

November 15, 2006

Hon. Julianne M. Bowler
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
One South Station, 5th Floor
Boston, MA 02210-2208

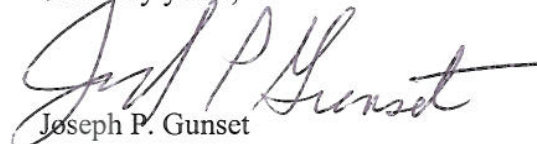
Re: NAIC Reinsurance Evaluation Office Proposal

Dear Commissioner Bowler:

This letter and attachment will supplement the preliminary comments submitted to you on behalf of Lloyd's regarding the captioned proposal (copy of our letter of November 7, 2006 attached for your convenient reference). As stated in our prior comments, we see much in the proposal to be commended and we congratulate the drafters for their efforts. We believe this proposal represents an important step forward in developing a new, more rational and more global approach to the subject of credit for reinsurance in the United States and the drafters of the proposal can be justly proud of their efforts.

While the proposal represents an excellent start, there are some issues we would like to raise regarding questions we have and clarifications and changes that we believe would be beneficial. Attached for your review and consideration is a black-lined mark up of the October 31 draft proposal, together with brief comments underlying the proposed changes to the draft. We hope you will find these comments to be helpful in your efforts. If you have any questions regarding any of these comments or suggestions, or if we may be of any assistance in this effort, we hope you will not hesitate to call upon us.

Sincerely yours,



Joseph P. Gunset

Cc: Hon. Alessandro Iuppa
Hon. Howard Mills

NYA521119.1

Joseph P Gunset
General Counsel

Sent Via Facsimile (617) 521-7758, e-mail & regular mail

November 7, 2006

Hon. Julianne M. Bowler
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
One South Station, 5th Floor
Boston, MA 02210-2208

Re: NAIC Reinsurance Evaluation Office Proposal

Dear Commissioner Bowler:

We have recently received the Reinsurance Evaluation Office ("REO") proposal (the "Proposal") developed by members of the NAIC Reinsurance Task Force. We would like to acknowledge this considerable and commendable effort and the leadership that you, NAIC President Al Iuppa, and your colleagues have shown in seeking to bring much needed modernization and rationalization to this country's outdated system of credit for reinsurance. Preliminarily, we wish to note that the draft Proposal reflects a great deal of effort and strategic thinking by its drafters. Our review and analysis of the Proposal is continuing but we did want to share with you and your Task Force colleagues our initial thoughts and reactions in advance of Wednesday's conference call.

We see much in the Proposal to be commended. Perhaps most important is the Proposal's implied recognition that the world has changed a great deal since our current credit for reinsurance rules were initially developed and that the time has come to take a new and more global approach to what clearly is and must be a global reinsurance marketplace.

We wholeheartedly endorse the concept set forth in the Proposal that reinsurance funding requirements must be based upon the financial strength and reliability of the reinsurer rather than a reinsurer's domicile and that all reinsurers assuming reinsurance risk from United States ceding insurers should be subject to the same analysis and requirements. We applaud the Proposal's farsighted recognition of the need to apply a single, uniform, national standard through the REO and we agree with the wisdom of establishing a specialized unit to review a highly technical area. Further, we are

Lloyd's America, Inc. THE MUSEUM OFFICE BUILDING 25 West 53rd Street 14th Floor New York NY 10019 www.lloyds.com/america
Telephone +1 212 382 4060 Fax +1 212 382 4070 Email joe.gunset@lloydsamerica.com

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gratified by the Proposal's recognition that the Lloyd's market should receive a group-wide rating based upon the market's overall financial strength. Given the common chain of security that underlies all Lloyd's policies, we believe that a market wide approach is clearly the proper approach to take with respect to Lloyd's.

