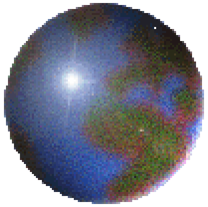
NAIC Reinsurance Collateral Update



Bryan Fuller
NAIC, Senior Reinsurance Manager

NAIC
making progress . . . together

Presentation Overview

- Current Charges of the Reinsurance Task Force
- Progress of Discussions
  - Proposed Regulatory Approach
- Reactions from Comment Letters
- Anticipated Next Steps

Reinsurance Evaluation Office (REO) Charge

- **REO Proposal**
  - Risk-based evaluation process for purposes of collateral recalibration.
  - The "REO" charge focused simply and in a limited manner on the refinement of a commercially feasible "design" and calibration of the REO concept.
- **Comments Regarding REO Proposal**
  - Collateral Only One Part of US Regulatory Regime
  - Need for More Comprehensive Reforms

NAIC
making progress . . . together

Regulatory Framework Charge

- The Financial Condition (E) Committee charges the Reinsurance Task Force to consider the design of a revised U. S. reinsurance regulatory framework.
  - The "framework charge" is much broader and more far-reaching, involves direct coordination with technical experts from other working groups, and may evolve through marked stages over time.

Regulatory Framework Charge

- Once the revised proposal is adopted, the Reinsurance Task Force shall coordinate input from various other NAIC groups, including at a minimum:
  - Receivership and Insolvency Task Force
  - Capital Adequacy Task Force
  - Accounting Practices and Procedures Task Force
  - Examination Oversight Task Force
  - Financial Analysis Working Group

NAIC
making progress . . . together

Reinsurance Regulatory Modernization Proposal

- Proposed Regulatory Approach
  - Regulatory Equivalence – Mutual Recognition
    - Reinsurance Supervision Review Department would determine which jurisdictions are "equivalent" to U.S. regulation.
  - Single State U.S. Regulator – U.S. Reinsurers
    - Domestic reinsurers would submit to one jurisdiction in order to access the U.S. market (minimum criteria established to qualify for single state regulatory approach)
  - Port of Entry – Offshore Reinsurers
    - Non-U.S. reinsurers from approved jurisdictions would be certified to access the U.S. market through one jurisdiction.

NAIC
making progress . . . together

A Principles-Based Approach

- Develops overarching principles to govern the regulatory equivalence of non-U.S. jurisdictions

- Moves the U.S. towards international standards

NAIC
making progress . . . together

Proposal Considerations

- Disparate Treatment
  - "Functionally equivalent" jurisdictions would have to:
    - Go through an evaluation by the Reinsurance Supervision Review Department (RSRD), which would make a recommendation to be voted on by U.S. state insurance regulators.
    - Become certified through a Port of Entry State
    - Post reduced collateral for appropriately rated reinsurers but still post collateral

NAIC
making progress . . . together

Value of a U.S. License

- Previous proposal was biased against the U.S.' own regulatory system and would have provided little reason for U.S. reinsurers to remain domiciled in this country.
  - Study Group Resolution
    - Amended proposal recalibrate collateral percentages and moved rating bands slightly according to NRSRO recommendations.
    - Require audited reconciliation to U.S. GAAP or U.S. SAP
    - U.S. licensed reinsurers rated Class 5 would also have to post collateral

NAIC
making progress . . . together

Potential Ratings Matrix

Potential Collateral	Bands	AM Best	S & P / Fitch	Moody's
60%	Class 1	A++	AAA, AA+	Aaa
70%	Class 2	A+	AA, AA-	Aa1, Aa2, Aa3
80%	Class 3	A, A-	A+, A, A-	A1, A2, A3
100%	Class 4	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3
100%	Class 5* (*100% for U.S. domestic licensed reinsurers)	B, B-, C++, C+,C, C-, D, E, F	BB+, BB, BB-, B+, B, B- S& P: CCC, (CC, C), (D), R, NR Fitch: CCC+, CCC, CCC-, DD	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C

NAIC
making progress . . . together

Collateral Recalibration of the Proposal

Potential Collateral	Bands	Total Recoverables (000's)	Collateral (Reduction)/Increase (000's)
60%	Class 1	7,135,482	(2,854,193)
70%	Class 2	25,582,599	(7,674,780)
80%	Class 3	61,152,864	(12,230,573)
100%	Class 4	2,110,519	0
100%	Class 5* (*100% for U.S. domestic licensed reinsurers)	67,362,668	67,362,668

