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February 5, 2018

Mr. Jake Stultz
Senior Accounting Policy Advisor
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500,
Kansas City, MO 64106

Subject: Aon Benfield recommendations on simplifying U.S. collateral requirements and the associated tracking and reporting of reinsurance recoverables

Dear Mr. Stultz,

Over the past several years, Aon Benfield has worked with U.S. ceding insurers and both U.S. and non-U.S. reinsurers in order to help clarify the statutory reporting requirements for reinsurance recoverables. We are submitting recommendations that we believe will help simplify the tracking and reporting of reinsurance recoverables while preserving most of the collateral reforms introduced by the Covered Agreement (BILATERAL AGREEMENT BETWEEN THE EUROPEAN UNION (EU) AND THE UNITED STATES OF AMERICA (U.S.) ON PRUDENTIAL MEASURES REGARDING INSURANCE AND REINSURANCE) and the Credit for Reinsurance Model Law and Regulation.

Specifically, this proposal attempts to:

1. Facilitate the tracking and reporting of reinsurance recoverables under U.S. statutory accounting

2. Preserve the state-based regulation of insurance and eliminate the need for additional agreements that might be negotiated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act by extending most of the terms and conditions of the Covered Agreement to other jurisdictions

3. Capitalize on the progress made by all parties with respect to collateral reform in the U.S.

4. Minimize the need for additional "guardrails" (e.g. protections) relative to U.S. ceding insurers, such as changes to risk-based capital requirements or additional regulatory approaches

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These recommendations are intended to provide a framework for moving forward with U.S. collateral reform, but not address every conceivable issue.

For purposes of clarity, we will call all reinsurers that fall under this new Covered Agreement "covered reinsurers". Thus reinsurers that would be subject to the provisions of the Covered Agreement or held to similar criteria would be known as covered reinsurers.

1. The Covered Agreement allows U.S. ceding insurers to get full credit for reinsurance ceded to EU reinsurers meeting the criteria under the agreement (e.g. minimum size, solvency ratio of 100% etc.) without providing any collateral for outstanding liabilities. We believe that this standard could be extended to large, highly rated reinsurers in certified reinsurer "qualified jurisdictions" or other domiciles with high regulatory standards.

Rationale: Since the amount of collateral is negotiable, ceding insurers can manage credit risk by their selection of reinsurers and by negotiating an amount of collateral they feel is necessary to minimize credit risk. Allowing reduced or no collateral for reinsurance credit, supports the work done towards collateral reform in the U.S. by regulators, reinsurers and ceding insurers.

We believe it makes sense to have a global approach / policy. This will alleviate the need to negotiate additional federal agreements (which could lead to different standards for reinsurers from different domiciles) and potentially conflict with existing state laws and regulations. There are reinsurers in Bermuda, Japan, Switzerland and other countries that should be able to achieve equal treatment to those in the EU. It would be preferable if the Covered Agreement could be amended at some point, so that all EU reinsurers would get equal treatment to all other reinsurers. (Please see "Thoughts on Amending the EU – U.S. Covered Agreement" on page 5.)

2. We suggest that the $250mn minimum capital requirements should be applied to all reinsurers (with the potential exception of EU reinsurers), and the minimum capital standards should be based on the reinsurer's most recently reported publicly available capital using the foreign exchange rate on the date of the reported financials.

Rationale: The size of an insurance or reinsurance company's capital base has been a key indicator of reinsurer impairment (e.g. supervision, rehabilitation, insolvency). Studies have shown that insurance and reinsurance companies with smaller capital bases have a higher probability of impairment.

This suggestion will eliminate the need for the U.S. to specify minimum capital requirements in multiple foreign currencies. The Covered Agreement specifies that EU reinsurers must possess a minimum capital of €225mn. This requirement is not onerous, but if the Covered Agreement is amended, it may make sense to apply the $250mn standard (using the exchange rate for the date of the reported capital) to EU reinsurers, so that a consistent approach can be used worldwide.

