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BY ELECTRONIC MAIL

Mr. Jake Stultz
Senior Accounting Policy Advisor
National Association of Insurance Commissioners
1100 Walnut Street
Kansas City, MO 64016-2197

Re: Credit for Reinsurance Model Law and Regulation and the Covered Agreement between the United States and the European Union

Dear Mr. Stultz:

The American Insurance Association ("AIA") thanks you for the opportunity to submit comments with respect 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 amending the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786).[1] AIA's comments are necessarily preliminary and contingent in the absence of a specific proposal regarding amending the credit for reinsurance model law and regulation. Our comments set forth a general overview of principles as the starting point for discussions. AIA looks forward to working with the NAIC and interested stakeholders to design a solution to ensure open insurance markets with financial stability and reciprocal treatment for all insurers and reinsurers.

AIA supports the Credit for Reinsurance Model Law and Regulation and continues to work for the model law's enactment in the states. The model is a success, with adoption in the overwhelming majority of the states. While the credit for reinsurance model and the concomitant reduction in collateral levels was very controversial at first, no known adverse financial results have ensued from the lowering of mandatory collateral. Reinsurance capacity for the U.S. ceding market is sufficient and the lowering of the 100% collateral requirement has not resulted in any reported financial stress for U.S. ceding insurers.

AIA likewise supports the Covered Agreement negotiated and signed by the U.S. and the EU. The Covered Agreement eliminates discriminatory measures against U.S. insurers and reinsurers, ensures a significant degree of market access, increases U.S. competitiveness, and boosts the

[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.

international standing of the U.S. state-based insurance regulatory system. The Covered Agreement establishes mutual acknowledgement of prudential supervision in the EU and the U.S., effectively eliminating barriers in Europe that U.S. groups faced since the implementation of the EU Solvency II framework for insurance supervision.

• *Potential Scope of Amending the Credit for Reinsurance Model*

The Covered Agreement prohibits states from requiring EU reinsurers to post collateral only if the reinsurer meets certain financial and other requirements. These reinsurer requirements under the Covered Agreement follow the requirements for certified reinsurer status under the credit for reinsurance model law and regulation. For example, the Covered Agreement allows an EU reinsurer to benefit from zero collateral only if the reinsurer maintains a capital and surplus minimum of $250,000,000, maintains a practice of prompt payment of claims and confirms it is not presently participating in a solvent scheme of arrangement involving U.S. ceding insurers. The EU reinsurer must also submit annual financial statements and actuarial opinions, as well as a list of overdue reinsurance claims outstanding for more than 90 days. All these requirements are consistent with the requirements for certified reinsurers under the model law and regulation.

As outlined in the Notice of Public Hearing, there are three potential methods for amending the credit for reinsurance model in response to the Covered Agreement. The zero collateral option could extend to only EU reinsurers qualifying under the Covered Agreement. Zero collateral could apply to qualifying reinsurers from foreign jurisdictions covered by potential future covered agreements. Alternatively, zero collateral could extend to all qualified reinsurers domiciled in NAIC qualified jurisdictions.

• *AIA Position on Scope of Zero Collateral Option*

AIA's guiding principle for these discussions is that a zero collateral option should be potentially available for qualified reinsurers domiciled in jurisdictions providing reciprocal rights to U.S. insurers and reinsurers with mutual acknowledgement of prudential supervision. The goal is to adopt an approach 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 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.

Extending zero collateral to all similarly qualified reinsurers domiciled in qualified jurisdictions has the benefit of adding uniformity and clarity to credit for reinsurance laws. The financial and claims paying standards set forth in the Covered Agreement for defining qualified reinsurers offers protections recognizing that only responsible and secure reinsurers would be eligible for zero collateral. AIA can support extending zero collateral to all similarly qualified reinsurers domiciled in qualified jurisdictions provided the jurisdiction recognizes the U.S. standards on group supervision and capital requirements, and does not impose market access barriers on U.S. insurers and reinsurers that would be inconsistent with the Covered Agreement.

