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Re: Proposed Amendments to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786)—Implementation of the EU-U.S. Covered Agreement

Dear Mr. Stultz and Mr. Schelp:

The American Insurance Association ("AIA") thanks you for the opportunity to submit comments in response to the Reinsurance (E) Task Force's proposed amendments to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).[1] The proposed amendments are in response to the Bilateral Agreement between the United States and the European Union on Prudential Measures Regarding Insurance and Reinsurance ("Covered Agreement") and its impact on the model law and regulation.

AIA supports the proposed amendments to the model law and regulation and appreciates the efforts of the Task Force in promptly addressing the issues raised by the Covered Agreement. AIA's guiding principle during this process is the zero collateral option available to qualified EU reinsurers by the Covered Agreement should be extended to qualified reinsurers domiciled in other foreign jurisdictions but only if those jurisdictions provide reciprocal rights to U.S. insurers and reinsurers with mutual acknowledgment of prudential supervision. The goal is to adopt a framework that assures U.S. standards on group supervision and capital requirements are respected on a mutual basis, and U.S. state regulation of insurers is recognized internationally. The critical issue for AIA is to treat all qualified reinsurers domiciled in qualified jurisdictions in

[1] AIA represents approximately 320 insurers that write more than $125 billion in U.S. property-casualty premiums each year. Our membership includes U.S. insurers that write insurance only within the U.S., U.S. insurers that write insurance inside and outside the U.S., and the U.S. subsidiaries of multi-national insurers.

the same manner as reinsurers from EU qualified jurisdictions are treated, so long as the jurisdiction accepts and recognizes the U.S. insurance regulatory system and does not impose market restrictions on U.S. insurers and reinsurers.

The Task Force's proposal creating reciprocal jurisdictions appears to accomplish this goal. The proposed model law and regulation provide that certain qualified reinsurers domiciled and licensed in a reciprocal jurisdiction do not need to post collateral for the ceding insurer to receive financial credit for the reinsurance. The proposal defines a reciprocal jurisdiction as one that has either entered a treaty with the U.S. regarding credit for reinsurance or a non-treaty qualified jurisdiction that meets additional requirements. The additional requirements are that the foreign jurisdiction: 1) provides that an insurer with its head office or domicile in such qualified jurisdiction shall receive credit for reinsurance ceded to a U.S.-domiciled assuming insurer in the same manner as credit for reinsurance is received for reinsurance assumed by insurers domiciled in such qualified jurisdiction; 2) does not require a U.S. domiciled assuming insurer to establish or maintain a local presence as a condition for entering a reinsurance agreement or as a condition for the ceding insurer to recognize credit for the reinsurance; 3) provides that insurers and insurance groups that are domiciled or maintain their headquarters in a U.S. state shall be subject to only worldwide prudential insurance group supervision, including worldwide group governance, solvency and capital, as applicable by the commissioner of the domiciliary state and will not be subject to group supervision at the level of the worldwide parent undertaking of the insurance or reinsurance group; 4) provides that information regarding insurers, and their parent, subsidiary or affiliated entities shall be provided to the commissioner of the ceding insurer in accordance with a memorandum of understanding between the state commissioner and the qualified jurisdiction; and 5) other additional factors considered relevant by the state commissioner.

While AIA believes the ultimate goal should be the entry of additional U.S. bilateral agreements or accession to the existing covered agreement with the EU in some manner, with foreign jurisdictions outside the EU, in the absence of such agreements, an approach granting reciprocal jurisdiction status on jurisdictions recognizing U.S. state regulation of group supervision and capital requirements is appropriate. It is essential, however, that U.S. state regulators retain the authority and the will to ensure that only those foreign jurisdictions recognizing U.S. regulation of insurers on an international basis are accorded reciprocal status. Accordingly, while AIA supports the current proposed amendments, we wish to raise the following comments in response to certain provisions in the model law and regulation.

