

*November 7, 2008  
Washington, D.C.*

***IIF ANNUAL SYMPOSIUM***

**Making the Economy Safe for Cross-Border  
Reinsurance: The RISSEB Alternative**

**L. Charles Landgraf**  
*Partner*  
*Dewey & LeBoeuf LLP*

# Present Reinsurance Situation: Distinction Between US and Rest of the World

- **US Ceding Insurers**

- place reinsurance with **US** reinsurers and take asset credit without requiring collateral based on the value of US license
- expect collateral from **all Non-US** reinsurers - irrespective of their security because of the present State-based credit for reinsurance requirements; i.e., top European reinsurers treated same as (hypothetical) "Taliban Re"

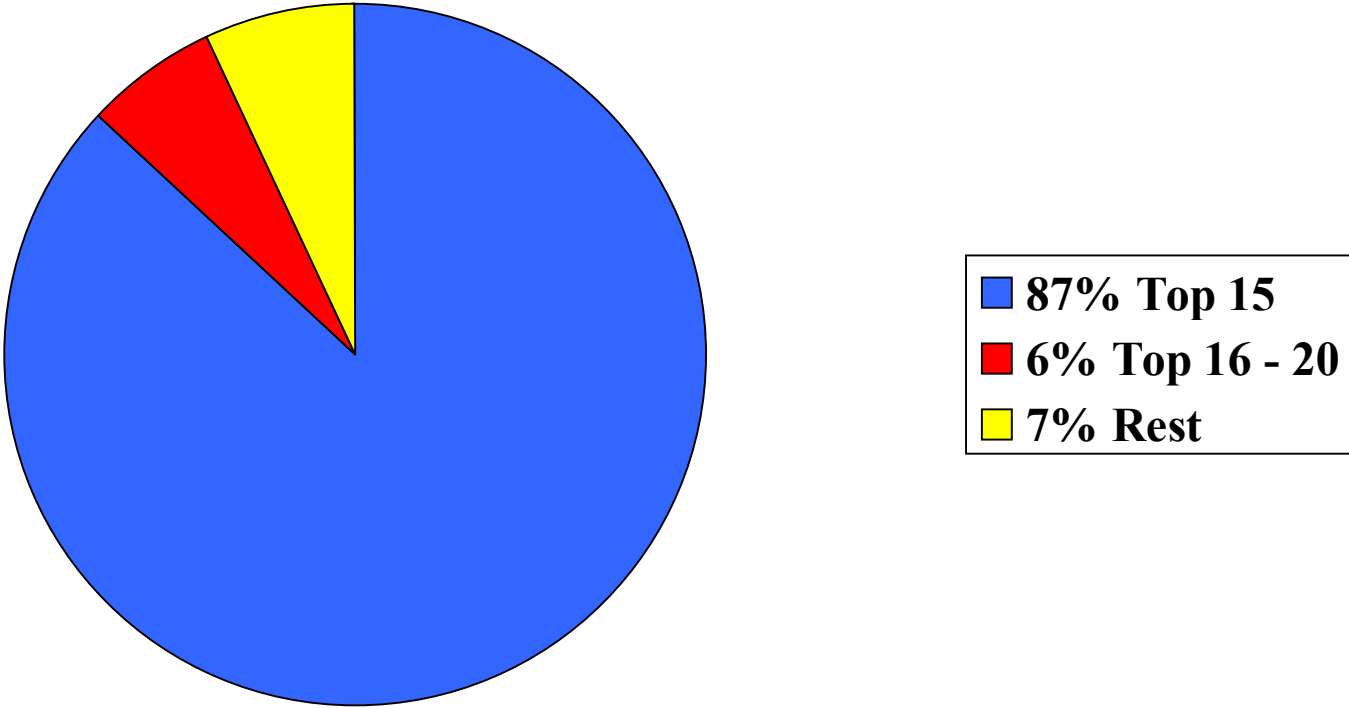
- **Non-US Ceding Insurers**

- don't distinguish between domestic and non-domestic reinsurers, rather consider quality, including of home-state supervision
- may require collateral as a commercial matter on a case by case basis - depending on the reinsured business and the security of the reinsurer