While we see much to be commended, we do have some concerns with the Proposal. We are developing more detailed comments on these points but, preliminarily, we would like to see greater flexibility available to the REO in setting appropriate funding levels. While ratings assigned by the nationally recognized rating agencies are clearly relevant to the overall analysis and offer a valuable tool to the REO in its evaluation of various reinsurers, we have received feedback from industry participants that suggest that the NRSRO chart as set forth in the current draft of the Proposal needs to be re-evaluated in that it does not in its present form accurately reflect the true financial strength of the various participants in the reinsurance marketplace. We plan to discuss this issue in greater detail in the comments we are preparing for submission to the Task Force by the 15th. We would also recommend that the drafters of the Proposal consider increasing the number of bands so as to reduce the deviation in the levels of funding between bands. We also question the wisdom of capping the various REO bands based upon the NRSRO's ratings, especially since the draft looks to the rating agency with the lowest rating as the basis for setting that cap for each reinsurer. We recognize that the Proposal does contemplate the possibility that exceptions might be granted through an appeal process but we question whether this approach will have sufficient flexibility to enable the REO to adjust funding levels based upon the unique facts and circumstances of various reinsurers.

We respectfully submit that a more flexible approach to the application of the rating bands would allow discretion to regulators who are in a position to take into account all available data and market intelligence, not just evaluations from NRSRO's. In the case of Lloyd's, it is our view that a fair and objective evaluation of the financial strength of the Lloyd's market, including its strong competitive position, operating performance, capitalization and financial flexibility, would suggest that Lloyd's should be ranked with the strongest and most financially secure reinsurers. Lloyd's ability—and willingness—to pay, is not in dispute.

In summary, the REO must be allowed to recognize that, while of value, NRSRO ratings tell only part of the story with respect to any reinsurer.

More generally, there are a number of areas where we believe greater detail is needed in the Proposal. We also think it essential for the Proposal to recognize more explicitly that the Lloyd's market is unique in terms of its history and structure and that requirements developed for a reinsurance corporation can frequently not be applied to a market like Lloyd's without modification. As previously noted, we will address these and other comments in our full submission to be submitted to the Task Force on or before the November 15 deadline. We appreciate your efforts to work diligently towards final resolution of this long standing debate as we believe it to be important that a new system be in place in time for application to reinsurance agreements incepting on or after January, 2008.

Hon. Julianne Bowler

November 7, 2006

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In summary, we believe the Proposal contains many very positive features but issues clearly remain. We are ready to work constructively with you and your colleagues to address these issues and to provide whatever further assistance you might require in this very worthy effort.

Sincerely yours,

cc: Hon. Alessandro Iuppa
(Via Facsimile (207) 624-8599, e-mail & regular mail)
Hon. Howard Mills
(Via Facsimile (212) 480-2310; (518) 473-6814, e-mail & regular mail)

Lloyd's Comments, Questions and Suggested
Revisions
November 15, 2006

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.”

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.

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.

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.

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 **all entities that assume reinsurance from United States ceding insurers and that seek an REO rating, including those** that do not have insurer financial strength ratings.

Lloyd's Comment: The last sentence of this paragraph as originally drafted suggested that the

REO will need to develop an evaluation process only for those reinsurers that do not have an NRSRO rating. We believe the REO must have a process in place to perform its own evaluation of all REO listed reinsurers, not just those who lack an NRSRO rating.

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.

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.

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. **The REO will perform its functions as specified below under the instructions and supervision of [insert appropriate regulatory oversight body]**

Lloyd's Comment: Some have questioned whether the establishment of the REO could be subject to constitutional challenge as a improper delegation of regulatory authority. At least part of that analysis might depend upon the relationship between the REO and state insurance regulators. In this regard, we believe the draft is presently unclear on the nature and extent of that relationship especially

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)

with respect to such questions as to whether REO decisions are binding on the states or are only intended to serve as recommendations. Also, while the draft does contemplate an appeal process at its end, there is no indication as to who the appeal is taken to, what the standard of review is or whether it is contemplated that judicial review of those decisions is or might be possible. We would ask the drafters to develop these issues further.

