NAIC Reinsurance Evaluation Office

Proposal to Grant Credit for Ceded Reinsurance

October 31, 2006 Draft

I EXECUTIVE SUMMARY

During the Joint Meeting of the Executive Committee/Plenary on Sunday, March 5, 2006, the following charge to the Reinsurance Task Force was adopted:

> "The Reinsurance (E) Task Force is directed to develop alternatives to the current reinsurance regulatory framework, including the use of collateral within the U.S. and abroad. Consider approaches that account for a reinsurer's financial strength regardless of domicile, i.e., state or country. Identify and consider variations in state law and regulation relative to reinsurance contracts, financial reporting, etc. As part of its deliberations, the Task Force should consult with international regulators in addition to all other interested parties. The Task Force shall present the proposal to the membership by the December 2006 national meeting."

Did the Task Force meet its charge? Only one alternative has been advanced. Why weren't other alternatives developed?

Did the Task Force identify such variations?

With regard to reinsurance, the U.S. regulatory system takes both a direct and an indirect approach. The direct regulation applies only to U.S.-licensed reinsurance companies. As with primary companies, the domiciliary regulator is responsible for performing periodic financial examinations and for ongoing solvency supervision; this is the state of incorporation for U.S.-based reinsurance companies and the state of entry for U.S. branches of companies based outside the U.S. Reinsurance is also regulated indirectly, through the process by which U.S. primary companies are given statutory credit on their balance sheet for risks they transfer via reinsurance. Full credit is virtually automatic if the reinsurer is subject to direct U.S. regulation. Otherwise, credit is only available if the reinsurer posts security in accordance with state laws based on the NAIC models.

In order for credit to be granted for reinsurance assumed from a U.S. cedent without posting collateral, the reinsurer must be licensed or accredited in the cedent's home state or in another U.S. state which has adopted the NAIC Credit for Reinsurance Model Law. The majority of reinsurers that post collateral are non-U.S. companies (because a U.S.-domiciled reinsurer must at a minimum be licensed in its domiciliary state). The security requirement for these unauthorized reinsurers has allowed U.S. regulators to avoid the need to assess the wide variety of regulatory systems in the reinsurers' home countries and reconcile their accounting and

oversight frameworks to their U.S. equivalents. Although there are a variety of systems of regulation and accounting standards around the world, the differences between them and the U.S. are less material in the context of U.S. reinsurance regulation for solvency because reinsurance obligations of unauthorized reinsurers must be 100% collateralized in order for the ceding company to take balance sheet and income statement credit. Some reinsurers collateralize their obligations by establishing Multiple Beneficiary Trust Funds, which subjects them to some degree of direct U.S. regulation, including the obligation to: (a) file detailed quarterly financial reports to evidence adequacy of the trust fund; (b) provide details of retrocessions; (c) file audited annual reports including certification of reinsurance reserves by a qualified actuary; and (d) submit to the jurisdiction of the courts of the ceding insurer's state of domicile and accept service of process for purposes of enforcing the reinsurance agreement.

Doesn't the proposed reduction of collateral for unlicensed reinsurers, make the differences between US and other regulatory systsems material?

U.S. regulators are proposing to amend the credit for reinsurance laws to establish a regulatory system that distinguishes financially strong reinsurers from weak reinsurers, without relying exclusively on their state or country of domicile, with collateral to be determined as appropriate. This proposal would create an organization called the Reinsurance Evaluation Office (REO) to rate the financial strength of reinsurers doing business in the U.S., irrespective of the reinsurer's country of domicile. State insurance regulators, through the REO, will establish procedures for the evaluation of the financial strength and operating integrity of reinsurers and, based on the outcome of the evaluation, assign a rating (REO-1 through REO-5) to each reinsurer. These ratings will be affirmed or modified through periodic reviews by the REO. The analysis would incorporate insurance financial strength ratings assigned by nationally recognized statistical rating organizations ("NRSRO's") and the expertise of the NAIC for evaluating other key factors delineated in the proposal. The analysis will also include a review of the financial strength and operating integrity, business operations, claims paying history, management expertise and overall performance of reinsurers in assigning ratings ("credit criteria"). The amount of collateral posted by each reinsurer would depend on the rating it receives from the REO.

