceded to the assuming insurer. If funds continue to be held in trust in accordance with Section 7, the commissioner may allow additional credit equal to the ceding insurer's *pro rata* share of such funds, discounted to reflect the risk of uncollectibility and anticipated expenses of trust administration. Notwithstanding the change of a certified reinsurer's rating or revocation of its certification, a domestic insurer that has ceded reinsurance to that certified reinsurer may not be denied credit for reinsurance for a period of three (3) months for all reinsurance ceded to that certified reinsurer, unless the reinsurance is found by the commissioner to be at high risk of uncollectibility.

C. Qualified Jurisdictions.

(1) If, upon conducting an evaluation under this section with respect to the reinsurance supervisory system of any non-U.S. assuming insurer, the commissioner determines that the jurisdiction qualifies to be recognized as a qualified jurisdiction, the commissioner shall publish notice and evidence of such recognition in an appropriate manner. The commissioner may establish a procedure to withdraw recognition of those jurisdictions that are no longer qualified.

(2) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a qualified jurisdiction, the commissioner shall evaluate the reinsurance supervisory system of the non-U.S. jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. The commissioner shall determine the appropriate approach for evaluating the qualifications of such jurisdictions, and create and publish a list of jurisdictions whose reinsurers may be approved by the commissioner as eligible for

certification. A qualified jurisdiction must agree to share information and cooperate with the commissioner with respect to all certified reinsurers domiciled within that jurisdiction. Additional factors to be considered in determining whether to recognize a qualified jurisdiction, in the discretion of the commissioner, include but are not limited to the following:

(a) The framework under which the assuming insurer is regulated.

(b) The structure and authority of the domiciliary regulator with regard to solvency regulation requirements and financial surveillance.

(c) The substance of financial and operating standards for assuming insurers in the domiciliary jurisdiction.

(d) The form and substance of financial reports required to be filed or made publicly available by reinsurers in the domiciliary jurisdiction and the accounting principles used.

(e) The domiciliary regulator's willingness to cooperate with U.S. regulators in general and the commissioner in particular.

(f) The history of performance by assuming insurers in the domiciliary jurisdiction.

(g) Any documented evidence of substantial problems with the enforcement of final U.S. judgments in the domiciliary jurisdiction. A jurisdiction will not be considered to be a qualified jurisdiction if the commissioner has determined that it does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(h) Any relevant international standards or guidance with respect to mutual recognition of reinsurance supervision adopted by the International Association of Insurance Supervisors or successor organization.

(i) Any other matters deemed relevant by the commissioner.

(3) A list of qualified jurisdictions shall be published through the NAIC Committee Process. The commissioner shall consider this list in determining qualified jurisdictions. If the commissioner approves a jurisdiction as qualified that does not appear on the list of qualified jurisdictions, the commissioner shall provide thoroughly documented justification with respect to the criteria provided under Subsections 8.C(2)(a) to (i).

(4) U.S. jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program shall be recognized as qualified jurisdictions.

D. Recognition of Certification Issued by an NAIC Accredited Jurisdiction.

(1) If an applicant for certification has been certified as a reinsurer in an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that jurisdiction's certification, and to defer to the rating assigned by that jurisdiction, if the assuming insurer submits a properly executed Form CR-1 and such additional information as the commissioner requires. The assuming insurer shall be considered to be a certified reinsurer in this state.

(2) Any change in the certified reinsurer's status or rating in the other jurisdiction shall apply automatically in this state as of the date it takes effect in the other jurisdiction. The certified reinsurer shall notify the commissioner of any change in its status or rating within 10 days after receiving notice of the change.

(3) The commissioner may withdraw recognition of the other jurisdiction's rating at any time and assign a new rating in accordance with Subsection B(8) of this section.

(4) The commissioner may withdraw recognition of the other jurisdiction's certification at any time, with written notice to the certified reinsurer. Unless the commissioner suspends or revokes the certified reinsurer's certification in accordance with Subsection B(8) of this section, the certified reinsurer's certification shall remain in good standing in this state for a period of three (3) months, which shall be extended if additional time is necessary to consider the assuming insurer's application for certification in this state.

E. Mandatory Funding Clause. In addition to the clauses required under Section 14, reinsurance contracts entered into or renewed under this section shall include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer under this section for reinsurance ceded to the certified reinsurer.

F. The commissioner shall comply with all reporting and notification requirements that may be established by the NAIC with respect to certified reinsurers and qualified jurisdictions.