# Structure of Global Reinsurance

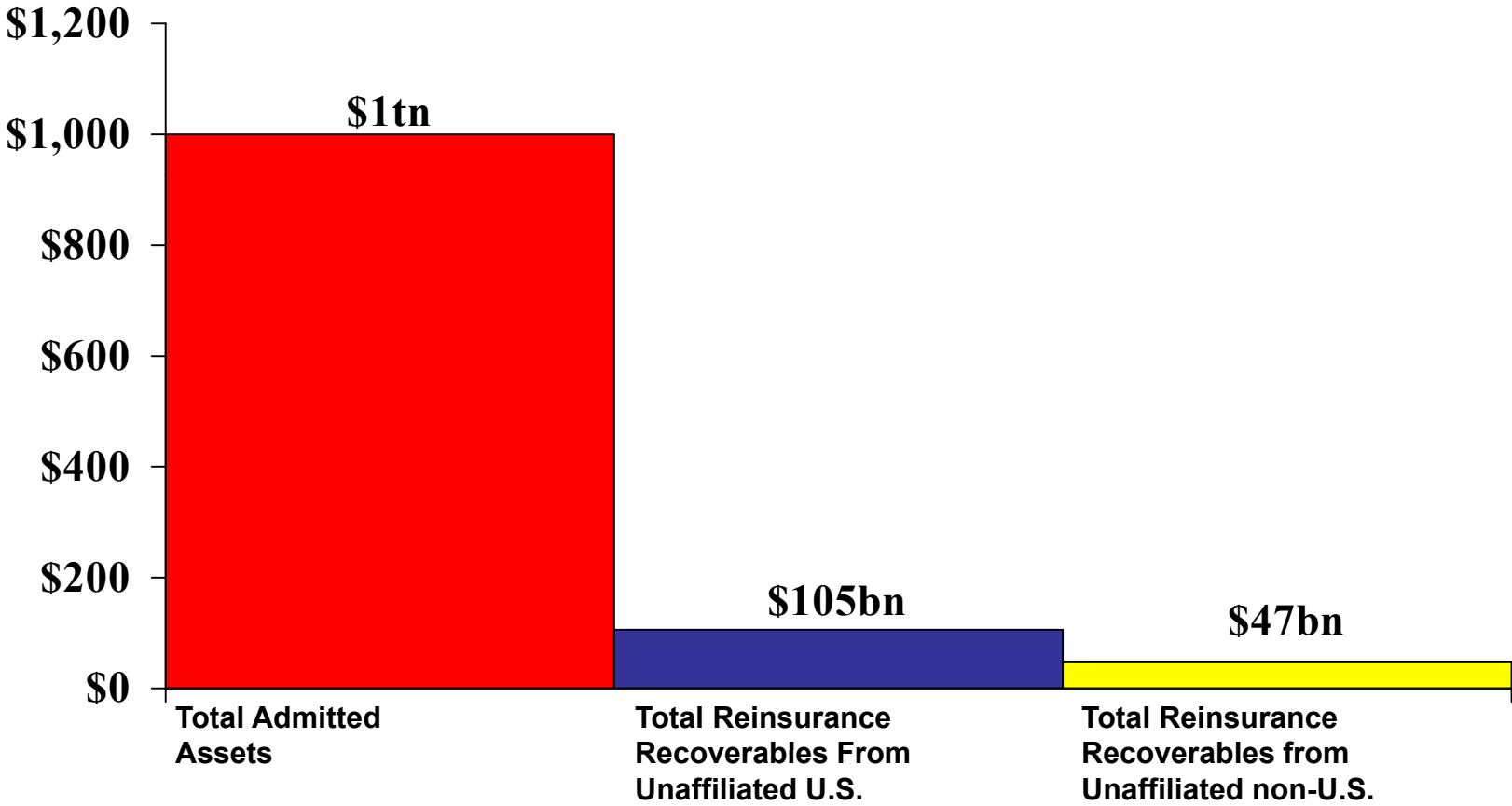
- Most major reinsurers underwrite a great part of their worldwide business from their home-country offices.
- Almost everywhere the regulatory environment allows an operation from a single headquarters without—
  - any conditions or restrictions, or
  - reporting or capitalization requirement, or
  - even any collateral requirements.
- If a major reinsurer opens (or acquires) branches or subsidiaries, it is done—
  - to build up a presence in a market,
  - to achieve closer contact to cedents, and
  - to better service them in their market.

