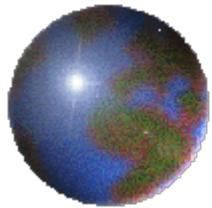


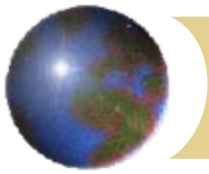
2008 SERA Conference

NAIC Reinsurance Modernization Proposal



*October 19, 2008
Orlando, Florida*

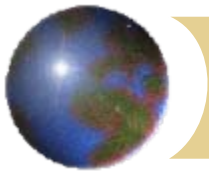
George Brady
NAIC International Counsel



NAIC Reinsurance Regulatory Modernization Proposal

Core principles of the proposal are:

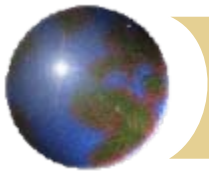
- **Flexible** to accommodate the rapidly changing reinsurance environment while providing for appropriate levels of financial **stability**, and solvency
- Facilitate cross-border transactions and enhance **competition** within the U.S. market while ensuring that U.S. insurers and **policyholders** are adequately protected



NAIC Reinsurance Regulatory Modernization Proposal

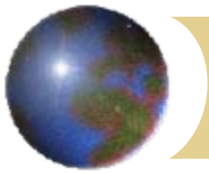
● Mutual Recognition

- A new NAIC entity called the Reinsurance Supervision Review Department (RSRD) would be established.
- Assessing regulatory effectiveness through an “**outcome-oriented**” approach, the RSRD would determine which non-U.S. jurisdictions are entitled to enter into mutual recognition agreements.



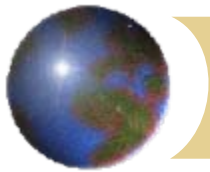
NAIC Modernization Proposal

- National Reinsurer: Single State U.S. Regulator – U.S. Reinsurers
 - Reinsurers would be licensed in one jurisdiction in order to access the U.S. market
 - minimum criteria established to qualify for single state regulatory approach done by RSRD



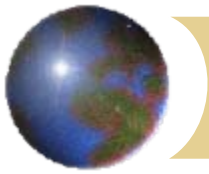
NAIC Modernization Proposal

- Port of Entry – Non-U.S. Reinsurers
 - Non-U.S. reinsurers from approved jurisdictions would be certified to access the U.S. market through one jurisdiction.
 - Become certified through a Port of Entry State
 - Post materially reduced collateral for appropriately rated reinsurers



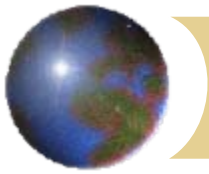
COLLATERAL REQUIREMENTS

- **Creates Alternative Credit for Cessions to Unauthorized Reinsurers (US and Non-US) Based On:**
 - **creditworthiness (ratings from 2 rating agencies)**
 - **a minimum net worth of \$250 million**
 - **an MOU and**
 - **required contract terms**
 - **unauthorized reinsurer required to post collateral if ceding company declared insolvent or rehab**









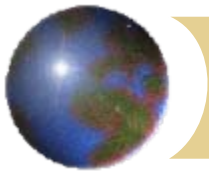
Reinsurance Modernization Proposal

- Establish appropriate collateral levels from zero to 100% based on rating and **other criteria on a prospective basis.**
 - Business practice of reinsurer
 - Slow pay reinsurers
 - Review audited financial statements
 - Any regulatory action against reinsurer



Reinsurance Modernization Proposal

 <u>Ratings</u>	<u>Collateral Required</u>
 Secure – 1	0%
 Secure – 2	10%
 Secure – 3	20%
 Secure – 4	75%
 Vulnerable – 5	100%



NAIC Modernization Proposal

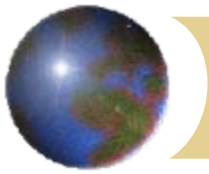
- Next Steps

- The NAIC reinsurance proposal passed at the Reinsurance task Force and E committee at the Fall NAIC in DC
- It will need to be passed at executive and plenary at December meeting
- Next steps after that will be implementation guidance and formation of RSRD and adoption in states



Why Are We Doing This?

- Reinsurance is a global financial service business
- Current model cannot be justified from a risk perspective
- Adds costs to the system that exceed the benefit provided
- Information systems and regulatory oversight has been enhanced since the current rules were put in place
- Reinsurance is a business-to-business transaction
- Collateral rules are intended to address solvency – we can do this without 100% collateral

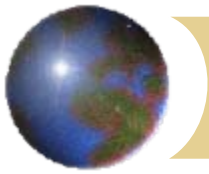


Potential Objections

● Too Much Reliance on Ratings Agencies

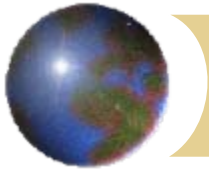
● Response

- ❑ Proposal requires \$250 million in capital
- ❑ Imposes due diligence on the ceding insurer, that might not have taken place with collateral
- ❑ Requires notification to department by ceding insurer if reinsurance portfolio is not well diversified and how they are managing that risk
- ❑ Added principle based standards for cessions to ALL reinsurers
- ❑ Recent concerns with rating agencies center around structured securities, not assessment of corporate credit



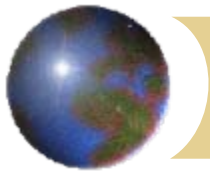
Potential Objections

- **Not Geographically Agnostic – Cessions to Licensed/Accredited Reinsurers Get Automatic Pass**
- **Response**
 - ❑ **Department has regulatory oversight over licensed/accredited reinsurers**
 - ❑ **Many direct licensed carriers assume some reinsurance – to impose collateral requirements on them would be a shock to the system**
 - ❑ **Proposal is giving a substantial benefit for cessions to qualified unauthorized reinsurers (i.E. Reduction in required collateral up to 90%)**
 - ❑ **Proposal adds principle based standards for cessions to ALL reinsurers**



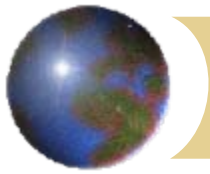
Potential Objections

- **US primary and reinsurers will likely oppose the proposals because:**
 - ❑ **(1) credit risk is now virtually eliminated by the collateral requirements;**
 - ❑ **(2) eliminates an advantage over their non-U.S. Counterparts**



Pros of Collateral Reduction

- Reinsurance Transactional Costs Will Be Reduced
- Worldwide Reinsurance Capacity Will Increase In An Amount Correlated To Frictional Cost Reduction
- While Cost Reduction May Not Be Significant Relative to the Amount Ceded Abroad, The Risk We Are Taking Is Not Significant
- Proposal Will Encourage Ceding Insurers To Assess The Credit Risk Of Reinsurers Before Entering Into Reinsurance Transactions



Pros of Collateral Reduction

- **May Spur Innovation in Securitizing Risk and In Expanding Secondary Market**
- **Establishes Consistency With Other Jurisdictions That Do Not Require Collateral**
 - The Regulation Requires Domiciliary Jurisdiction Of Reinsurers To Allow U.S. Reinsurers Access To Their Respective Market On Terms As Favorable As Those Set Forth In Proposal
 - Moves The N.Y. Model Towards International Standards