Section ~~8~~9. Credit for Reinsurance—~~Certified Reinsurers~~Designated Reinsurer in a Designated Jurisdiction

A. Pursuant to [cite state law equivalent of Section ~~2E~~2F [cite to new section of model law] of the Credit for Reinsurance Model Law], the commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer that has ~~been certified as a reinsurer in this state~~its head office or is domiciled in a designated jurisdiction (hereinafter a "designated reinsurer") at all times for which statutory financial statement credit for reinsurance is claimed under this section. ~~The credit allowed shall be based upon the security held by or on behalf of the ceding insurer in accordance with a rating assigned to the certified reinsurer by the commissioner. The security shall be in a form consistent with the provisions of [cite state law equivalent of Section 2E and Section 3 of the Credit for Reinsurance Model Law] and 11, 12 or 13 of this Regulation. The amount of security required in order for full credit to be allowed shall correspond with the following requirements:~~

(1) ~~**Ratings** **Security Required**~~

~~Secure – 1 0%~~
~~Secure – 2 10%~~
~~Secure – 3 20%~~
~~Secure – 4 50%~~
~~Secure – 5 75%~~
~~Vulnerable – 6 100%~~

~~(2) Affiliated reinsurance transactions shall receive the same opportunity for reduced security requirements as all other reinsurance transactions.~~

~~(3)~~ The commissioner shall require the ~~certified~~designated reinsurer to post one hundred percent (100%), for the benefit of the ceding insurer or its estate, security upon the entry of an order of rehabilitation~~,~~ [resolution], liquidation [receivership] or conservation [winding-up proceedings] against the ceding insurer.

~~(4) In order to facilitate the prompt payment of claims, a certified reinsurer shall not be required to post security for catastrophe recoverables for a period of one year from the date of the first instance of a liability reserve entry by the ceding company as a result of a loss from a catastrophic occurrence as recognized by the commissioner. The one year deferral period is contingent upon the certified reinsurer continuing to pay claims in a timely manner. Reinsurance recoverables for only 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~~

(3) Credit for reinsurance under this section shall apply only to reinsurance contracts entered into or renewed on or after the later of (i) the effective date of the ~~certification of the assuming insurer.~~agreement or memorandum of understanding (MOU) that resulted in the non-U.S. jurisdiction being deemed a designated jurisdiction agreement ("DJ Agreement" or "DJA"); (ii) if applicable, the date the commissioner finds the non-U.S. jurisdiction to be a designated jurisdiction or (iii) the effective date of this regulation. Any reinsurance contract entered into prior to the applicable effective date of ~~the certification of the assuming insurer~~subsection that is subsequently amended ~~after the effective date of the certification of the assuming insurer~~, or a new reinsurance contract, covering any risk for which collateral was provided previously, shall only be subject to this section with respect to losses incurred and reserves reported from and after the later of (i) the effective date of this regulation, (ii) the DJA, or (iii) the effective date of the amendment or new contract.

(~~6~~4) Nothing in this section shall prohibit the parties to a reinsurance agreement from agreeing to provisions establishing security requirements that exceed the minimum security requirements established for ~~certified~~designated reinsurers under this section.

~~B. Certification Procedure.~~

~~(1) The commissioner shall post notice on the insurance department's website promptly upon receipt of any application for certification, including instructions on how members of the public may respond to the application. The commissioner may not take final action on the application until at least thirty (30) days after posting the notice required by this paragraph.~~

~~**Drafting Note:** States that do not wish to make the internet the required mechanism for providing public notice should modify this provision accordingly. This provision was intended to provide a less formal notice requirement than is typically called for under state Administrative Procedure Acts.~~

~~(2) The commissioner shall issue written notice to an assuming insurer that has made application and been approved as a certified reinsurer. Included in such notice shall be the rating assigned the certified reinsurer in accordance with Subsection A of this section. The commissioner shall publish a list of all certified reinsurers and their ratings.~~

~~(3~~ (5) In order for the ceding insurer to be eligible for ~~certification~~financial statement credit for reinsurance under this section, the assuming insurer shall meet the following requirements:

(a) ~~The assuming insurer must be~~Be domiciled ~~and~~or maintain its head office and be licensed to transact insurance or reinsurance in a ~~Qualified~~Designated Jurisdiction, as ~~determined by the commissioner pursuant to Subsection C of this section.~~set forth in (i) an enforceable treaty or regulatory agreement between the United States of America and the non-U.S. jurisdiction designated in such agreement; or (ii) a Memorandum of Understanding (MOU) acknowledged by the commissioner (a Designated Jurisdiction Agreement).

(b) ~~The assuming insurer must maintain~~ Maintain capital and surplus, or its equivalent, of no less than $250,000,000 or the local currency equivalent in the assuming insurer's Designated Jurisdiction, calculated in accordance with Subparagraph (4)(h) of this subsection. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having minimum capital and surplus equivalents (net of liabilities) of at least $250,000,000 or currency equivalent in the assuming insurer's Designated Jurisdiction and a central fund containing a balance of at least $250,000,000~~.~~ or currency equivalent in the assuming insurer's Designated Jurisdiction.