While extending zero collateral to all qualified reinsurers may be the ideal, the Covered Agreement did represent a *quid pro quo* negotiated agreement, where zero collateral was leveraged to obtain EU recognition of U.S. prudential measures, including group supervision standards and capital and solvency requirements. The Covered Agreement provides U.S. insurers and reinsurers with significant market access guarantees in the European Union, as well. Extending zero collateral to all qualified reinsurers domiciled in NAIC-approved qualified jurisdictions without some type of binding, international reciprocal agreement or understanding between the jurisdictions, does risk forfeiting the leverage of collateral without obtaining mutual recognition between the foreign jurisdiction and the U.S. system of insurance supervision. This leverage issue could be addressed by amending the definition of qualified jurisdictions under the credit for reinsurance model to restrict it to only those jurisdictions that recognize U.S. standards on group supervision and capital requirements, and do not impose market access barriers on U.S. insurers and reinsurers.

Potential problems surfacing from a foreign jurisdiction's treatment of U.S. insurers or reinsurers may be largely unknown now. For example, the problems U.S. group insurers faced as a result of the EU's Solvency II initiative were not known when the Covered Agreement was initially being discussed. There potentially may be future unknown issues arising between the foreign jurisdiction and the U.S. over insurance regulation.

One approach to the potential *quid pro quo* issue is to extend zero collateral only to those qualified reinsurers domiciled in qualified jurisdictions entering a covered agreement with the U.S. similar to the U.S-EU Covered Agreement that mutually acknowledges the prudential supervision of both jurisdictions' regulation of insurance. The drawback to this approach is it may not be realistic to wait for additional separate covered agreements to be negotiated and signed in the near future. Demanding a covered agreement to be negotiated and executed could also reduce the degree of uniformity in the treatment of the various qualified jurisdictions.

Another approach would allow qualified jurisdictions an opportunity to accede to the existing U.S.-EU Covered Agreement. Though the Dodd-Frank Act does not specifically reference the possibility of a country acceding to an existing covered agreement, it does give the federal government the authority to enter into covered agreements with multiple countries. We believe a third party could accede to the existing U.S.-EU Covered Agreement through all three parties signing an instrument of accession by which the third party, the U.S. and the EU agree to apply the recognition and requirements of the Covered Agreement to each other, including the mutual acknowledgement of the parties' regulatory systems that is part of the Covered Agreement.

An advantage to this approach is it would likely increase the number of foreign jurisdictions recognizing the mutual standards of the Covered Agreement, and would do so in a legally binding international agreement between sovereign entities. In addition, it would reduce the time and resources required to negotiate new covered agreements. Allowing other parties to accede to the existing Covered Agreement is consistent with the Dodd-Frank Act and international law. One potential negative implication of an accession approach is that mere accession to the standards of the U.S.-EU Covered Agreement might not address a regulatory issue unique to a specific jurisdiction.

In contrast to requiring actual accession to the U.S.-EU Covered Agreement, another approach might be to revise the definition of qualified jurisdiction in the credit for reinsurance model to require that a qualified jurisdiction must also provide mutual recognition, open markets for U.S. insurers and reinsurers, and reciprocal rights similar to those set forth in the U.S.-EU Covered Agreement. The process for certifying qualified jurisdictions would permit public comment by U.S. insurers and reinsurers regarding whether the jurisdiction creates artificial barriers to U.S. insurers and reinsurers and include regular reviews of whether the jurisdiction did provide mutual recognition, open markets and reciprocal rights. This process would grant flexibility for regulators to consider any future access problems that might develop in the jurisdiction.

• *Criteria for Evaluating Qualified Jurisdictions*

The Notice of Public Hearing also requests suggestions regarding the criteria for determining a "qualified jurisdiction" under the credit for reinsurance model. Pursuant to the current model law, a state commissioner is to evaluate "the appropriateness and effectiveness of the reinsurance supervisory system of the jurisdiction and "the rights, benefits and the extent of reciprocal recognition afforded … to reinsurers licensed and domiciled in the U.S." Qualified jurisdictions must agree to share information and cooperate with the commissioner with respect to the certified reinsurer. A jurisdiction may not be a qualified jurisdiction if it does not enforce final U.S. judgments and arbitration awards.

If the model is amended to allow all qualified reinsurers domiciled in a qualified jurisdiction to post zero collateral, qualified jurisdiction status should be modified to clarify that only those jurisdictions agreeing to mutual recognition, open markets, and reciprocal rights similar to those set forth in the US-EU Covered Agreement are eligible to be qualified jurisdictions.

• *Additional Guardrails Based On Zero Collateral*

The Notice of Public Hearing further asks interested stakeholders to consider additional "guardrails" relative to U.S. ceding insurers to help address increased financial solvency risks caused by the elimination of collateral.