Does any other country unilaterally, and without a treaty, relax its regulatory standards for the benefit of unlicensed insurers – without regard to the reinsurer's domicile?

The expertise of the NAIC is the most evident in the strength and contributions of its member regulators. Since the member's states are delegating their authority to the REO, what specific and available expertise exists?

Reinsurance Evaluation Office Proposal

Procedure to Grant Credit for Ceded Reinsurance

1. Overview

This proposal establishes enhanced regulatory requirements that will provide reasonable and prudent controls over the reinsurance credit risk exposure of U.S. ceding insurers. These credit requirements will apply to all companies that assume reinsurance liabilities ("reinsurers"), regardless of whether they are licensed, accredited, or unauthorized. These rules will be based on the established credit criteria.

U.S. ceding insurers will be permitted to take reinsurance credit, as an asset or deduction from liabilities, if the reinsurer meets its applicable collateral requirements and the reinsurance agreements meet other applicable regulatory requirements (e.g., insolvency clause, transfer of risk, agent for service of process, U.S. choice of law and court). Nothing in this proposal precludes ceding insurers from requiring a reinsurer, rated or not, to post additional collateral to secure some or all of its obligations, as a matter of commercial contractual commitment. Nor does anything in this proposal prohibit a ceding insurer from agreeing to an uncollateralized reinsurance agreement, but the cedent will not receive any reinsurance credit on its annual statement.

It is important to note that the proposal does not eliminate collateral requirements and, in fact, would increase collateral for U.S. reinsurers. The proposal calibrates the collateral amount and correlates it to an evaluation of the reinsurer in accordance with the credit criteria.

NRSRO financial strength ratings provide an opinion of the insurer's overall financial strength and ability to meet its policyholder obligations. As such, these ratings are meant to be summary measures of investment quality, counterparty credit risk, and claims paying ability. The REO will need to establish and implement methodologies that draw from both the marketplace and existing regulatory regimes.

The proposal removes collateral that protects the U.S. cedents and benefits unlicensed reinsurers who are not subject to the comprehensive regulatory standards that exist in the U.S. Why is that desirable? How is a system that benefits unlicensed companies and punishes US licensed insurers and reinsurers "jurisdictionally agnostic?"

How does the proposal promote solvency and protect against default by an unlicensed reinsurer by reducing collateral and passing the costs of unlicensed reinsurer failure to cedents and policyholders?

What is the value of a US license? Why would reinsurers hire US employees, lease or buy US real estate, pay federal, state and local taxes, maintain 50 state licenses, and subject themselves to conservative state regulatory standards if there is no benefit?

Other than providing less collateral, these minimal standards for unlicensed reinsurers pale by comparison with the comprehensive regulatory standards for licensed companies. Are the other US standards unnecessary? Why do US licensed companies have to meet greater standards, maintain their assets in the US, and provide collateral?

Most US licensed ceding companies will not have the negotiating clout to demand additional collateral from unlicensed companies.

Why is a reduction of collateral for reinsurers not regulated by states and an increase in collateral for licensed companies seen as enhancing state regulatory requirements?

What standards will apply to limit the discretion of the REO? Is the delegation legal? What appeals process is involved? Who can appeal? And how does that process align with the state administrative procedure laws?

Insurer financial strength ratings are relied upon by insurance agents, brokers, and consumers, are used by insurers in their advertising, and provide a tool for regulators to assess insurer risk. Because not all insurers are NRSRO rated, the REO will need a process, consistent with current financial analysis techniques, for evaluating entities that do not have insurer financial strength ratings.

What will this process involve? What standards will limit the REO's discretion?

While this statement may be accurate, it is an inaccurate characterization of the US credit for reinsurance standards.