(c) Maintain an RBC of 300 percent Authorized Control Level or equivalent requirement in the assuming insurer's Designated Jurisdiction. This requirement may also be satisfied by an association including incorporated and individual unincorporated underwriters having an RBC of 300 percent Authorized Control Level or equivalent requirement in the assuming insurer's Designated Jurisdiction. ~~The~~

~~assuming insurer must maintain financial strength ratings from two or more rating agencies deemed acceptable by the commissioner. These ratings shall be based on interactive communication between the rating agency and the assuming insurer and shall not be based solely on publicly available information. These financial strength ratings will be one factor used by the commissioner in determining the rating that is assigned to the assuming insurer. Acceptable rating agencies include the following:~~

~~(i) Standard & Poor's;~~
~~(ii) Moody's Investors Service;~~
~~(iii) Fitch Ratings;~~
~~(iv) A.M. Best Company; or~~
~~(v) Any other Nationally Recognized Statistical Rating Organization.~~

~~(d) The certified reinsurer must comply with any other requirements reasonably imposed by the commissioner.~~

~~(4) Each certified reinsurer shall be rated on a legal entity basis, with due consideration being given to the group rating where appropriate, except that that has been approved to do business as a single certified reinsurer may be evaluated on the basis of its group rating. Factors that may be considered as part having an RBC of the evaluation process include, but are not limited to, the following:~~

~~(a) The certified reinsurer's financial strength rating from an acceptable rating agency. The maximum rating that a certified reinsurer may be assigned will correspond to its financial strength rating as outlined300 percent Authorized Control Level or equivalent requirement in the table below. The commissioner shall use the lowest financial strength rating received from an approved rating agency in establishing the maximum rating of a certified reinsurer. A failure to obtain or maintain at least two financial strength ratings from acceptable rating agencies will result in loss of eligibility for certification:~~

~~Ratings~~	~~Best~~	~~S&P~~	~~Moody's~~	~~Fitch~~
~~Secure – 1~~	~~A++~~	~~AAA~~	~~Aaa~~	~~AAA~~
~~Secure – 2~~	~~A+~~	~~AA+, AA, AA-~~	~~Aa1, Aa2, Aa3~~	~~AA+, AA, AA-~~
~~Secure – 3~~	~~A~~	~~A+, A~~	~~A1, A2~~	~~A+, A~~
~~Secure – 4~~	~~A-~~	~~A-~~	~~A3~~	~~A-~~
~~Secure – 5~~	~~B++, B+~~	~~BBB+, BBB, BBB-~~	~~Baa1, Baa2, Baa3~~	~~BBB+, BBB, BBB-~~
~~Vulnerable – 6~~	~~B, B-C++, C+, C, C-, D, E, F~~	~~BB+, BB, BB-, B+, B, B-, CCC, CC, C, D, R~~	~~Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C~~	~~BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD~~

~~(b) The business practices of the certified reinsurer in dealing with its ceding insurers, including its record of compliance with reinsurance contractual terms and obligations;~~

~~(c) For certified reinsurers domiciled in the U.S., a review of the most recent applicable NAIC Annual Statement Blank, either Schedule F (for property/casualty reinsurers) or Schedule S (for life and health reinsurers);~~

~~(d) For certified reinsurers not domiciled in the U.S., a review annually of Form CR-F (for property/casualty reinsurers) or Form CR-S (for life and health reinsurers) (attached as exhibits to this regulation);~~

~~(e) The reputation of the certified reinsurer for prompt payment of claims under reinsurance agreements, based on an analysis of ceding insurers' Schedule F reporting of overdue reinsurance recoverables, including the proportion of obligations that are more than ninety (90) days past due or are in dispute, with specific attention given to obligations payable to companies that are in administrative supervision or receivership;~~

~~(f) Regulatory actions against the certified reinsurer;~~

~~(g) The report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in paragraph (h) below;~~

~~(h) For certified reinsurers not domiciled in the U.S., audited financial statements (audited U.S. GAAP basis if available, audited IFRS basis~~

~~statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings, and actuarial opinion (as filed with the non-U.S. jurisdiction supervisor). Upon the initial application for certification, the commissioner will consider audited financial statements for the last three (3) years filed with its non-U.S. jurisdiction supervisor;~~

~~(i) The liquidation priority of obligations to a ceding insurer in the certified reinsurer's domiciliary jurisdiction in the context of an insolvency proceeding;~~

(d) Provide prompt written notice and explanation to the commissioner of the domestic insurer if:

(i) The assuming insurer falls below the minimum capital and surplus, or its equivalent, as applicable, specified in Section (9)(A)(5)(b), or the requirement specified in Section 9(A)(5)(c); or

(ii) Any regulatory action is taken against the assuming insurer for serious noncompliance with applicable law.