3. We suggest that (with the possible exception of the EU reinsurers) all reinsurers that want to become covered reinsurers must have two or more public, interactive financial strength ratings of A- or A3 or higher. We suggest that this requirement be used in lieu of a Solvency II solvency ratio of 100% or greater.

Rationale: The main reasons for using ratings as opposed to a solvency ratio of 100% or greater are as follows:

a. Interactive financial strength ratings are publicly available, updated as needed, and already used by regulators, ceding insurers and reinsurers. There can be a significant lag as to the reporting of capital and capital scores for reinsurers outside the U.S. Most non-U.S. reinsurers only release financial statements publicly on an annual basis. The reports are made publicly available anytime from 3 to 8 months after year-end (or the reinsurer's fiscal year-end). There may be a similar delay or longer for solvency ratios under Solvency II to become publicly available. In an extreme case, a U.S. ceding insurer may not know the capital or solvency position of an EU reinsurer until 15 months after a major catastrophe. Consider the Japanese (Tohoku) earthquake which occurred in March 2011. U.S. ceding insurers were unable to review the capital position of non-U.S. reinsurers until 13 or more months after the event. In contrast, rating agencies can react to events more quickly and have the ability to trigger a downgrade (if warranted). Since rating agencies (through the interactive rating process) have access to non-public data, their ratings may represent a more current view of the capital position and financial strength of reinsurers. Therefore, financial strength ratings may be a better metric to measure a reinsurer's capital adequacy and the associated credit risk at any point in time.

b. Using two ratings was universally accepted by the reinsurers, their trade associations, regulators and U.S. ceding insurers when the New Credit for Reinsurance Model Law and Regulation was adopted in the fourth quarter of 2011. Also, two public, interactive financial strength ratings alleviate the dependency on a single rating agency. The A-, A3 threshold is suggested as it is the most common minimum requirement that U.S. ceding insurers use for acceptable counterparties. The A-, A3 threshold also appears to be an appropriate threshold based on the ratings scale of the Credit for Reinsurance Model Regulation. Certified reinsurers rated A-, A3 or above are only required to post 50% collateral or less, while certified reinsurers rated below A- or A3 are required to post 75% collateral or more for outstanding liabilities.

c. Certified reinsurers below A- or A3 are required to provide 75% of collateral or more under the Credit for Reinsurance Model Law and Regulation.

d. We believe the two public, interactive financial strength ratings is a higher standard than the 100% solvency ratio (which is the regulator intervention ratio). To highlight the potential downside of a using the solvency ratio, an EU reinsurer could have a solvency ratio just above the regulatory intervention level and still qualify to be a covered reinsurer.

e. This will also alleviate the U.S. regulators from examining capital standards of every potential new jurisdiction (and reviewing these capital standards when significant changes are made).

f. Incorporating this higher standard may alleviate the need for additional "guardrails" relative to U.S. ceding insurers (such as higher risk-based capital requirements).

Overall, we feel that it is simpler and more transparent to use public, interactive financial strength ratings as opposed to solvency ratios.

4. Regulators could elect to retain the qualified jurisdiction requirement. In our view, the EU should be considered a qualified jurisdiction as well as the current certified reinsurer qualified jurisdictions.

Rationale: The qualified jurisdiction requirement encourages the exchange of information and could be withheld if U.S. reinsurers did not get similar or equal treatment in non-U.S. domiciles. Becoming a qualified jurisdiction may be easier for a non-U.S. domicile than negotiating a separate agreement similar to the Covered Agreement.

5. All lines of business reinsured by covered reinsurers would be subject to the same collateral requirements.

Rationale: Currently, certified reinsurers may only be certified for select lines of business. But this requirement is not mandated by the Covered Agreement. Rarely does the covered lines distinction come into play, and many states do not specify what lines are certified. Removing the line of business requirement eliminates the need for regulators and ceding insurers to monitor and track recoverables by line of business, without any measurable change to credit risk.