Many regulators have characterized the current system as deeming that reinsurance recoverables are 100% at risk if purchased from a non-U.S. company and is a risk-free enterprise if purchased from a U.S. company. Another frequent comment is that the current binary system of regulation does not adequately address the credit risk that reinsurance poses to the cedent's balance sheet. Finally, it has been noted that 96.4% of unaffiliated non-U.S. ceded premiums go to reinsurers in 10 countries; 85% of the total goes to Bermuda, UK, Germany and Switzerland, which have developed economies and sophisticated regulatory systems.

Does this imply that state insurance departments are not capable of determining if their domestic assuming insurers present solvency concerns?

What conclusions have US regulators drawn about these countries? Have US regulators determined that these jurisdictions' regulations are as conservative as the US standards? In actuality the US standards, including Sarbanes Oxley, the model audit rule, SAP, US risk-based capital and related capital requirements and asset restrictions, are much more conservative.

Balancing the technical issues related to solvency with those related to market fairness requires vigilance. While the quality of most reinsurers enhances the value of a ceding company's reinsurance program, it cannot be denied that there are reinsurers of poor quality that compromise such programs and place ceding insurers at risk.[1] The current collateral system does not adequately correlate the level of collateral to the degree of risk.

The current system is not intended to be a credit risk based system. Rather it is a "licensing system", that provides the same options to US and non-US companies. Unlicensed reinsurers can obtain a license or give their ceding insurers collateral. Collateral under the current system is in lieu of licensing.

2. Establishment of the Reinsurance Evaluation Office

State insurance regulators, through the REO, will establish procedures to evaluate the financial strength and operating integrity of reinsurers and, based on the outcome of the evaluation, affirm or modify the rating of each reinsurer that participates in this program.

What are the procedures to be established? Is it prudent for regulators to authorize the delegation of authority to a non-governmental organization without standards?

The new process will utilize established credit criteria and will rate each reinsurer that applies in one of the following categories: REO-1; REO-2; REO-3; REO-4 or REO-5.

All states currently require unauthorized or unaccredited reinsurers to post collateral equal to 100% of the reinsurance obligations assumed under the NAIC Credit for Reinsurance Model Law and

How is this relevant? It relates to surplus lines not reinsurance. The REO proposal requires new collateral from licensed reinsurers. How much money has been lost due to licensed reinsurer failure?

[1] NAIC experience with *the Non Admitted Quarterly Insurers Listing* indicates unauthorized reinsurer insolvency, while occurring at a rate below the level of direct insurer insolvency, occurs with 10 times greater frequency among U.S. domestic unauthorized reinsurers than among alien unauthorized reinsurers. See analysis in AM Best, *Annual Review of the Excess and Surplus Lines Industry* (September 2001)

Credit for Reinsurance Model Regulation. Elimination of the 100% collateralization requirement and establishment of a new process for applying the credit criteria to reinsurers would therefore require amendment of the model law and regulation.

> Legislation in the various states will be needed to implement this proposal. If not universally adopted, will the proposed system complicate and weaken solvency regulation? Are there a minimum number of states that must pass this before it becomes effective?

The NRSRO ratings represent the starting point of the REO rating assignment process, so that the level of accuracy is vested in the NRSRO process and is consistent with the standards used by the markets to assess credit risk. Another standard set forth in the Proposal is the strength of financial regulation in the reinsurer's jurisdiction of domicile. The proposal establishes a list of evaluation criteria, while recognizing the difficulty inherent in determining the quality of regulation in various foreign countries in the absence of any counterpart to the NAIC Financial Regulation Standards and Accreditation Program in place either through the International Association of Insurance Supervisors (IAIS) or some other comparable international body.

> This proposal makes the rating agencies de facto regulators. Do state regulators intend to abdicate their regulatory role?

> Are there standards that foreign country regulation must meet? What US regulatory standards are not necessary for effective solvency regulation? If the US standards are not necessary for foreign insurers, why are they essential for US licensed insurers?

3. Reinsurer Rating Requirements

A. Initial Application

To be rated, a reinsurer must submit the following information to the REO for review:

> Why do US licensed insurers have to submit an application, when they have previously submitted this information to their domestic regulator, the NAIC, and most other states?