Ratings from S & P, Data from NAIC FRD

NAIC
making progress . . . together

Collateral Reduction

- Therefore, collateral would be recalibrated by the current proposal:
  - $ 22.7 billion in reduced collateral for Class 1-4 non-U.S. reinsurers
  - $ 67.3 billion in increased collateral for Class 5 U.S. reinsurers*
    - * Increase would be only $ 14.2 billion if the proposal included only unaffiliated reinsurance assumptions. Difference includes affiliated transactions including inter-company pools.

NAIC
making progress . . . together

Disparate Treatment

- It makes no sense to continue to treat non-U.S. reinsurers that are regulated by "functionally equivalent" foreign regulators that have also submitted themselves to a U.S. "port of entry" state as if they posed risks to U.S. ceding companies different from the risks posed by licensed U.S. reinsurers."
  - The members of the study group were attempting to deal with the delegation of authority concerns within the original REO proposal.

NAIC
making progress . . . together

Disparate Treatment?

- This would maintain ultimate regulatory control at the state level while giving non-U.S. reinsurers an opportunity to access the entire U.S. market without the need to become licensed in the U.S.
  - RSRD would evaluate non-U.S. regulatory regimes and deliver a recommendation to U.S. state insurance regulators who would vote to decide whether or not a jurisdiction should qualify as "functionally equivalent".

NAIC
making progress . . . together

Affiliate Transactions

- Proposal to allow for reduction in collateral for affiliated transactions.
  - Study Group Considerations
    - In a troubled company situation, this could give rise to transfer pricing issues (Is the direct insurer being overcharged, as a way of transferring profits within the group to lightly regulated jurisdictions?)
    - U.S. licensed reinsurers would still have to post collateral if they receive a Class 5 rating.

NAIC
making progress . . . together

Credit Quality of the Reinsurers

- *Short-tail criteria versus long-tail criteria*
  - Higher credit quality criteria are typically required for reinsurers that assume longer tail exposures. The natural pattern of the counterparty credit risk is that time is a great dissipater of credit quality. What might seem acceptable in the context of a 12-month or 18-month time frame has to be given an entirely different perspective when it comes to classes like casualty, where recoveries may be required over 10 or more years.

NAIC
making progress . . . together

Credit Quality of the Reinsurers

- *Short-tail criteria versus long-tail criteria*
  - While recent catastrophic events have not resulted in large numbers of troubled company situations, there is no guarantee that this will continue in the future.
  - Reinsurers could face significant liquidity and capital constraints in a relatively short time frame in the event of one or more significant catastrophic events in excess of $ 100 billion.

NAIC
making progress . . . together

Diversification of Credit Risk

- No diversification requirement in the proposal which translates into a lack of effective credit risk management.
  - Study Group Resolution: The purpose of the proposal is to put collateral where there is perceived increased exposure to weak and/or slow paying reinsurers. The proposal does not force ceding insurers to transact business with certain reinsurers as that is a management decision and not necessarily a regulatory one.

NAIC
making progress . . . together

Credit for Reinsurance Model Law

- ***Model Law Development Criteria***
  - The Executive Committee of the NAIC, upon a recommendation of the Parent Committee, will determine if a proposed new Model Law (or Regulation) or amendment to an existing Model Law (or Regulation) meets a two-pronged test as follows:
    - **The issue that is the subject of the Model Law necessitates a *national standard* and requires *uniformity* amongst all states; and**
    - **Where NAIC Members are *committed* to devoting *significant regulator and association resources* to educate, communicate and support a model that has been adopted by the membership.**

NAIC
making progress . . . together

Next Steps

- Complaint – Limited Comment Period
  - Extended comment period to Oct. 19, 2007 (will allow for nearly 45 day total comment period)
- Interim Meeting – Atlanta, GA (in conjunction with the NAIC Financial Summit
  - Request for interim meeting the afternoon of Nov. 7 and Nov. 8, 2007
  - Conference calls anticipated before and after interim meeting
- Winter National Meeting – Houston, TX
  - Meeting the afternoon of Sunday, Dec. 2, 2007

NAIC
making progress . . . together