# Reinsurance Recoverables Concentrated in High Quality Reinsurers



Source: Swiss Re, sigma No. 5/2003

# Non-Affiliated Reinsurance Credit Exposure of U.S. P/C Industry



Source: Best's Aggregate & Averages – Property/Casualty, United States and Canada  
2003 Edition and 2003 Supplement

## Current U.S. Credit for Reinsurance Rules

- If it is U.S., it is 100% safe
- If it is non-U.S., it is 100% unsafe
- Neither statement is correct
  - Many of the oldest, largest, strongest reinsurers are non-U.S.
  - U.S. P/C insolvencies:
    - 2001 = 24
    - 2002 = 28
    - 2003 = 20

# European Approach

- European insurers and reinsurers, with support of their supervisors, use a **Risk Based Collateral Approach** when placing their outward reinsurance/retrocession programs.
- This approach requires active management of counterparty risks.
- **Prior** to placements—
  - selection of reinsurers according to their security and payment behaviour
- **Placements** with secure and reliable reinsurers taking account of geographic and cumulative diversification needs
- **After** placements—
  - Further continuous monitoring of reinsurers security and payment behaviour
  - Early intervention when problems occur, e.g.
    - ❖ Requirement of collateral
    - ❖ Or strategy to collect and offset balances or commute

# Issues Presented by Current U.S. System

- Collateral undoubtedly provides a level of security (at a cost) but may give a **false sense of security**.
- Collateral only secures:
  - Known claims (up to the amount reserved); and
  - IBNR if collateralized (up to the amount estimated and reserved).
  - Therefore, it is no cure for **new** or **non-reserved** claims which the cedent does not show in its balance sheet yet (reserve deficiencies)
- In case of a major **catastrophe**—
  - no collateral will have been posted to secure reserving and support claims payments
  - collateral has to be established and first payments have to be made at the same time

## Issues Presented by Current U.S. System (continued . . .)

1. Cedent might choose its reinsurer just because of the collateral provided.
2. Cedent may not conduct an independent review of the solvency and stability of the reinsurer.
3. Cedent might not choose:
  - the most secure and stable reinsurer;
  - the reinsurer with the best payment record; or
  - the best underwriting experience (as compared to start-ups).

## Some questions:

- Why is there this split between the **US** and the **rest of the world** on the question of reinsurance credit?
  - Just a question of trust?
  - General negative assessment of the reinsurance market?
  - Bad experiences with Non-US reinsurers versus US reinsurers?
  - Much beloved old habits?
- Is there a reason why the US sees problems with the collectibility of reinsurance when the rest of the world does not?
- Why is there an assumption of specific problems with Non-US reinsurers?

# Collectibility of Reinsurance Claims

- According to A.M. Best there were no P/C insolvencies due to reinsurer failure (i.e. non collectibility of reinsurance) between 1993 and 2002.
- According to the US Reinsurance Collateral White Paper, published by the NAIC's Reinsurance Task Force on December 6, 2005, foreign reinsurers have a better payment record than US-domestics.
- Most EU-based reinsurers looking for relief have been operating in the US for decades and maintain either branches or subsidiaries or have major assets situated in the US.
- Cedents placing reinsurance are sophisticated buyers (B to B deals) and should possess the means and tools for reinsurance collections.
- U.S. State Department has confirmed that there is no problem with enforcement of reinsurance arbitral awards under New York Convention. (*Letter to Rep. Ed Royce, Dec. 29, 2003.*)

# Solvency II and EU Reinsurance Directive

The focus of European reforms:

1. To create a single European insurance Market (EU Reinsurance Directive)
2. To modernise the supervision and financial reporting framework (Solvency II / IFRS)

The **EU Reinsurance Directive** ...

- follows the standards on supervision of reinsurance worked out by the IAIS;
- was to be implemented by the 27 EU Member States by the end of 2007;
- creates one EU-wide authorization system for EU domiciled reinsurers (example of an international mutual recognition agreement);
- abolishes collateral obligations within the EU territories for EU reinsurers;
- provides for the possibility of either imposing collateral obligations on NON-EU reinsurers or entering into a mutual recognition agreement with Non-EU jurisdictions.

