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November 8, 2006

VIA E-MAIL

The Honorable Julie Bowler
Commissioner of Insurance State of Massachusetts
Chair, NAIC Reinsurance Task Force
One South Station, 4th Floor
Boston, MA 02110

Re: October 31, 2006 Draft NAIC Rating Evaluation Office: Proposal to Grant Credit for Ceded Reinsurance (the Proposal)

Dear Commissioner Bowler:

This letter is filed on behalf of the Reinsurance Association of America (RAA). The RAA is a national trade association representing property and casualty organizations that specialize in reinsurance. The RAA membership is diverse, including large and small, broker and direct, U.S. companies and subsidiaries of foreign companies. Together, RAA members write nearly 2/3 of the gross reinsurance coverage provided by U.S. property and casualty reinsurers and affiliates.

The RAA is opposed to the Proposal for several reasons. First and foremost, it ascribes no value to the rigorous U.S. regulatory structure vis-a-vis other regulatory regimes. The Proposal has the effect of liberalizing requirements for non-U.S. reinsurers over whom U.S. regulation has no authority and penalizing U.S. licensed reinsurers who submit to the most conservative -- and costly -- disclosure and capital requirements in the world. These requirements include: (a) a significant risk based capital requirement; (b) use of Statutory Accounting Principles which lead to non-recognition of significant assets; (c) substantial limitations on insurer investments; and (d) a general prohibition of discounting of loss reserves. By requiring companies that are subject to these stringent requirements to also post collateral, the Proposal provides no incentive for a company to maintain, much less obtain, a license in the United States.

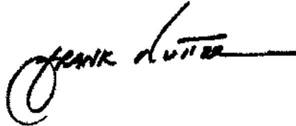
Second, there has been no showing that a change to the current system is necessary. In fact, the evidence is to the contrary. The November 2005 Collateral White Paper confirmed that the current U.S. system of regulating reinsurance has worked well as demonstrated by the lack of reinsurance-driven insolvencies of U.S. cedents and the fact that U.S. cedents oppose any change to the current collateral system. Moreover, the

White Paper made clear that the U.S. system is not discriminatory because it provides options that are available to both licensed and non-licensed entities.

In addition to these fundamental flaws, there are numerous unanswered questions and technical issues with the Proposal. A list of the most significant questions and issues is attached.

Thank you for the opportunity to offer the RAA's comments on the Proposal. Please contact us if you have any questions or need further information.

Sincerely yours,



Frank Nutter
President

Tracey Laws
Senior Vice President & General Counsel

Attachment

cc: Reinsurance Task Force
Financial Conditions (E) Committee
Bryan Fuller, NAIC Staff
Debra Hall, Co-Chair of IP Group
David Gates, Co-Chair of IP Group
Sandy Praeger, NAIC Vice President

NAIC REINSURANCE EVALUATION OFFICE PROPOSAL

Questions For Regulators

What is the rationale or goal of this proposal?

"Why does the current system have to be changed?" is a threshold question that has been asked several times. To our knowledge, the Reinsurance Task Force has never answered this question. However, proponents of changing the collateral system have articulated three reasons why change is necessary: (1) to promote the efficient use of global capital; (2) to increase reinsurance capacity in the United States; and (3) to address a perceived trade barrier. As summarized below, a change to the current collateral system – including the Proposal currently being considered by the Reinsurance Task Force – would not accomplish any of these goals:

- **The Proposal does not promote the efficient use of global capital.**
  - The premise behind the proposal is that the current collateral requirements for unlicensed reinsurers impose transaction costs and restrictions on capital that are unnecessary for highly rated reinsurers.
  - In actuality, this proposal raises collateral requirements for licensed-U.S. companies more than it reduces collateral requirements for unlicensed alien reinsurers.
  - Accordingly, it shifts those "presumed" inefficiencies from the unlicensed reinsurers to the U.S. licensed market where collateral truly is unnecessary and inefficient.
  - Licensed insurers that assume reinsurance already bear the significantly higher compliance costs of U.S. regulation. The imposition of collateral on licensed reinsurers only adds incremental costs and eliminates the value of being licensed and doing business as a U.S. company. **There is no incentive for companies to maintain, much less obtain, a US license under the Proposal.**

- **The Proposal does not increase reinsurance capacity in the United States.**
  - Some proponents of the proposal believe that collateral discourages capacity even though the White Paper concluded that the elimination of the global costs of collateral under the current system would not significantly impact capacity.
  - Even if one assumes that collateral does have a direct impact on capacity, this proposal imposes more collateral on the licensed market than it reduces in the unlicensed market. If you subscribe to the logic that collateral reduces or constrains capacity, the proposal would actually reduce capacity from the licensed market.

- **The Proposal does not fix a perceived trade barrier because there is no barrier.**

  - The current system has not impeded the market share of alien reinsurers, which has grown substantially over the past decade.
  - Collateral is not discriminatory because it is in lieu of licensing. Alien reinsurers can choose to be regulated and licensed to the same degree as U.S. companies in lieu of posting collateral. The majority of alien reinsurers choose to post collateral because it is less expensive than complying with U.S. regulation.
  - Collateral is not necessary from licensed U.S. reinsurers because their assets are already physically located in the U.S., where they are subject to court judgments and regulatory takeover in the event the reinsurer's financial condition triggers RBC Authorized Control Level action.
  - The assets of unlicensed alien reinsurers are out of the regulatory reach and oversight of the U.S.—That is where collateral is really needed.