• *The Model Law's Definition of Reciprocal Jurisdiction Needs to be More Specific*: The proposed model law allows a ceding insurer to receive credit for reinsurance for cessions to a qualified reinsurer domiciled and licensed in a reciprocal jurisdiction without the posting of collateral by the reinsurer. The model law defines reciprocal jurisdictions as jurisdictions entering a treaty with the U.S. involving credit for reinsurance. The model law also permits non-treaty jurisdictions to be reciprocal jurisdictions. Unfortunately, the model law is mostly silent on the specific requirements for non-treaty jurisdictions, leaving those requirements to the proposed model regulation. The model law defines a reciprocal jurisdiction as any qualified jurisdiction (under the credit for reinsurance model law), which is not a party to a U.S. treaty relating to credit for reinsurance, "which meets certain additional requirements as specified by

the commissioner in regulation." Credit for Reinsurance Model Law, Proposed Section 2(F)(1)(a)(2). The specific requirements for a non-treaty jurisdiction to qualify as a reciprocal jurisdiction are subsequently set forth in the proposed model regulation at section 9(B)(2).

It is critical that if the zero collateral option is to be extended to reinsurers domiciled and licensed in jurisdictions that have not executed a treaty with the U.S., such foreign jurisdictions must recognize the U.S. standards on group supervision and capital requirements and must not impose any market access barriers on U.S. insurers and reinsurers. This requirement must be set forth in the model law and not be subject to subsequent regulations implementing the law. While AIA can understand the desire to set forth implementation specifics in the model regulation, at the very least the model law must include the standard of mutual respect and equal access to U.S. insurers and reinsurers to guide the implementing regulations. Otherwise, the law conceivably allows conferring of reciprocal status to non-treaty jurisdictions that fail to fully recognize U.S. state regulation of group supervision and capital standards and impose access restrictions to U.S. insurers and reinsurers. The model law needs to include specific language establishing this mutual respect of U.S. supervision and market access as a *sine qua non* of qualifying as a reciprocal jurisdiction. The model law also needs a specific provision authorizing the state regulator to review, and as necessary remove, reciprocal status on an ongoing basis.

• *Definition of Non-Treaty Reciprocal Jurisdiction*: Section 9(B)(2) of the model regulation includes the requirements for a qualified jurisdiction without a treaty to be eligible for reciprocal jurisdiction status. As stated above, the requirements of reciprocal jurisdiction status belongs in the model law rather than the regulation. In addition, subsection 9(B)(2)(c) requires modification. The subsection states the jurisdiction must: "Provide[] through statute, regulation or the equivalent in such qualified jurisdiction, that insurers and insurance groups that are domiciled or maintain their headquarters in this state or another jurisdiction accredited by the NAIC shall be subject only to worldwide prudential insurance group supervision including worldwide group governance, solvency and capital, and reported, as applicable, by the commissioner or the commissioner of the domiciliary state and will not be subject to group supervision at the level of the worldwide parent undertaking of the insurance or reinsurance group by the qualified jurisdiction." Read literally, the section suggests if an insurance group based in a foreign jurisdiction has an insurer domiciled in a U.S. state, the state commissioner would have worldwide supervision over the group. While we understand the intent of this section is to ensure that U.S. insurers and U.S. groups are subject to only U.S. capital and solvency supervision, and we support such intent, the proposed language may need a slight reworking.

• *Interplay between Certified and Reciprocal Reinsurer Status*: The proposal creates the category of a reciprocal reinsurer. By necessity, the model law and regulations, of course, retain the certified reinsurer category as well. Most reciprocal reinsurers presumably would also be, or at least previously have been, certified reinsurers. This dual status creates potential for ambiguity. A reinsurer presumably retains certified status even after attaining reciprocal status to handle legacy claims under reinsurance contracts entered previously. To eliminate potential confusion, the model law or regulation might specify how collateral is to be posted for certified reinsurers subsequently attaining reciprocal status and whether having obtained reciprocal status means that any such insurer must separately satisfy the requirements for a certified reinsurer each

year for historical assumed business. Likewise, the model law or regulation should clarify whether a reciprocal reinsurer, if it subsequently loses reciprocal status, may post collateral according to the certified reinsurer status it previously held.