6. We suggest that all reinsurers that wish to become covered reinsurers apply for the designation and pay a small annual filing fee. We also suggest that the NAIC keep a current list of covered reinsurers on behalf of all states.

Rationale: The rationale for the above recommendations is as follows:

a. Having a list of covered reinsurers alleviates each state regulator and every ceding insurer from determining whether a reinsurer meets the capital and solvency requirements. Having a single list would also alleviate the need for groups with statutory companies in different domiciles to check the status in multiple states.

b. Having a centralized list avoids duplication of effort at the state level. It eliminates the need for each state to develop and maintain their own listing. States could simply have a link to the NAIC list.

c. This approach eliminates the need for covered reinsurers to apply in each state and pay multiple filing fees. The filing fee would be used to offset the cost of maintaining the list of covered reinsurers.

7. We suggest October 1 as the designated date for reinsurers to become covered. If a reinsurer does not appear on the NAIC list of covered reinsurers by October 1, they would be subject to normal collateral requirements. This would allow ceding insurers three months to obtain collateral from reinsurers.

Rationale: There needs to be a cutoff to ensure ceding insurers can obtain the required collateral prior to year-end. The cut-off needs to be early enough so that both ceding insurers and reinsurers are aware of the year-end collateral requirements. The October 1 date should allow ceding insurers and reinsurers to work together to meet year-end collateral requirements.

8. As far as a transition, if all of the above recommendations are implemented, we believe that certified reinsurers could be converted to covered reinsurers at some point in the future.

Rationale: Most if not all certified reinsurers would meet or exceed covered reinsurer criteria. Since the benefits of being a covered reinsurer are superior to a certified reinsurer (in almost all cases), and the requirements are essentially the same, there is little need for certified reinsurers to continue to exist. This also simplifies reporting on a go-forward basis as a reporting category can be eliminated. Therefore, all reinsurers would be in one of three categories:

1. Covered reinsurers - Meeting the requirements above and listed on the NAIC website
2. Authorized reinsurers - Meeting current licensing requirements at the state level
3. Unauthorized reinsurers – Reinsurers who are neither covered nor authorized and are required to provide 100% collateral for outstanding reinsurance recoverables.

9. These changes should be incorporated into a new Credit for Reinsurance Model Law and Regulation. In conjunction with these changes, Schedule F should be simplified.

Rationale: These recommendations, if adopted, would need to be incorporated into the relevant law and regulation. Ultimately, schedule F can be simplified as there will be no need to track recoverables from catastrophes and track rating changes for certified reinsurers.

Thoughts on Amending the EU – U.S. Covered Agreement

It took a great deal of effort to negotiate and execute the Covered Agreement. We believe the appetite to revise the agreement is low. However, we are suggesting only one material change to the agreement. Specifically, we suggest replacing the 100% solvency ratio requirement with a

requirement of two interactive, public financial strength ratings of A- or A3 or higher. As mentioned above, the ratings may provide a more up-to-date standard than the solvency ratio.

We view the other suggested changes as relatively minor. The EU could be considered a "qualified jurisdiction". For consistency, we also suggest setting the minimum capital at $250mn using the foreign exchange rate on the date of the reported financials.

Consistent with the Covered Agreement, no collateral would be required for reinsurers that meet the suggested requirements.

We suggest that no changes are made to the Covered Agreement until the new law and regulations incorporating the above suggestions are in place.

The above recommendations could be adopted without making any changes to the Covered Agreement. (EU reinsurer would be subject to different requirements.) However, it may make sense to consider amending the Covered Agreement, so that there is one approach that applies to all reinsurers globally.

We hope that all interested parties find these recommendations helpful.

Please contact me if you have any questions regarding our recommendations,

Kind Regards,

Michael McClane

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