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, **REO-6 or REO-7.**

Lloyd's Comment: When read together with Section 4BI (page 10), it is apparent that there are only three rating bands (REO 1, 2 and 3) that contemplate less than 100% funding and that the funding level gaps between these rating bands are quite substantial, at 30% between levels. Given that movement between rating bands would result in an increase or decrease in funding requirements, we recommend use of a greater number of rating bands with smaller funding gaps between them. In this regard, we note that the REO 1, 2 and 3 bands, as proposed, would include six A.M. Best rating categories and ten rating categories each for S&P, Moody's and Fitch. We believe that three REO rating categories are too few and the changes in funding levels between categories are too dramatic. Also, we believe reinsurers enjoying the highest REO rating should be permitted zero funding.

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 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.

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 **such as the Financial Sector Assessment Programme.**

Lloyd's Comment: The Financial Sector Assessment programme is a joint IMF and World Bank effort introduced in May 1999. It aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries and gives regard to International Association of Insurance Supervisors' standards. Whilst not perhaps absolutely comparable in detail, the goals are similar to the NAIC Accreditation Programme and is worthy of consideration.

3. Reinsurer Rating Requirements

A. Initial Application

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

- I. An application form (see Appendix I) **modified as deemed appropriate by the REO for use by insurance markets such as Lloyd's;**

Lloyd's Comment: The application form developed for a reinsurer structured as a corporation would need to be modified for use by the Lloyd's market give the structural differences between the two.

- II. Audited financial statements for the last 3 years filed with its domiciliary regulator **by the reinsurer or, in the case of an REO rated group, by the group** (unless otherwise permitted by the REO), pursuant to or including a reconciliation to U.S. GAAP or U.S. Statutory Accounting Principles, **unless such reconciliation is waived by the REO based upon a determination by the REO that such reconciliation is not needed to perform the appropriate review of such statements.**

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;
- iii. A corporate affiliation with an established insurer or reinsurer;
- iv. Other information the REO deems relevant;

Lloyd's Comment: We assume the audited financial statements contemplated by this subsection could be satisfied in Lloyd's case by Lloyd's market returns to the UK Financial Services Authority. While the Lloyd's market has been in operation for more than 300 years, new syndicates are formed within the market from time to time and so some of the syndicates may have been in operation for less than three years although all syndicates' underwriting is supported by Lloyd's chain of security.

We would also ask that the REO be allowed discretion to accept audited financial statements without reconciliation to US GAAP or US Statutory Accounting if the REO is satisfied that the accounting standards under which the financial statements were prepared are sufficiently analogous to US standards to make such reconciliation unnecessary (e.g. UK GAAP as modified by Lloyd's internal accounting rules)

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

Lloyd's Comment: We request that the proposal be clarified to state that by "NRSRO ratings", the draft includes only interactive NSRO ratings based upon full access to all relevant information and does not include involuntary ratings that are based only upon public information. Given the importance of the NRSRO ratings to the REO's activities, we believe that ratings based upon less than full information should not be relied upon.

- 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;

- V. Biographical information concerning all members of its board of directors and senior officers or equivalent governing body (*Appendix I*) **modified as deemed appropriate by the REO for use by insurance markets such as Lloyd's;**

Lloyd's Comment: The information required is designed for a reinsurer structured as a corporation and would need to be modified for use by the Lloyd's market given the structural differences between the two.

- 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*) **as proscribed by the REO as appropriate for the applicant reinsurer. Schedule F on assumed reinsurance shall list reinsurance assumed from US domestic ceding insurers.** 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;

Lloyd's Comment: Is it contemplated that Schedule F will list all cedents worldwide or just US ceding insurers? We assume the latter was intended given that reinsurance assumed by Lloyd's underwriters from a UK or German ceding insurer would seem to be of little to no relevance to the REO's activities and in any event, is properly supervised by a reinsurer's domiciliary regulator (i.e. in Lloyd's case by the Financial Services Authority).

In addition, we also assume that a non-US reinsurer will not be required to obtain collateral from its retrocessionaires and categorise its reinsurers accordingly in their Schedule F, because to do so would require a UK-regulated entity such as Lloyd's to seek collateral from its retrocessionaires when none is required by applicable law or commercial practice and to do so would be in contravention of the European Reinsurance Directive.

Finally, we believe it will be necessary to revise the proscribed Schedule F (Parts 1 and 2) format for use by the Lloyd's market.