# Solvency II

## The **Solvency II** Project—

- is following the IAIS standards requiring a proper reinsurance management strategy including internal control systems monitoring reinsurance by cedents;
- is planned to be passed by the end of 2008 (?) with a final implementation in member states by 2010;
- represents a shift from a simple quantitative approach of monitoring solvency to a sophisticated holistic approach;
- resulting in a comprehensive risk management system and a risk based solvency framework;
- rationalises supervision for multinational groups (lead supervisor); and
- gives credit for geographic diversification of multinational groups.

## NAIC vs. Europe on Solvency II

- NAIC November 3 Letter to EU Council expresses “serious reservations and concerns” about proposed Solvency II:
  - Reliance on institutions’ enterprise risk management and use of “internal models”
  - Allowance for diversification benefits in group structure
  - “discriminatory treatment” of non-EU insurers
- Escalating rhetoric in trans-Atlantic dialogue on these points and U.S. State-based collateral requirements for non-US reinsurers
- Failure of EU to recognize non-governmental NAIC has competent authority and prospective refusal of Europe to accord States “equivalent” prudential status
- Is a Federal structure needed to bridge this emerging “competency” divide?

# Reinsurance Supervisory Standards Evaluation Board Act of 2008 (H.R. 6213)

- **Overview of Proposed Legislation**

- H.R. 6213 would establish standards and procedures to evaluate both state and foreign reinsurance supervisory systems.
- Newly created **Reinsurance International Solvency Standards Evaluation Board (RISSEB)** would evaluate supervisory systems and certify jurisdictions with acceptable levels of prudential supervision for their domiciled reinsurers.
- Reinsurers domiciled in certified jurisdictions to be treated on **equal basis** as reinsurers domiciled in the same State as the ceding insurer for purposes of credit for reinsurance regulation.

# Reinsurance Supervisory Standards Evaluation Board Act of 2008 (H.R. 6213)

- **Establishment of RISSEB**

- Nonprofit board, similar to Public Company Accounting Oversight Board ("PCAOB") set up by Sarbanes-Oxley Act (i.e., *not* an agency or establishment of U.S. Government)
- 7 members appointed by President from individuals with "demonstrated expertise in reinsurance matters"
- Majority of members would have reinsurance regulatory expertise
- Selected from lists recommended by state insurance regulators or associations representing regulators (e.g., NAIC)
- Subject to Presidential oversight (i.e., authority to suspend Board actions "significantly contrary" to public interest, following public notice and comment)

# Reinsurance Supervisory Standards Evaluation Board Act of 2008 (H.R. 6213)

- **Evaluation and Certification of Reinsurance Supervisory Systems**
  - Upon request and payment of a fee, RISSEB would certify reinsurance supervisory systems that:
    - (1) satisfy capital and risk management standards established by the Board; and
    - (2) have acceptable levels of prudential supervision over domiciled reinsurers.
  - Certification effective for one year.
  - Evaluation standards, procedures, fees and certification determinations subject to public notice and comment.

# Reinsurance Supervisory Standards Evaluation Board Act of 2008 (H.R. 6213)

- **Uniform Reinsurance Supervision Standards**
  - RISSEB to establish uniform standards for evaluating supervisory systems' capital and risk management regulation and adequacy of prudential supervision.
  - RISSEB to also propose uniform standards to appropriate state and federal entities to improve reinsurance regulation where new standards or conflicts of law have emerged.

# Reinsurance Supervisory Standards Evaluation Board Act of 2008 (H.R. 6213)

- **Treatment of Certified Supervisory Systems**
  - Preemption of any credit for reinsurance requirements of ceding insurer's domiciliary State that treat reinsurers supervised by certified jurisdictions differently from domestic reinsurers domiciled and in good standing in such State.

# Reinsurance Supervisory Standards Evaluation Board Act of 2008 (H.R. 6213)

- **Year-end 2008 Considerations**

- How does the financial crisis impact perceptions of reinsurance system, which has exhibited little strain so far?
- What do regulatory gaps over AIG holding company system mean for reform agenda?
- Will the banking crisis increase national balkanization or lead to more cooperation?
- Do we really have a choice? Nov 14-15 Summit begins the answer

Questions?