(e) Confirm that the assuming insurer is not presently participating in any solvent scheme of arrangement, which involves any domestic ceding insurers, and agrees to notify the ceding insurer and the commissioner and to provide 100 percent security to the ceding insurer consistent with the terms of the scheme should the assuming insurer enter into such an arrangement. ~~A certified reinsurer's participation in any solvent scheme of arrangement, or similar procedure, which involves U.S.~~~~any domestic~~ ~~ceding insurers. The, and agrees to notify the ceding insurer and the commissioner shall receive prior notice from a certified reinsurer that proposes participation by the certified reinsurer in a solventand to provide 100 percent security to the ceding insurer consistent with the terms of the scheme of should the assuming insurer enter into such an arrangement; and~~ .

~~(k) Any other information deemed relevant by the commissioner.~~

~~(5) Based on the analysis conducted under Subparagraph (4)(e) of a certified reinsurer's reputation for prompt payment of claims, the commissioner may make appropriate adjustments in the security the certified reinsurer is required to post to protect its liabilities to U.S. ceding insurers, provided that the commissioner shall, at a minimum, increase the security the certified reinsurer is required to post by one rating level under Subparagraph (4)(a) if the commissioner finds that:~~

~~(a) More than fifteen percent (15%) of the certified reinsurer's ceding insurance clients have overdue reinsurance recoverables on paid losses of ninety (90) days or more which are not in dispute and which exceed $100,000 for each cedent; or~~

~~(b) The aggregate amount of reinsurance recoverables on paid losses which are not in dispute that are overdue by ninety (90) days or more exceeds $50,000,000.~~

~~(6~~(f) The assuming insurer must submit a properly executed Form CR-1 (attached as an exhibit to this regulation) as evidence of its submission to the jurisdiction of this state, appointment of the commissioner as an agent for service of process in this state, consent to pay all final judgments obtained by U.S. ceding insurers that have been declared enforceable, and agreement to provide security for one hundred percent (100%) of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers if it resists enforcement of a final U.S. judgment.

~~(7~~ (g) The ~~certified~~designated reinsurer must agree to meet applicable information filing requirements as determined by the commissioner~~, both with respect to an initial application for certification and on an ongoing basis.~~. All information submitted by certified reinsurers which are not otherwise public information subject to disclosure shall be exempted from disclosure under [cite state law equivalent of Freedom of Information Act] and shall be withheld from public disclosure. The applicable information filing requirements are, as follows:

~~(a) Notification within ten (10) days of any regulatory actions taken against the certified reinsurer, any change in the provisions of its domiciliary license or any change in rating by an approved rating agency, including a statement describing such changes and the reasons therefore;~~

(i) ~~(b) Annually~~ At least annually, but not more than semi-annually, and prior to entry into the reinsurance agreement, Form CR-F or CR-S, as applicable [per the instructions to be developed as an exhibit to this model];

~~(c) Annually, the report of the independent auditor on the financial statements of the insurance enterprise, on the basis described in Subsection (d) below;~~

(ii) ~~(d) Annually~~ With respect to two years preceding entry into the reinsurance agreement and annually thereafter, audited financial statements (audited ~~U.S. GAAP basis if available, audited IFRS basis statements are allowed but must include an audited footnote reconciling equity and net income to a U.S. GAAP basis, or, with the permission of the state insurance commissioner, audited IFRS statements with reconciliation to U.S. GAAP certified by an officer of the company), regulatory filings~~ in accordance with the applicable law of the Designated Jurisdiction of the assuming insurer's head office, external audit report, and solvency and financial condition report or actuarial opinion in each case (as filed with the ~~certified reinsurer's~~assuming insurer's supervisor, if any).~~; Upon the initial certification, audited financial statements for~~

~~the last three (3) years filed with the certified reinsurer's supervisor;~~

(iii) ~~(e)~~ At least annually, but not more than semi-annually, and prior to entry into the reinsurance agreement, an updated list of all disputed and overdue reinsurance claims outstanding for 90 days or more, regarding reinsurance assumed from U.S. domestic ceding insurers;

~~(f) A certification from the certified reinsurer's domestic regulator that the certified reinsurer is in good standing and maintains capital in excess of the jurisdiction's highest regulatory action level; and~~

~~(g) Any other information that the commissioner may reasonably require.~~

(h) The assuming insurer must maintain a practice of prompt payment of claims under reinsurance agreements. The lack of prompt payment will be evidenced if any of the following criteria is met:

(i) More than fifteen percent (15%) of the reinsurance recoverables are overdue and in dispute as reported to the commissioner;

(ii) More than fifteen percent (15%) of the assuming insurer's ceding insurance clients have overdue reinsurance recoverables on paid losses of ninety (90) days or more which are not in dispute and which exceed $100,000 or currency equivalent in the assuming insurer's Designated Jurisdiction for each cedent; or

(iii) The aggregate amount of reinsurance recoverables on paid losses which are not in dispute that are overdue by ninety (90) days or more exceeds $50,000,000 or currency equivalent in the assuming insurer's Designated Jurisdiction.