- VII. A list of all disputed² or overdue³ recoverables. The list shall be used to determine whether there are any potential collectibility issues. Provisions⁴ (penalties) will 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 **except to the extent that such recoverables are secured by acceptable collateral;**

Lloyd's Comment: Is it contemplated that the 20 percent penalty for overdue or disputed reinsurance proceeds should be applicable even if the overdue or disputed reinsurance proceeds are collateralized?

- VIII. An application fee of \$XXXXX;
- IX. A signed consent to obtain financial and operational information material from the domiciliary regulator;

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

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.

- 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 **or, if the domiciliary regulator is unable under its own law to share such information with a private association, that it will provide the information requested by the REO to the state regulatory authorities supervising the REO;**

Lloyd's Comment - The free flow of information between reinsurers' domestic regulators and the REO is both important and highly desirable. We would ask, however, whether the REO's status as a private association might make it difficult for some regulators under their own laws to share confidential information with a private association, even with the reinsurer's consent. Also, it is clear that the REO could keep such information confidential? These issues, to the extent they are genuine concerns, can most likely be addressed by using state regulators as the conduit for the flow of information.

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

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:

- I. The **interactive** 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 REO would give regard to the rating level issued by the majority of NRSRO's. An REO rating higher or lower than that indicated in the table below may be assigned by the REO, if it believes it appropriate to do so based upon the other factors in Sections B ii- vi below the lowest shall be used:

Lloyd's Note: The Table Set forth below has been substantially revised from the prior proposal

Bands	Standard & Poor's	A.M. Best	Moody's	Fitch*
	<i>Rating</i>	<i>Rating</i>	<i>Rating</i>	<i>Rating</i>
1	AAA	A++	Aaa	AAA
2	AA+, AA, AA-	A+	Aa1, Aa2, Aa3	AA+, AA, AA-
3	A+, A, A-	A, A-	A1, A2, A3	A+, A, A-
4	BBB+, BBB, BBB-	B++, B+	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
5	BB+, BB, BB-	B, B-	Ba1, Ba2, Ba3	BB+, BB, BB-
6	B+, B, B-	C++, C+	B1, B2, B3	B+, B, B-
7	CCC Or lower	C, C- Or lower	Caa Or lower	CCC, Or lower
Not rated	NR	NR 1-5		

Lloyd's Comment We have several issues with respect to this subsection.

Firstly, we believe there should be more bands and these should be aligned to the approach to NRSRO ratings that we understand is generally used by some insurance agents, brokers and analysts.

As previously noted and for the reasons stated, we believe that the NRSRO ratings should be limited to interactive ratings and that the number of rating categories should be increased.

We also believe that connecting the REO rating to the lowest NRSRO rating can yield unfair results. If AM Best, S&P and Moody's all have a reinsurer at REO-2, is it fair to increase that reinsurer's funding burden because Fitch has the reinsurer rated at

REO-3? We would recommend a majority rule approach (i.e. the REO band should be based upon the REO rating tied to the level of rating by the majority of NRSRO's).

We also urge that REO be allowed discretion to grant a reinsurer a higher REO rating that might result from sole reliance on the NRSRO's ratings. The NRSRO ratings are a good starting point and a useful tool, but we do not believe these ratings should be used to impose a ceiling on a reinsurer's maximum permissible REO ratings.

- II. The strength of financial solvency regulation in the reinsurer's jurisdiction of domicile;
- III. The length of time that the reinsurer **or, in the case of an REO rated group, the group** has actively assumed risks, which may not be less than 3 years, unless specifically permitted by the REO;

Lloyd's Comment: We think it reasonable that, with respect to Lloyd's, the seasoning rule be applied at market level rather than at syndicate level.

- 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. **In making this determination, the REO shall consider the following factors [insert objective criteria].;**

Lloyd's Comment - The prompt payment concept is an important one but we would ask regulators to work towards development of objective criteria to supplement the largely subjective analysis that seems to be contemplated by this subsection as written.