• *Scope and Timing of Application of Reciprocal Status*: Proposed section 2(F)(7) states the reciprocal provisions "shall apply only to reinsurance agreements entered into, amended, or renewed on or after the [date of adoption of model revisions] and only with respect to losses incurred and reserves reported from and after the later of (i) the [date of adoption], or (ii) the effective date of such new reinsurance agreement, amendment, or renewal. This subsection shall not apply to reinsurance agreements entered into before the subsection's application, or to losses incurred or to reserves posted before the subsection's application."

AIA believes the word "amended" should be deleted from the proposed section. Allowing zero collateral to apply when a reinsurance agreement is merely amended, particularly if the amendment is minor or technical, could have severe unwanted financial consequences.

In addition, the triggering event for reciprocal status to apply to reinsurance contracts is not the date of adoption of the model revisions, but rather the date the reinsurer is qualified as a reciprocal reinsurer. For example, if a reinsurer's domiciliary jurisdiction is not classified as a reciprocal jurisdiction until 2024, only those contracts entered in or after 2024 should qualify for reciprocal status, even if the model is enacted in 2019. Otherwise, the change in collateral status is being applied retroactively to reinsurance agreements entered prior to the reinsurer's reciprocal rating.

Also, the language in the section regarding application of the section only to "losses incurred or to reserves reported/posted from and after the later of" the subsection's application poses problems for agreements that may be entered into after reciprocal status is obtained by the reinsurer but covering losses incurred or reserves posted prior to such status having been obtained, including adverse development covers and loss portfolio transfers. These agreements can relate to long tail claims occurring in the past but with the agreement signed after the losses have occurred or reserves reported/posted. To deal with these types of agreements and to better reflect the intent of this provision, the language could be modified as suggested below:

Proposed section 2(F)(7) may be modified as follows:

"This subsection shall apply only to reinsurance agreements entered into~~**, amended,**~~ or renewed on or after the [~~**date of adoption of model revisions**~~ **date of granting reciprocal status to the applicable assuming insurer**] and only with respect to losses ~~**incurred and reserves reported**~~ **ceded** from and after the later of (i) the [~~**date of adoption**~~ **date of granting reciprocal status to the applicable assuming insurer**], or (ii) the effective date of such new reinsurance agreement~~**, amendment,**~~ or renewal. This subsection shall not apply to reinsurance agreements entered into before the subsection's application, or to losses ceded ~~**incurred or to reserves posted**~~ before the subsection's application."

• *Requesting Information Beyond Scope of Treaty*: The model law includes a provision, at section 2(F)(1)(h), that the commissioner may request the reciprocal reinsurer to "satisfy any other

requirements deemed relevant by the commissioner." The section further provides that if such information request is beyond the scope of a treaty relating to credit for reinsurance, "the failure to satisfy such other requirements will not alter the ability of the ceding insurer to take credit for such reinsurance." This proposed language is somewhat confusing and, to an extent, places the ceding insurer in limbo as the issue becomes whether the ceding insurer may or may not take credit for reinsurance when an information request beyond the permissible scope of a treaty is made upon the reinsurer. To clear up potential confusion, the model law should simply provide the commissioner shall not require any additional information inconsistent with an executed treaty. In the alternate, the model law could state the reinsurer need not produce additional information if such information request is inconsistent with the treaty. Any loss of credit for reinsurance should be predicated upon removal of the reinsurer from the list of reinsurers with reciprocal status in the jurisdiction which necessarily in turn is based upon, among satisfaction of the other conditions, whether such reinsurer has provided all required information to the extent it may be required.

•*Affiliate Transactions*: The credit for reinsurance model regulation provisions pertaining to certified reinsurers includes a provision clarifying how certified reinsurer cessions to affiliates are to be treated for credit for reinsurance purposes. Section 8(A)(2) of the model regulation provides "Affiliated reinsurance transactions shall receive the same opportunity for reduced security requirements as all other reinsurance transactions." Adding a similar provision in the reciprocal jurisdiction section of the model regulation would clarify whether reciprocal reinsurer cessions to affiliates are to be treated in a similar manner.