(8) Change in ~~Rating or Revocation of Certification~~Designated Reinsurer Status.

(a) In the case of a ~~downgrade by a rating agency or other~~ disqualifying circumstance under this section, the commissioner shall upon written notice to the designated reinsurer provide such reinsurer 30 days from the initial notice to submit a plan to remedy the disqualifying event and 90 days from the initial notice to remedy the disqualifying event, and inform the supervisory authority of the corresponding designated jurisdiction.

(b) After expiration of the 90 day period referenced in section 8(a) or less under exceptional circumstances in which a shorter period is necessary for policyholder and other consumer protection, the commissioner may, subject to any applicable treaty or agreement, require the designated reinsurer to post collateral as a condition to allow a ceding insurer to take credit for reinsurance or for risk mitigation effects of reinsurance agreements or to maintain or adopt any requirement to have a local presence.

~~(b) The commissioner shall have the authority to suspend, revoke, or otherwise modify a certified reinsurer's certification at any time if the certified reinsurer fails to meet its obligations or security requirements under this section, or if other financial or operating results of the certified reinsurer, or documented significant delays in payment by the certified reinsurer, lead the commissioner to reconsider the certified reinsurer's ability or willingness to meet its contractual obligations.~~

~~(c) If the rating of a certified reinsurer is upgraded by the commissioner, the certified reinsurer may meet the security requirements applicable to its new rating on a prospective basis, but the commissioner shall require the certified reinsurer to post security under the previously applicable security requirements as to all contracts in force on or before the effective date of the upgraded rating. If the rating of a certified reinsurer is downgraded by the commissioner, the commissioner shall require the certified reinsurer to meet the security requirements applicable to its new rating for all business it has assumed as a certified reinsurer.~~

~~(d) Upon revocation of the certification of a certified reinsurer by the commissioner, the assuming insurer shall be required to post security in accordance with Section 10 in order for the ceding insurer to continue to take credit for reinsurance ceded to the assuming insurer. If funds continue to be held in trust in accordance with Section 7, the commissioner may allow additional credit equal to the ceding insurer's *pro rata* share of such funds, discounted to reflect the risk of uncollectibility and anticipated expenses of trust administration. Notwithstanding the change of a certified reinsurer's rating or revocation of its certification, a domestic insurer that has ceded reinsurance to that certified reinsurer may not be denied credit for reinsurance for a period of three (3) months for all reinsurance ceded to that certified reinsurer, unless the reinsurance is found by the commissioner to be at high risk of uncollectibility.~~

~~C.~~B. ~~Qualified~~ Designated Jurisdictions.

(1) If, upon conducting an evaluation under this section with respect to the reinsurance supervisory system of any non-U.S. assuming insurer~~,~~ and the entry of an applicable agreement or MOU that meets the requirements of Section [2.F.(3) of the NAIC Credit for Reinsurance Model Law (a designated jurisdiction or DJ agreement), the commissioner determines that the jurisdiction qualifies to be recognized as a ~~qualified~~designated jurisdiction, the commissioner shall publish notice and evidence of such recognition in an appropriate manner. The commissioner may establish a procedure to withdraw

recognition of those jurisdictions that are no longer ~~qualified~~designated.

(2) In order to determine whether the domiciliary jurisdiction of a non-U.S. assuming insurer is eligible to be recognized as a ~~qualified~~designated jurisdiction, the commissioner shall evaluate the reinsurance supervisory system of the non-U.S. jurisdiction, both initially and on an ongoing basis, and consider the rights, benefits and the extent of reciprocal recognition afforded by the non-U.S. jurisdiction to reinsurers licensed and domiciled in the U.S. The commissioner shall determine the appropriate approach for evaluating the qualifications of such jurisdictions, and create and publish a list of jurisdictions whose reinsurers ~~may be approved by the commissioner as eligible for certification. A qualified~~would qualify as "designated reinsurers". A designated jurisdiction must agree to share information and cooperate with the commissioner with respect to all ~~certified~~designated reinsurers domiciled within that jurisdiction. Additional factors to be considered in determining whether to recognize a ~~qualified~~designated jurisdiction, in the discretion of the commissioner, include but are not limited to the following:

(a) The framework under which the assuming insurer is regulated.