I. An application form *(see Appendix I)*;

II. Audited financial statements for the last 3 years filed with its domiciliary regulator (unless otherwise permitted by the REO), pursuant to or including a reconciliation to U.S. GAAP or U.S. Statutory Accounting Principles.

> What standards would apply to any application for a waiver of the audited financial statement filing? Is the REO given unfettered discretion?

> To have a level playing field the reconciliation must be to SAP. Why are unlicensed companies given an advantage?

The REO may consider the following factors in evaluating a request for a waiver of the 3-year requirement:

i. The insurance industry experience of the reinsurer's senior management and staff;

ii. The amount of the reinsurer's unencumbered statutory capital and surplus;

> How can the amount of capital be evaluated with confidence if audited financials are not provided?

iii. A corporate affiliation with an established insurer or reinsurer;

iv. Other information the REO deems relevant;

III. Certification of all current NRSRO ratings issued for the reinsurer;

IV. A properly executed Form AR-1 by which the reinsurer submits to the jurisdiction of U.S. courts and appoints an agent for service of process in the United States. Form AR-1 will not be accepted from any reinsurer which is domiciled in a country or state which the REO has determined does not adequately and promptly enforce valid U.S. judgments or arbitration awards;

> If enforcement of judgments is not a problem, are unlicensed reinsurers willing to sign an amended AR-1 that requires 100% collateral if they challenge a US judgment abroad? (Assuming the judgment has been served upon their US agent for service of process.)

V. Biographical information concerning all members of its board of directors and senior officers or equivalent governing body *(Appendix I)*;

VI. A report in the form of the NAIC Property and Casualty Annual Filing Blank Schedule F, or for life companies the NAIC Life, Accident & Health Filing Blank Schedule S *(Appendix II)*. For those parts of Schedule F where data is reported by counterparty whose net reinsurance recoverable or payable in total is less than 5% of statutory surplus, that counterparty may be reported as an aggregated amount. All contracts on Schedule S, regardless of the amount, must be reported individually;

VII. A list of all disputed[2] or overdue[3] recoverables. The list shall be used to determine whether there are any potential collectibility issues. Provisions[4] (penalties) will

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[2] "Dispute" for this purpose means pending litigation, or arbitration, or notification through a formal written communication from a reinsurer denying the validity or amount of claim. Amounts in dispute are treated like recoverables more than 90 days past due: 20% is included in the provision for reinsurance.

[3] The relevant ratio for the statutory provision for reinsurance is the percentage of loss recoverables more than 90 days overdue (i.e., not current).

[4] GAAP financial statements have no provision for reinsurance. GAAP statements show all reinsurance recoverables as assets, not as contra-liabilities, and they reduce the assets for expected uncollectible amounts, just as for other receivables. Note 22D to the financial statements, Uncollectible Reinsurance, discloses "uncollectible reinsurance written off during the year" by reinsurer, in four categories: (i) losses incurred, (ii) loss adjustment expenses incurred, (iii) premiums earned, and (iv) other. This write-off is not directly related to the provision for reinsurance, though it may serve as a check. A company with write-offs consistently greater than its provision for reinsurance may be underestimating its liabilities.

The company's Appointed Actuary must discuss reinsurance collectibility and its effect on loss reserve adequacy in the Statement of Actuarial Opinion. The Appointed Actuary should use the Schedule F exhibits as one source of information on potential collectibility problems. The NAIC Instructions to the Statement of Actuarial Opinion, section 11, say

be enforced for reinsurance recoverables that are unsecured, overdue, or in dispute. The penalty shall be 20% of loss recoverables in dispute or more than 90 days past due;

> Why are disputed claims considered in the reinsurer's claims payment history? Who determines if the dispute is legitimate or not?

VIII. An application fee of $XXXXX;

> Why should US licensed insurers, who are currently subject to more stringent and conservative solvency regulation than unlicensed companies, be required to post collateral and pay a licensing application fee on top of all of the other licenses and fees they already pay to support the state system? Are these fees the means by which the REO will be funded? If not, how?