Additional guardrails may be unnecessary and even counter-productive. It is worth noting that lowering the collateral standard from the 100% requirement was considered controversial and risky by many when introduced by the revised credit for reinsurance model in 2011. Yet, despite the lowering of collateral, there has not been any reported evidence of financial solvency concerns with ceding insurers directly resulting from the lowering of collateral. In addition, as noted, zero collateral would apply only to those reinsurers meeting the financial and other standards set forth in the Covered Agreement. Those reinsurers would also have to be domiciled in qualified jurisdictions with effective reinsurance supervisory systems and acceding to the prudential supervisory standards of the Covered Agreement. In such a scenario, placing unnecessary "guardrails" on U.S. ceding insurers would risk lowering available capital in the market, impair open reinsurance markets, and perhaps discourage ceding insurers from purchasing reinsurance.

While there is no specific proposal outlining the nature of the "guardrails," the Covered Agreement prohibits states from adopting requirements that would have substantially the same impact on the foreign reinsurer as existing collateral requirements being eliminated pursuant to the Covered Agreement. In other words, any proposed "guardrail" proposal applied alternatively to the U.S. ceding company customers of an EU reinsurer that even indirectly results in differentiated, unfair treatment of that reinsurer would be subject to possible federal preemption.

The NAIC's Financial Condition ("E") Committee circulated a proposed Contingency Plan Regarding Consumer Protection Collateral in the fall of 2016. While the "guardrails" under current discussion have not been specified, to the extent they parallel the prior contingency plan, AIA refers to the December 14, 2016 letter it filed with the NAIC together with other joint insurance trade associations. The joint trades' letter notes the contingency plan was only in outline form and lacked specifics, making it "impossible to determine how adoption of such a plan would work in practice."

The joint trades' letter raised the following questions in reference to the contingency plan that would likewise need to be resolved prior to full consideration of a guardrails proposal:

• Status of current credit for reinsurance laws and whether financial statement credit would continue for cessions.

• Whether insurers could still negotiate for collateral and if they did, whether the insurers would receive financial statement credit for the reinsurance.

• Whether the contingency plan or the new guardrails would apply prospectively only or have retroactive application to existing reinsurance contracts.

• The scope of the guardrails. For example, whether the guardrails would apply only to those reinsurance agreements with qualifying reinsurers eligible for zero collateral or whether the guardrails would apply to all of an insurer's reinsurance agreements.

• How alternative risk transfers would be treated under the guardrail system.

•Whether federal preemption might apply if the guardrails replace collateral by adopting substantially similar requirements.

While the "guardrail" discussion in the Notice of Public Hearing mentions "additional 'guardrails' relative to U.S. ceding companies," – a suggestion that AIA would not support-- the NAIC may want to consider guidance increasing transparency and efficiency in the reinsurer transaction. If collateral is to be eliminated through the qualifying jurisdiction process, it is important that the ceding insurer has knowledge of the financial strength of the reinsurer with whom it is contracting. For example, transparency regarding the reinsurer's catastrophe program, including how it controls its exposures to catastrophe risk, its exposures to catastrophe risk, and its retrocession program could aid ceding insurers in making informed decisions.

• *Other Covered Agreement Considerations*

The Public Notice invites interested stakeholders to offer other considerations relating to states' implementation of the Covered Agreement. AIA offers the following issues for additional consideration:

1) The Covered Agreement (at Article 3 Paragraph 4) references reporting requirements permissible "if requested by the supervisory authority." It should be clarified this means a supervisory authority may exercise its discretion via its annual reporting requirements – similar to the requirements in the current certified reinsurer regulations and the certified reinsurer checklist. Regulators should not be able to make these sorts of requests on an ad hoc basis. Instead, to the extent regulators do request such reports, they should remain part of the regulatory process and framework.

2) The Covered Agreement (at Article 3 Paragraph 6) discusses the manner in which a supervisory regulator may determine that a EU reinsurer no longer qualifies for zero collateral. The language is not very specific. The model law may wish to detail the process for "de-certifying" a reinsurer previously qualified for zero collateral.

3) The Covered Agreement (at Article 4) refers to measures that a host supervisor cannot take vis-à-vis the worldwide group from the home jurisdiction. As the NAIC is well aware, AIA has a long-standing public policy principle that indicates that an insurer should only be subject to group supervision by a single jurisdiction.

AIA thanks you for the opportunity to offer preliminary comments 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