(b) The structure and authority of the domiciliary regulator with regard to solvency regulation requirements and financial surveillance.

(c) The substance of financial and operating standards for assuming insurers in the domiciliary jurisdiction.

(d) The form and substance of financial reports required to be filed or made publicly available by reinsurers in the domiciliary jurisdiction and the accounting principles used.

(e) The domiciliary regulator's willingness to cooperate with U.S. regulators in general and the commissioner in particular.

(f) The history of performance by assuming insurers in the domiciliary jurisdiction.

(g) Any documented evidence of substantial problems with the enforcement of final U.S. judgments in the domiciliary jurisdiction. A jurisdiction will not be considered to be a ~~qualified~~designated jurisdiction if the commissioner has determined that it does not adequately and promptly enforce final U.S. judgments or arbitration awards.

(h) Any relevant international standards or guidance with respect to mutual recognition of reinsurance supervision adopted by the International Association of Insurance Supervisors or successor organization.

(i) The elimination, under specified conditions, of local presence requirements imposed by the domiciliary jurisdiction on a U.S.-based assuming reinsurer, as a condition for entering into any reinsurance agreement with a ceding insurer which has its head office or is domiciled in the non-U.S. jurisdiction or for allowing the ceding insurer

to recognize credit for reinsurance or credit for risk mitigation effects of such reinsurance agreement.

(j) The elimination of prudential insurance solvency and capital, governance, and reporting requirements for a U.S.-based assuming reinsurer by a non-U.S. jurisdiction and establishing that the commissioner of a U.S.-based assuming reinsurer that has its head office or is domiciled in this state will exercise worldwide prudential insurance group supervision for that reinsurer.

(~~i~~k) Any other matters deemed relevant by the commissioner.

(3) Notwithstanding the foregoing, these conditions and qualifications do not apply to any jurisdiction that has entered into an enforceable treaty or regulatory agreement with the United States of America that establishes their eligibility for designated jurisdiction status or its equivalent. The eligibility of such jurisdictions for the designated jurisdiction status shall be determined in accordance with the terms and conditions of such treaty or agreement.

(4) A list of ~~qualified~~designated jurisdictions shall be published through the NAIC Committee Process. Such list shall indicate the respective effective date of each such DJ Agreement. The commissioner shall consider this list in determining ~~qualified~~designated jurisdictions. If the commissioner approves a jurisdiction as ~~qualified~~designated that does not appear on the list of ~~qualified~~designated jurisdictions, the commissioner shall provide thoroughly documented justification with respect to the criteria provided under Subsections 8.C(2)(a) to (~~i~~k).

(4) U.S. jurisdictions that meet the requirements for accreditation under the NAIC financial standards and accreditation program shall be recognized as ~~qualified~~designated jurisdictions.

~~D~~C. Recognition ~~of Certification Issued~~as a Designated Jurisdiction by an NAIC Accredited Jurisdiction.

(1) If ~~an applicant for certification~~ a non-U.S. jurisdiction has been ~~certified as a reinsurer in~~ deemed a designated jurisdiction pursuant to Section 9.B. by an NAIC accredited jurisdiction, the commissioner has the discretion to defer to that NAIC accredited jurisdiction's ~~certification, and to defer to the rating assigned by that jurisdiction~~designation, if the ~~assuming insurer~~ designated jurisdiction submits ~~a properly executed Form CR-1 and~~ such additional information as the commissioner requires. The ~~assuming insurer~~ jurisdiction shall be considered to be a ~~certified reinsurer~~ designated jurisdiction in this state.

(2) Any change in the ~~certified reinsurer's~~ designated jurisdiction's status~~ or rating~~ in the other jurisdiction shall apply automatically in this state as of the date it takes effect in the other jurisdiction. The ~~certified~~ designated reinsurer shall notify the commissioner of any change in its status~~ or rating~~ within 10 days after receiving notice of the change.

(3) The commissioner may withdraw recognition of the other jurisdiction's ~~rating~~ designated jurisdiction determination at any time ~~and assign a new rating~~ in accordance with Subsection B~~(8)~~ of this section.

(4) The commissioner may withdraw recognition of the other jurisdiction's ~~certification~~ determination at any time, with written notice to the ~~certified~~ designated reinsurer~~.~~ in accordance with Subsection A(8) of this section. Unless the commissioner suspends or revokes the ~~certified~~ designated reinsurer's ~~certification~~ status in accordance with Subsection ~~B~~A(8) of this section, the ~~certified~~ designated reinsurer's ~~certification~~ status shall remain in good standing in this state for a period of three (3) months, which shall be extended if additional time is necessary to ~~consider the assuming insurer's application for certification~~ determine whether the designated reinsurer qualifies in this state.