IX. A signed consent to obtain financial and operational information material from the domiciliary regulator;

X. A certification from the domiciliary regulator that the company is in good standing, that it has received the signed consent called for in requirement IX and that it will provide the information requested by the REO;

XI. A description by the reinsurer's domiciliary regulator of its regulatory structure and authority, the substance of financial and operating standards for reinsurers in their jurisdiction, the form and substance of public and regulatory reports, whether U.S. regulators can gain access to those reports, and a copy of its most recent IAIS insurance core principles self-assessment and (where available) the International Monetary Fund's Financial System Stability Assessment, or any other equivalent report. If current information for this jurisdiction is already on file with the REO, it may be incorporated by reference; and

> Why should US licensed insurers be subject to this provision?

XII. Any other information that the REO may reasonably require.

> What are the standards that the REO would utilize in demanding and evaluating any additional information?

B. Assignment of Rating

Based upon a review of the information submitted or any other available information, public or otherwise, the REO will assign an appropriate rating to the reinsurer based on the credit criteria. In making this assignment, the REO shall consider:

Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over 90 days past due.

An estimate of uncollectible reinsurance is distinct from the statutory provision for reinsurance. There may be a large provision for reinsurance despite confidence that the reinsurance will ultimately be collectible.

How were the rating "bands" chosen? If the market requires "A-" or better ratings for reinsurer acceptability in an era of 100% collateral, why does the REO proposal permit a reduction of collateral for reinsurers that have lower

I. The financial strength ratings issued to the reinsurer by NRSRO's: unless an exception is granted through the appeal process, the maximum rating available shall be the REO category corresponding to the reinsurer's NRSRO rating according to the following table. If the reinsurer has inconsistent ratings from more than one NRSRO, the lowest shall be used:

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

Many international regulators appeared before the Reinsurance Task Force and stated that their new regulatory processes were either untested or not fully developed and deployed. How do you regulate the strength of an untested system? Is each individual state going to be regulated as well?

II. The strength of financial solvency regulation in the reinsurer's jurisdiction of domicile;

III. The length of time that the reinsurer has actively assumed risks, which may not be less than 3 years, unless specifically permitted by the REO;

IV. The reinsurer's reputation for prompt payment of valid claims under reinsurance agreements, including the proportion of the reinsurer's obligations that are more than 90 days past due or are in dispute, including receivables payable to companies that are in Administrative Supervision or Receivership;

Why are disputed claims considered in the prompt payment of valid claims? Is the REO also going to evaluate the validity of claims – in lieu of judge, jury or arbitrator?

V. Additional Criteria to consider:

i. If a reinsurer has no NRSRO rating, the rating shall be determined by the REO;

Is there any value to having all or substantially all of a reinsurer's assets in the US?

ii. Groups of reinsurers (including both affiliated groups and Lloyd's) maintaining multibeneficiary trusts shall receive a group-wide rating based on overall financial strength; however, each member insurer or Lloyd's

syndicate shall submit a separate application to the REO.

Why are groups of reinsurers maintaining a multiple beneficiary trust ("MBT") treated differently than other groups of reinsurers? Why do unlicensed MBT groups fare better than licensed companies?

iii. If a reinsurer's surplus is less than $100 million as recorded in the application documents, the maximum REO rating the company can receive shall be a REO-2;

VI. Other factors deemed appropriate by the REO.

What standards apply and how can these "other factors" be used?

4. Collateral Requirements for Reinsurers[5]

A. General Standard

I. U.S.-licensed ceding insurers may only take credit for reinsurance for qualifying reinsurance contracts (no change is intended to existing regulatory requirements; e.g., insolvency clause, transfer of risk, agent for service of process, U.S. choice of law and court), and only for the lesser of the liability reinsured or the amount of acceptable collateral provided, except for:

i. Reinsurance with an inception date on or after [effective date] ceded to reinsurers rated by the REO, or other reinsurance ceded to reinsurers maintaining qualifying multibeneficiary trusts, to the extent provided pursuant to the standards below;

If this proposal applies prospectively only, why is the language regarding MBT reinsurers necessary here? What is the intent of this extra language?

ii. Credit consistent with state law for qualifying pooling arrangements or mandatory reinsurance arrangements unless not allowed by the cedent's domiciliary regulator; and

What does "qualifying pooling arrangements" mean?

iii. Transactions entered into before [effective date], to the extent that they qualify for full credit under the standards in effect on that date.