- V. Additional Criteria to consider:
 - i. If a reinsurer has no NRSRO rating, the rating shall be determined by the REO;
 - 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. **In the case of Lloyd's, it will be required to co-ordinate the Lloyd's market's application and to provide information on syndicates' financial performance and their liabilities, where required by the REO.**

Lloyd's Comment: We believe that the appropriate approach is to require Lloyd's to co-ordinate the filing of syndicate information. Please note that 'syndicates' do not have any legal persona as such, and therefore can not have the regulatory obligations that can be imposed on the Society of Lloyd's and its individual members.

- 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. **In the case of an REO rated group, the maximum REO rating the group can receive shall be a REO-2 unless the group maintains joint assets for the protection of all policyholders of any member of the group in the minimum amount of \$[insert] which joint assets may be maintained in the group's jurisdiction of domicile;**

Lloyd's Comment: We request clarification that Lloyd's would be permitted to meet the "\$100 million surplus" standard by reference to central assets of Lloyd's, such as the Central Fund.

VI. Other factors deemed appropriate by the REO.

4. Collateral Requirements for Reinsurers⁵

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~~

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.

~~ceded to reinsurers maintaining qualifying multibeneficiary trusts~~, to the extent provided pursuant to the standards below;

Lloyd's Comment We are somewhat confused by the reference to REO rated reinsurers "or" reinsurers like Lloyd's that maintain MBTF's. It is our understanding that MBTF reinsurers will be eligible for an REO rating.

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

Lloyd's Comment: Would Section 4 B IV below regarding multiple beneficiary trust fund reinsurers fit more appropriately here as an alternative way for REO rated reinsurers to meet any applicable REO funding requirements?

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, ~~zero~~ **20%**;
 - ii. REO-2, ~~zero~~ **50%**;
 - iii. REO-3, ~~30%~~ **80%**;
 - iv. REO-4, ~~50%~~ **100%**;
 - v. REO-5, ~~80%~~ **100%**;
 - vi. **REO 6, 90%**
 - vii. **REO 7** or unrated, 100% or such higher amount as the REO may determine based upon risk of adverse loss development.

Lloyd's Comment As previously noted, we believe there should be a larger number of REO rating bands with smaller funding level differences between them and that the highest REO rated reinsurers should be permitted zero funding. It is presumed that a reinsurer that has sufficient financial strength and market reputation to achieve the highest rating from the REO would, by definition, present little to no credit risk. As a result, there would seem to be no reason to impose upon such a reinsurer the burden and cost of maintaining collateral, especially since the cost of the collateralization will likely result in an increase in reinsurance premiums paid by US ceding insurers.

- II. **Credit shall be allowable for liabilities ceded to REO rated reinsurers that meet their applicable collateralization requirements, if any, as set forth above.** ~~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:~~

- ~~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.~~

Lloyd's Comment: It is felt the impact of the rating is sufficiently explained in the commentary above.

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

Lloyd's Comment: We are confused by the use of the word "alternatively" and believe this subsection might more appropriately appear at the end of Section 3 as previously indicated.

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, **modified as deemed appropriate by the REO for use by insurance markets such as Lloyd's;**

Lloyd's Comment: Please refer to our comment under Section 3 A I.

- iii. An updated list of all disputed and overdue reinsurance claims **regarding reinsurance assumed from US domestic ceding insurers;** and

Lloyd's Comment Is this requirement to be based on claims involving US ceding insurers or worldwide?

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

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

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).
- 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 as proscribed by the REO as appropriate for the applicant reinsurer** 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;

Lloyd's Comment: See earlier comments on Sections 3 vi and C i above.

- 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).
- 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.
- IV. **Rating recommendations and other actions taken by the REO shall be reviewable by [insert the regulatory authority supervising the REO] (the "supervising regulator") either at the request of a party that is aggrieved by the REO's action or failure to act or at its own discretion. Such review shall be conducted according to the following procedures [insert details]. There will be an appropriate appeal process for a review of rating decisions taken by the REO.**

Lloyd's Comment – For the reasons stated above, we recommend that the actions of the REO be under the supervision of and reviewable by an appropriate insurance regulatory authority.

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