~~E. Mandatory Funding Clause. In addition to the clauses required under Section 14, reinsurance contracts entered into or renewed under this section shall include a proper funding clause, which requires the certified reinsurer to provide and maintain security in an amount sufficient to avoid the imposition of any financial statement penalty on the ceding insurer under this section for reinsurance ceded to the certified reinsurer.~~

~~F~~D. The commissioner shall comply with all reporting and notification requirements that may be established by the NAIC with respect to ~~certified~~ designated reinsurers and ~~qualified~~ designated jurisdictions.

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February 6, 2018

Re: NAIC response to Covered Agreement collateral provisions

Dear Mr. Stultz

Thank you for the opportunity to address the NAIC's plans for proceeding with collateral reform arising from the Bilateral Agreement Between the United States (US) and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement). These comments are submitted on behalf of Swiss Re and Zurich as a first response to the NAIC's request for comments. As the Reinsurance Task Force process continues, we look forward to providing additional comments on specific proposals.

The Covered Agreement delegates to the states and the NAIC the important implementation issues and we appreciate the NAIC's leadership and this Task Force's leadership in taking on that challenge. It is clear that implementation of the Covered Agreement will require the NAIC to review its process for determining Qualified Jurisdictions and certified reinsurers as well as eliminate collateral requirements for certified reinsurers from the EU. From the standpoint of Swiss Re and Zurich as Swiss re/insurers, we believe it is important for the NAIC to apply the same collateral benefits to certified reinsurers from other qualified jurisdictions, such as Switzerland.

As a general principle, we believe that re/insurers from any highly regarded regulatory jurisdiction should be allowed to assume risk freely on a cross-border basis. Such a principle also seems to be supported by the NAIC, given the general recognition that implementation of the Covered Agreement should not create an uneven playing field across EU and non-EU jurisdictions. If implementation proceeds successfully, the NAIC has the opportunity to set a great precedent globally.

There are many viable options available to the NAIC in this endeavour, including adding an entirely new classification of reinsurer able to assume business without regulatory collateral, amending the current certified reinsurer provisions to make the terms and conditions of the Covered Agreement applicable to all certified reinsurers, as well as options in between. Each option will have pros and

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cons. Since the Covered Agreement provisions on reinsurance collateral were derived from the NAIC credit for reinsurance models and enforcement will be in the hands of state regulators, we would not see it as extraordinary to apply the Covered Agreement provisions to reinsurers outside of the EU.

Whatever the direction, we hope the NAIC will act in sufficient time to allow states to enact the necessary changes to state law in a timely manner. We look forward to the public discussion of these issues on February 20th and stand ready to assist in the policy decisions and drafting as the RTF work proceeds.

Yours sincerely,

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Swiss Re Americas

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Schweizerische Eidgenossenschaft
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Confederazione Svizzera
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Document ID: 033.0
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Our reference: gaj
Bern, 2 February 2018

Request for comments on approaches to reinsurance collateral reform

Dear Ms. President,

We highly appreciate the NAIC's call for comments and the possibility to provide feedback to some elements of the NAIC's questionnaire. Our following comments pertain to approaches (2) and (3) in particular.

The Covered Agreement between the United States and the European Union has the potential to discriminate against those non-US reinsurers that are domiciled outside the European Union. The same applies to international insurance groups since the scope of the collateral requirements also extends to their intra-group reinsurance transactions.

While there is a number of large providers in the global reinsurance market, it is not concentrated. Should the risk of unequal reinsurance treatment in the US insurance market materialize, it would not only imply an uneven playing field in the global reinsurance market but also incentivize US cedents to select their reinsurance providers from a smaller group. Such a concentration would likely be contrary to the goals of stability on the local and global level.

Therefore, Switzerland strongly advocates for a non-discrimination among non-US reinsurers on the US market. This might be achieved by entering into additional covered agreements as outlined in approach (2). However, the approach under point (3), which builds on the NAIC's Qualified Jurisdiction concept, would equally well lead to the desired outcome of equal treatment. Presumably, this approach could even be faster, cheaper and less cumbersome for participants and stakeholders alike. Hence, while Switzerland is open to both the approaches

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(2) and (3), it would from this perspective appear preferable if the NAIC and the state regulators were to impose the same collateral requirements on Qualified Jurisdiction as on European Union based reinsurers.

Let me thank you again for this opportunity to express our view.