• *Reciprocal Jurisdiction Requirements*: Section 9(C) of the model regulation provides "Credit shall be allowed when the reinsurance is ceded to an assuming insurer meeting each of the conditions set forth below." The subsections then set forth various requirements the reinsurer must meet to qualify for zero collateral. The requirements are modeled after the requirements set forth in the Covered Agreement. This creates a potential problem if treaties are subsequently entered with other countries and the terms do not mirror those in the Covered Agreement. The proposal should contain some flexibility to handle subsequent treaties. Otherwise, the model law and regulation may need constant revision. A new proposed section could clarify that reinsurer requirements are to be consistent with any subsequent U.S. treaty relating to credit for reinsurance.

• *Posting of Collateral in Liquidation or Rehabilitation*: Proposed section 2(F)(5) of the model law provides "The commissioner shall require" a reciprocal reinsurer to post 100% collateral for the benefit of the ceding insurer or its estate upon entry of an order of rehabilitation, liquidation, or conservation against the ceding insurer. The mandatory nature of the posting of 100% collateral is inconsistent with the Covered Agreement. The Covered Agreement provides that 'if subject to a legal process of resolution, receivership, or winding up proceedings…,the ceding insurer, or its representative, may seek, and if determined appropriate by the court in which the resolution, receivership, or winding up proceedings is pending, may obtain an order requiring that the assuming insurer post collateral for all outstanding ceded liabilities." Covered Agreement, Article 3, Section 4(k). The model law should reflect the permissive nature of the Covered Agreement that the ceding insurer or the estate may request full collateral and the receivership court shall review and determine the request.

• *Definition of Reciprocal Jurisdiction Based on Treaty*: Section 9(B)(1) of the model regulation defines reciprocal jurisdictions based on entry of a treaty with the U.S. relating to credit for reinsurance. The section defines a reciprocal jurisdiction, in part, as "A non-U.S. jurisdiction that has entered into a treaty or international agreement with the United States regarding credit for reinsurance, all of the terms of which are relevant to credit for reinsurance are in effect, including an agreement entered into pursuant to [Dodd–Frank Wall Street Reform and Consumer Protection Act, 31 U.S.C. § 314]." This language is somewhat unclear and potentially suggests that *all* the terms of the treaty must relate to credit for reinsurance. It might be better to modify the language as follows: "A non-U.S. jurisdiction that has entered into a treaty or international agreement with the United States regarding credit for reinsurance, all of the terms of which **that** are relevant to credit for reinsurance are in effect, including an agreement entered into pursuant to [Dodd–Frank Wall Street Reform and Consumer Protection Act, 31 U.S.C. § 314]."

• *Suspension or Revocation of Status as a Reciprocal Reinsurer*: Section 9(F) of the model regulation discusses suspension and revocation of reciprocal reinsurer status. While the proposed regulations provide the commissioner is to give the reinsurer 30 days to remedy any alleged defect in the reinsurer's status as a reciprocal reinsurer and requires the commissioner to wait an additional 90 days to determine whether to deny statement credit for reinsurance for the ceding insurer and require the posting of collateral by the reinsurer, the regulation should give the commissioner discretion to allow a longer grace period for the ceding insurer to retain statement credit and for the reinsurer to remedy the alleged defect and/or post collateral. Elimination of credit all at once for a reinsurer's ceding insurers could have a significant financial impact on U.S. ceding insurers. In addition, reinsurers losing reciprocal status may not be in a position to immediately post full collateral on all their existing agreements. The model should provide commissioners discretion to temporarily delay sanctions and provide extended compliance periods for the reinsurer where immediate application of sanctions would be unfair to the parties or would pose a risk of unnecessary financial stress. The model should also specifically state whether a revocation of reciprocal status applies retroactively to existing agreements as well as prospectively to new and renewal agreements.

• *Treatment of Solvency Ratio for Associations*: Section 9(C)(3)(c) of the model regulation sets forth eligible solvency ratios for reinsurers that are associations, including incorporated and individual unincorporated underwriters. The section provides that the association must have a solvency ratio of 100% SCR under Solvency II or a Risk-Based Capital of 300% of the authorized control level. It is not specified whether the solvency level must be maintained across the entire syndicate or on a syndicate by syndicate basis.