II. Acceptable collateral means funds held under a reinsurance contract by or on behalf of the ceding insurer as security for the payment of the assuming insurer's obligations thereunder, including funds held in trust for the ceding insurer meeting the requirements of Section 10 of the Credit for Reinsurance Model Regulation and

[5] Collateral requirements will apply to all reinsurers, both U.S. and non-U.S. and will apply universally for all liabilities whether affiliated or unaffiliated.

other applicable law, and which are held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer in the form of:

i. Cash;

ii. Publicly traded securities listed and rated NAIC 1 by the Securities Valuation Office of the National Association of Insurance Commissioners and qualifying as admitted assets;

iii. Clean, irrevocable, unconditional and "evergreen" letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in [subsection 4(B) of the Model Act], effective no later than December 31 of the year for which filing is being made, and in the possession of, or in trust for, the ceding company on or before the filing date of its annual statement; or

iv. Any other form of security acceptable to the REO.

What other form of security is acceptable? What standards will the REO utilize in exercising its discretion? In the current collateral discussion, some suggested that state commissioners could waive the 100% collateral standard. Is this level of discretion intended?

B. Reinsurance Ceded to REO-Rated Reinsurers

I. The collateral required for liabilities arising out of reinsurance contracts with inception dates on or after [effective date] will depend on the reinsurer's or group's rating. The minimum collateral for such liabilities will be the following percentages of the gross liabilities secured:

i. REO-1, 20%;
ii. REO-2, 50%;
iii. REO-3, 80%;
iv. REO-4, 100%;
v. REO-5 or unrated, 100% or such higher amount as the REO may determine based upon risk of adverse loss development.

Most licensed insurers and reinsurers will fit is this category. What does requiring 80% collateral say about US regulation of these companies?

II. The maximum credit allowable for liabilities that are not fully secured by acceptable collateral as provided above shall be the following percentage of the collateral posted:

The interplay between subsections I and II has created ambiguity. How are these provisions intended to work?

i. For reinsurers rated REO-1, 500% of the acceptable collateral;

ii. For reinsurers rated REO-2, 200% of the acceptable collateral; or
iii. For reinsurers rated REO-3, 125% of the acceptable collateral;
iv. For reinsurers rated REO 4 or 5, and for unrated reinsurers, 100% of the acceptable collateral.

III. The ceding insurer must notify its domiciliary regulator upon making any draw upon the collateral, unless the draw is the agreed-upon method for paying a claim that has been accepted by the reinsurer.

> Does this require prior notice before a draw down? Doesn't any draw make the remaining collateral posted at less than 100% automatically inadequate?

IV. Alternatively, credit may be taken for reinsurance secured by a qualifying multibeneficiary trust arrangement in accordance with the following provisions:

> What is meant by "alternatively"? Does the proposal apply retroactively for MBT reinsurers? Are MBT reinsurers eligible for different standards?

i. A multibeneficiary trust arrangement may be established by a single reinsurer, by a group of affiliated reinsurers under common control or by a group including incorporated and individual unincorporated underwriters whose incorporated members are not engaged in any business other than underwriting as a member of the group and are subject to the same level of regulation and solvency control by the group's domiciliary regulator as are the unincorporated members.

ii. Assets satisfying the requirements of [Subsection 7(E) of the Model Reg] shall be held in trust in a qualified U.S. financial institution [as defined in [subsection 4(B) of the Model Act], for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. To enable the REO to determine the sufficiency of the trust fund, the reinsurer or group shall report information annually to the REO that is substantially the same as that required to be reported on the NAIC Annual Statement form by licensed insurers. A participating reinsurer shall submit to examination of its books and records by the REO and bear the expense of examination.

> Are MBT reinsurers eligible for different "sufficiency" standards?