Kind regards

Jörg Gasser
State Secretary

February 6, 2018

VIA E-Mail

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Superintendent Maria T. Vullo, Chair (New York)
Director Chlora Lindley-Myers, Vice Chair (Missouri)
National Association of Insurance Commissioners,
Reinsurance (E) Task Force

Attention: Mr. Jake Stultz, jstultz@naic.org

RE: NAIC Implementation of reinsurance collateral provisions of the Bilateral Agreement Between the United States of America and the European Union (EU) on Prudential Measures Regarding Insurance and Reinsurance (Covered Agreement)

Dear Superintendent Vullo, Director Lindley-Myers, Members of the Task Force & Interested Regulators:

Thank you for the opportunity to express XL Group's views in connection with the implementation of the historical Covered Agreement between the US and the EU. XL Catlin is a Bermuda domiciled global group providing property, casualty and specialty insurance and reinsurance to industrial, commercial and professional firms, insurance companies and other enterprises on a worldwide basis. The US is a major market for us, and like everyone in this room, we greatly appreciate the opportunity to engage in this open and deliberative process.

Today the NAIC has asked for comments on a variety of steps it could take in connection with the implementation of the Covered Agreement between the US and the EU. While it makes its way through this process, one choice is abundantly clear. This is a pivotal moment in time for the NAIC to demonstrate the strength of state-based insurance regulation; a time to exhibit the agility of this 150 - year old institution; and an opportunity to exemplify the leadership necessary for matters that involve cross-border issues in this rapidly converging global market. And XL Catlin urges you to seize this opportunity so as to promote greater uniformity, clarity and expediency in our US reinsurance marketplace and provide a mechanism to ensure a level playing field here and overseas.

The Covered Agreement is a great step forward in the reduction of cross-border market barriers. It sets the stage for the development of a level playing field in the US reinsurance market and to ensure US companies avoid barriers when accessing the EU. We applaud the NAIC, the FIO and the US Trade Representatives for their persistence in securing this Agreement. But we urge the NAIC to go even further than the four corners of this Agreement. We ask you to extend the benefits of the Covered Agreement to the Qualified Jurisdictions that seek such standing. This will ensure a level playing field for reinsurers from all such jurisdictions without compromising the protections in place under the Agreement. The States, with the NAIC's leadership, have the power to go at this alone, without the need for perhaps multiple formal Covered Agreements that may take years to negotiate. This is not needed if the NAIC chooses to exercise its independent powers to expand the treatment set out in the Agreement to those Qualified Jurisdictions.

This would be a natural extension to make given that the reinsurance provisions of the Covered Agreement were built on the foundations of the NAIC Credit for Reinsurance Model Law. Qualified Jurisdictions are subject to a rigorous process that will serve this expansion well. In order to achieve this status, a Jurisdiction's reinsurance supervisory system must maintain a level of effectiveness in financial solvency regulation that is deemed acceptable for the purposes of reinsurance collateral reduction. The Jurisdiction's demonstrated practices and procedures with respect to reinsurance supervision must be consistent with its reinsurance supervisory system, and the Jurisdiction's laws and practices must satisfy the criteria required of Qualified Jurisdictions as set forth in the Credit for Reinsurance Model Act. It is with this sound backdrop and the fundamental building blocks that the NAIC already has put in place, that we recommend providing reinsurers domiciled in NAIC Qualified Jurisdictions with similar reinsurance collateral requirements as the reinsurers domiciled in the EU provided those reinsurers meet the financial and other requirements also set out in the Model Law and which again serve as a foundation for the terms of the Covered Agreement.

These requirements were widely consulted on, carefully constructed over a number of years and have proven to be very effective. We therefore do not see any need to amend the Model Law in this respect and do not see any need for additional "guard rails" that would only serve to tilt the level playing field further.

This approach would create a level playing field for reinsurers' access to the US market. There is, of course, a broader level playing field that needs to be ensured and that is the access that US companies have to Qualified Jurisdictions. A major success of the Covered Agreement was to provide a mechanism to ensure that US companies were not subject to discriminatory or other barriers in accessing the EU market. This was the important quid pro quo. This too can be embedded in the Qualified Jurisdiction criteria to ensure fair market access for US insurers and reinsurers. This would leave these decisions in the hands of functional regulators and avoid the complexities that were experienced in the delivery of the Covered Agreement. As the global market place and its regulation continue to change, this approach would undoubtedly prove more flexible to respond to such change than a Covered Agreement approach.

In conclusion, the time is right for the NAIC to express its continued commitment to maintaining a healthy, vibrant reinsurance marketplace that is open to non-domestics and is based on a level playing field. It is also an important moment for the NAIC to continue to demonstrate its leadership in supporting US insurers and reinsurers in accessing markets overseas. We encourage you to take that bold step forward.

Thank you.

Elisabeth Ditomassi

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