• *Solvency and Capital Ratios*: Section 9(C)(3)(d) of the model regulation relates to solvency and capital ratios for eligible reciprocal reinsurers. After stating the commissioner has discretion to apply different ratios for other jurisdictions as applicable, the section further states"…provided that to the extent that information or agreement is not required by a treaty or international agreement referred to in [cite state law equivalent of Section 2(F)(1)(a)(i) of the Credit for Reinsurance Model Law], the failure to satisfy such other requirements will not alter the ability of the ceding insurer to take credit for such reinsurance." This language appears misplaced as neither the section nor the subsection relates to the providing of information by the

reinsurer. The language may more properly belong in Section 9(C)(5). Moreover, as discussed above in connection with section 2(F)(1)(h) of the model law, the proposed language in question is somewhat confusing and, to an extent, places the ceding insurer in limbo as the issue becomes whether the ceding insurer may or may not take credit for reinsurance when an information request beyond the permissible scope of a treaty is made upon the reinsurer. The language should provide either that the commissioner shall not require any additional information inconsistent with an executed treaty or that the reinsurer is not required to provide information inconsistent with an applicable treaty.

• *Solvent Schemes of Arrangement*: Section 2(F)(1)(d)(v) of the model law requires a reciprocal reinsurer include a representation that it is not presently participating in a solvent scheme of arrangement involving the state's ceding insurers and that it will provide 100% collateral should the reinsurer subsequently enter into such a solvent scheme of arrangement. The model law or regulation should define the scope of solvent schemes of arrangement to provide clarity regarding what type of reorganizations trigger the additional collateral requirements. For example, so-called Part VII transfers might be considered similar to solvent schemes. While the use of solvent schemes in the model law and regulation likely refer solely to fixed commutations of liabilities rather than Part VII transfers of liabilities to a different entity, clarification would be helpful. Moreover, to the extent Part VII liability transfers actually are contemplated within the meaning of a solvent scheme of arrangement, would any additional collateral be required if the transfer were to another qualified EU reinsurer or a reinsurer in another reciprocal jurisdiction? Additional collateral would not seem necessary if the reorganization or transfer was simply to another reciprocal reinsurer. As to solvent schemes functioning as commutations, the proposal should state whether the amount of liabilities for collateral purposes is to be determined by the ceding insurer, by the domiciliary regulator, or by the scheme itself?

• *Prompt Payment of Claims Calculation*: Section 9(C)(6)(b) of the model regulation calculates a reinsurer's practice of prompt payment by, among other factors, reference to the number of overdue reinsurance recoverables of 90 days or more in the amount of "$100,000 or its equivalent calculated by reference to foreign currency exchange rates compiled from key data contributors and established as of the preceding December 31." The Covered Agreement, however, establishes this requirement at a stable, non-floating, 90,400 Euro. Covered Agreement Article 3 Section 4(i)(ii). For EU reinsurers, at least, the regulation should set the threshold at 90,400 Euro. In addition, the regulation does not define "key data contributors."

• *Prompt Payment of Claims Calculation Aggregate Recoverable Amount*: Section 9(C)(6)(c) of the model regulation calculates a reinsurer's practice of prompt payment by whether the aggregate amount of overdue reinsurance recoverables of 90 days exceeds "$50,000,000 or its equivalent calculated by reference to foreign currency exchange rates compiled from key data contributors and established as of the preceding December 31." The Covered Agreement, however, establishes this requirement at a stable, non-floating, 45,200,000 Euro. Covered Agreement Article 3 Section 4(i)(ii). For EU reinsurers, at least, the regulation should set the threshold at 45,200,000 Euro. In addition, the regulation does not define "key data contributors."

AIA thanks you for the opportunity to offer comments on the proposed credit for reinsurance model law and regulation amendments and looks forward to continuing to work with the NAIC and all interested stakeholders during this process.

Sincerely,

Steven Bennett
Associate General Counsel
American Insurance Association