This proposal does not accomplish any of the purported goals of increasing efficiency, promoting capacity, or reducing barriers to trade—In fact it does the opposite!

What does this proposal actually do?

- It **negates the value of a U.S. license** and **devalues the U.S. regulatory system.** Although sometimes referred to as "US reinsurers" in this document, the proposal actually requires US **licensed insurers** to post collateral for any assumed reinsurance. The proposal nullifies the value of a US license for insurers that predominantly assume reinsurance business. It also significantly reduces the value of a US license for companies that write insurance and reinsurance, including reinsurance of their affiliates.
- It **increases credit and insolvency risks** to U.S. ceding companies and their policyholders.
- It creates a **de facto regulator in ratings agencies** and cedes to the rating agencies primary responsibility for solvency oversight.
- It puts **U.S. reinsurers at a competitive disadvantage** by requiring them to pay significantly higher regulatory compliance costs to be licensed in the U.S. and then requiring them to post collateral on top of that.
- It **treats the regulatory regimes of other jurisdictions as being on par with the U.S.** system that includes Sarbanes Oxley, the Model Audit Rule, conservative Statutory Accounting Principles, U.S. risk-based capital and the Actuarial Opinion Model Law. It does this without even evaluating the equivalency of standards yet to be defined in other jurisdictions (i.e., Solvency II).
- It could **adversely impact market behavior** in unintended ways by discouraging the diversification of risk and by providing further incentives for reinsurance capital and operations to move offshore.

- The proposal treats a viable S&P rated A+ reinsurer the same as it does a BBB- rated reinsurer that is in runoff. A reinsurer that is no longer able to do business by marketplace standards would still only be required to post collateral at 80% of its reinsurance liabilities.
- The proposal erroneously assumes that a downgraded reinsurer will be able to post collateral at the same time it is being downgraded for having insufficient capital. Collateral is not something that can be demanded once the reinsurer gets downgraded. It gives no consideration to the recent reinsurer ratings spiral that included reinsurer downgrades from AA- to BBB- over a period of months.

The proposal creates an environment whereby an unlicensed reinsurer says "I'd gladly pay you Tuesday for a hamburger today." It allows unlicensed reinsurers to do business without collateral today in exchange for the promise that "After I am downgraded for not having sufficient capital—then I will gladly raise capital to secure my liabilities." It leaves U.S. regulators without oversight or enforcement power if an unlicensed reinsurer chooses to exit the U.S. market for any reason.

Who benefits from this proposal?

- A very select few unlicensed reinsurers - including those who maintain multi-beneficiary trusts - receive the vast majority of the benefit.

Who is at greater risk from this proposal?

- U.S. policyholders, licensed cedents, and licensed reinsurers
- U.S. regulators/receivers
- U.S. guaranty funds
- The majority of unlicensed reinsurers and U.S. captive companies
- Certain state economies could suffer if new reinsurers are competitively disadvantaged in the U.S. and therefore decide to form offshore. The same is true to a greater extent if foreign parents of U.S. reinsurers stop writing business through their U.S. subsidiaries and instead choose to write U.S. business from abroad.

What are the most significant unanswered questions concerning this proposal that should be addressed before regulators vote?

If implemented, what is the impact of this proposal?

- Has the NAIC done an analysis of the impact of this proposal on:
  - US licensed insurers that only cede business?
  - Licensed insurers that cede and assume business?
  - Licensed insurers that predominantly assume business?
  - Unlicensed reinsurers?
- Such an analysis should be performed and shared with regulators and interested persons before moving forward on the proposal.

Legal questions:

- Is the delegation of authority to the REO legal?
- What standards apply to the REO's discretion? The discretion appears to be unfettered.
- What is the appellate process to appeal REO decisions? Who can appeal? Who or what is the appellate panel?
- How does the REO appellate process align with the states' administrative procedure laws?
- Are unlicensed reinsurers willing to prove that US judgments are enforceable in their home countries by signing an amended AR-1 that requires forfeiture of any benefits of the rating proposal if they ever challenge a US judgment (relating to reinsurance of a US ceding company) in a court outside of the US if the judgment is served upon the appointed agent for service of process?

Assignment of rating issues:

- If, as market reports suggest, the market requires "A -" or better ratings for reinsurer acceptability in an era of 100% collateral, why does the REO rating system permit a reduction of collateral for reinsurers that have lower ratings?
- How is the "strength of financial solvency regulation in the reinsurer's jurisdiction of domicile" to be determined?
  - How do you rate the strength of an untested system?
  - Are all US states going to be rated separately?
- Doesn't any draw on the collateral, either individual collateral or MBT collateral make the remaining collateral inadequate?
  - For example, assuming collateral is posted at 20% of liabilities, if a company draws 100% for a particular claim, isn't everything else – by definition – underfunded?
- How will failing reinsurers be able to post collateral increases as their ratings and financial prospects are dropping?
- Has consideration been given to the administrative difficulties for insurers and regulators this creates?

Does the proposal provide preferential treatment for Multiple Beneficiary trusts? If so, why?

- Are multiple beneficiary trusts receiving retroactive treatment as stated in Sections 4.A.I.i. and 4.B.IV)?
- Are multiple beneficiary trusts otherwise subject to the same collateralization standards?

We urge prudent regulators to answer these questions before deciding to change the system.