



AMERICAN ACADEMY *of* ACTUARIES

September 1, 2011

Commissioner Thomas B. Considine
Reinsurance (E) Task Force
National Association of Insurance Commissioners
Via email: RCouch@NAIC.org , Dschelp@NAIC.org

Re: NAIC 7/26/11 Exposure Draft of the Credit for Reinsurance Model Law (#785) and Regulation (#786) (“Model”)

The American Academy of Actuaries¹ (Academy) Reinsurance Subcommittee offers the following comments on the July 26, 2011 exposure drafts of proposed amendments to the Model.

Actuarial reserves are required to make adequate provision for all future insurance obligations of the insurer. When setting reserves, the impact of reinsurance is considered integral.

As currently proposed, the exposed draft of the Models would require actuaries to dynamically adjust the amount of reserve credit taken based upon reinsurer rating changes when there is a lack of sufficient credible historical experience:

- on the variation in ratings of reinsurers,
- the impact that changes in those ratings will have on their claims paying ability and
- the impact that the Models’ call for a increase in collateral upon a downgrade will have on the reinsurer

While this is customarily done with assets when performing reserve adequacy testing, there are far fewer data points available to the actuary to make a reasonable estimation of the potential effects of the items bulleted above.

We therefore suggest that the use of actuarial judgment be permitted to make the required adjustment based upon the best available market information, actuarial standards and common actuarial practice as outlined in applicable actuarial practice notes and not be constrained by overly restrictive regulatory language.

In addition, we have two other areas of concern with the Models:

¹ The American Academy of Actuaries (“Academy”) is a 17,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

- With the experience of the financial uncertainty of past few years, we are concerned, should similar circumstances re-occur, it might be difficult for reinsurers to find adequate collateral in times of falling values. Discretion should be granted Commissioners to allow reserve credit even if collateral requirements are not met so long as regulators deem that the reinsurance is still collectible.
- A reinsurance agreement negotiated between two parties should allow the cedant to choose an arrangement that anticipates that their financial statement will show no impact of the reinsurance agreement. If a cedant does not take reinsurance credit, the agreement should be exempt from any requirements as to the Model Law’s required language regarding the adequacy of funding of required collateral.

Required Collateral. As currently written, the proposal has the potential for creating financial volatility in the insurance industry due to the possible downgrade of one or more certified reinsurers or a drop in the value of collateral. There could be wide swings in reserves due to certain cash flow testing scenarios failing as a result of loss of reserve credit even in situations where the current status of the reinsurer is in line with requirements. To address this volatility, regulators should have authority to continue to allow discretionary reserve credit even if collateral becomes technically insufficient, but the reinsurance is still deemed collectible.

To accomplish this, the task force should consider expanding the commissioner’s authority to exercise discretion to protect the cedant’s policyholders and maintain a stable insurance market. That discretion could also be useful to regulators who seek to moderate the pro-cyclical effects of economic downturns on the U.S. insurance market. Using the collectability of the reinsurance recoverable as a primary determinant of reinsurance reserve credit would bring the process closer in line with what the actuary does in setting GAAP reserves today. As an example of how this could be accomplished, we refer you to the New York Insurance Department’s recent amendments to 11 New York Codes Rules and Regulations (NYCRR) 125 for your consideration as appropriate safeguards in the exercise of an essential broader discretion.

Section 2 E (5) (e) in the current draft of the Model Law does give the commissioner some flexibility to proceed with a certified reinsurer rating when certification has been terminated due to suspension or inactive status, but we believe it is important to allow discretion in other circumstances as well.

This issue could be addressed by inserting a sentence modified from 11 NYCRR Section 125.4(h) (7) at end of Section 2 E (5) (d) of the draft Credit for Reinsurance Model Law as follows:

“Notwithstanding the insufficiency of such security, the commissioner may, in the interest of ensuring market stability and the solvency of the ceding insurer, upon request by the ceding insurer, authorize the ceding insurer to continue to take credit for the reinsurance recoverable, or part thereof, for some specified period of time following such change or withdrawal, unless the reinsurance recoverable is deemed uncollectible.”

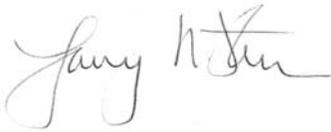
Required Reinsurance Contract Provisions. Section 8 E of the Model Regulation requires that reinsurance contracts include a Mandatory Funding Clause. However, we believe parties should

be free to agree on a contract for reinsurance under which the ceding insurer does not intend or expect to show any impact of the reinsurance agreement in their statutory financial statements. Therefore, it should be made clear the Mandatory Funding Clause should not be required in situations where there is no statutory financial statement impact.

Managing the risk of an enterprise does not always require reinsurance reserve credit be an integral portion of the transaction. Reinsuring tail risk, for example, only meets the qualifications to be able to take reserve credit when the coverage is “in the money”. Since these agreements, while potentially important, will only come “in the money” in very rare occasions, it seems unnecessary to burden the reinsurance agreements with additional required language that the draft Model now requires.

We would be happy to participate in further discussions on this issue. If you have any questions, please contact Tina Getachew, Senior Policy Analyst, Risk Management and Financial Reporting Council by phone (202/223/8196) or email getachew@actuary.org.

Sincerely,

A handwritten signature in cursive script that reads "Larry Stern".

Larry Stern
Chair, Reinsurance Subcommittee
Risk Management and Financial Reporting Council
American Academy of Actuaries