C. Interim Reporting Requirements

I. A rated reinsurer or group of reinsurers must file the following reports quarterly with the REO:

i. A statement certifying that there has been no change in the provisions of its domiciliary license or its rating, or a statement describing such changes and the reasons therefor;

ii. Information comparable to relevant provisions of the quarterly NAIC financial statement;

Which provisions are "relevant"? Are other provisions "irrelevant"? Is the determination of relevant financial information being delegated to the REO without standards?

iii. An updated list of all disputed and overdue reinsurance claims; and

iv. Any other information that the REO may reasonably require.

What are the standards that apply to the REO's discretion?

II. A rated reinsurer must immediately advise the REO of any changes in its NRSRO rating, domiciliary license status or directors and officers.

Are unlicensed insurers required to disclose information regarding any changes in director and officer information, such as convictions or bankruptcies? What are the penalties if they do not comply?

D. Annual Recertification Requirements

I. Reinsurers may be re-rated by the REO as frequently as the relicensing period of the reinsurer's domiciliary jurisdiction, but no less frequently than annually. However, the ratings given by the NRSRO's will be continually monitored to determine if the amount of collateral needs to be increased by a reinsurer (in the case of a deterioration in REO rating) or may be decreased (in the case of an amelioration in REO rating).

How will failing reinsurers be able increase collateral as their ratings and financial prospects are dropping? Rating agency downgrades can occur repeatedly over several months, weakening or eliminating a reinsurer's business opportunities. Is it reasonable to expect the unlicensed reinsurer to meet the increased collateral requirements while it is being downgraded for having insufficient capital and business prospects?

II. Rated reinsurers that intend to continue receiving a rating from the REO must reapply annually with the submission of the following documents:

i. "Rating Renewal" Application filing, including an audited report in the form of the NAIC Property and Casualty Annual Filing Blank Schedule F, or for life companies the NAIC Life, Accident & Health Filing Blank Schedule S (Appendix 2). For those parts of Schedule F where data is reported by counterparty

whose net reinsurance recoverable or payable in total is less than 5% of statutory surplus, that counterparty may be reported as an aggregated amount. All contracts on Schedule S, regardless of the amount, must be reported individually;

ii. A reapplication fee of $XXXX; and

iii. Any other information that the REO may reasonably require.

E. Change in or Revocation of Rating

I. The REO will have the authority to amend or withdraw a reinsurer's rating at any time if the reinsurer fails to meet the minimum requirements listed above or if other financial or operating results of the reinsurer lead the REO to reconsider the reinsurer's ability or willingness to meet its contractual obligations.

II. If the rating of a reinsurer improves, then it will be permitted to meet the collateral requirements applicable to its new rating on a prospective basis (i.e., for all reinsurance contracts incepting after confirmation of the improved rating).

> Have the administrative burdens for ceding insurers and regulators been considered? Maintaining appropriate levels of collateral based upon the shifting ratings of a stable of reinsurers will prove costly and challenging – particularly as some changes are prospective only and may occur in the middle of an ongoing contract.

III. In the event of a deterioration in the rating of a reinsurer, the reinsurer will be required to meet the collateral requirements applicable to its new rating for all existing and new contracts subject to evaluation by the REO. Notwithstanding the change or withdrawal of a reinsurer's rating, U.S. ceding companies may continue to take annual statement credit for a period of [3] months for all reinsurance ceded to that reinsurer for which they were previously allowed credit, unless the reinsurance is deemed uncollectible.

> As many liability lines have obligations extending to 40 years and beyond, the likelihood of rating changes is significant. The proposal recognizes the difficulty of obtaining an increase in collateral over a three-month period. How difficult will it be to obtain and maintain sufficient collateral over a 40-year period from reinsurers who don't maintain assets in the US and whose financial condition is deteriorating?

IV. There will be an appropriate appeal process for a review of rating decisions taken by the REO.

> Is the establishment of the appellate process being delegated to the REO? What standards apply? Who can appeal? Reinsurers? Ceding insurers? Regulators? Is there a process of appeal beyond the REO? To whom? How does that align with the various state's administrative procedures laws? If individual commissioners can change the REO ratings on appeal, how does the lack of uniformity fit within the objectives of the NAIC?