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Subject: NAIC Reinsurance Collateral White Paper

Dear Commissioner Bowler,

The European Commission and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) would like to thank you and your colleagues on the NAIC Reinsurance Task Force for drafting the Reinsurance Collateral White Paper, which clearly represents a considerable amount of work and for providing the European Commission and CEIOPS with the opportunity to comment on the paper.

Detailed comments on the White Paper are provided in the Annex to this letter, an advanced copy of which was sent to you for discussion at your recent meeting in Chicago.

This issue is of great importance to the European Commission and to European Insurance Supervisors and we hope that the publication of the White Paper will prove to be another important step towards the successful resolution of this issue, i.e. the removal of collateral requirements for European reinsurers operating in the US.

As you are aware, the European Parliament and the Council have recently adopted the EU Reinsurance Directive, which introduces a system of supervision in the EU based on home country control in accordance with harmonised EU supervision rules and prohibits Member States from introducing or keeping rules requiring EU reinsurers to post collateral.

EU Member States will have 24 months from the date that the Directive enters into force to implement the Directive into national law and a further 12 months to remove any pre-existing collateral requirements for EU reinsurers.

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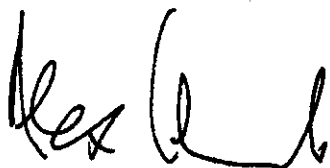
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At the most recent EU-US regulatory dialogue meeting we shared a draft roadmap with you and your colleagues that set out a provisional timetable which envisaged that US collateral requirements would be phased out as the EU Reinsurance Directive was implemented by Member States.

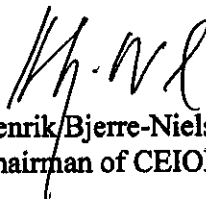
The EU Reinsurance Directive will have entered into force by the time of our next EU-US regulatory dialogue meeting. We believe that in order to maintain the momentum gained from the introduction of the EU Reinsurance Directive and the work done by the NAIC Reinsurance Task Force in preparing the White Paper it is vital that we agree a roadmap at our next meeting.

Thanks again to you and your colleagues for the work that you have done in drafting the NAIC Reinsurance Collateral White Paper.

Yours sincerely,



Alexander SCHAUB
Director General



Henrik Bjerre-Nielsen
Chairman of CEIOPS

Annexes: CEIOPS and European Commission Comments on NAIC US Reinsurance Collateral White Paper

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CEIOPS and European Commission Comments on NAIC US Reinsurance Collateral White Paper

0. Introductory Remarks

The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the European Commission would like to thank the NAIC for drafting the Reinsurance Collateral White Paper, which clearly represents a considerable amount of work, and for providing CEIOPS and the Commission with the opportunity to comment on the paper.

This issue is of great importance to European Insurance Supervisors and the European Commission and we hope that the publication of the White Paper will prove to be another important step towards the successful resolution of this issue, i.e. the removal of the collateral requirement.

The EU Reinsurance Directive introduces a system of supervision based on home country control in accordance with harmonised supervision rules and prohibits Member States from introducing or keeping rules requiring reinsurers to post collateral. Given the international nature of reinsurance business and the importance that geographical spread and diversification of risks play in sound risk management reinsurance practice, we believe that a system based on mutual recognition is more appropriate for today's international reinsurance markets than a system that relies primarily on the posting of collateral.

The White Paper does not currently explicitly address this fundamental issue – i.e. does the NAIC agree that a system based on home state regulation and mutual recognition is in principle more appropriate for international reinsurance markets than a system that relies to a significant extent on the posting of collateral? If the answer to this question is yes, which the opening sentence to the "pro-maintenance" arguments on page 18 of the White Paper suggests, then we think that the balance of the paper would be greatly improved by making this clear in both the introduction and conclusion to the paper. While the issues that need to be considered on the road to achieving full mutual recognition are being discussed, the NAIC should not delay the introduction of measures that will more immediately address the basic unfairness and costs to non-US reinsurers of the current collateral rules.

We also regret that the paper does not include an analysis of whether additional costs are imposed on direct insurers and policyholders in the US as a result of the current collateral rules as well as an assessment of the overall economic impact of the rules.

CEIOPS and the European Commission have organised their comments on the contents of the paper into three sections:

1. General comments on the White Paper;
2. Comments on Appendix II – Reinsurance Regulatory requirements in other major markets - including a revised summary of the European Reinsurance Directive and a description of the current arrangements in some Member States regarding the supervision of reinsurance undertakings;

3. Comments on Appendix III – Disclosure and Transparency.

These are the areas where CEIOPS and the European Commission felt they could most usefully provide input. We have not provided comments on all of the "pro-maintenance" arguments put forward in the paper, as we are aware that a number of European trade associations and European companies have already provided you with comments on these arguments, which we assume will be taken into account in the final version of the White Paper.

1. General Comments

Unauthorised re-insurers - At the bottom of page 1 in the background section, the White Paper suggests that collateral requirements apply to all unauthorised reinsurers, not just to non-US reinsurers. This point is made and re-made throughout the paper to justify the current regime and to suggest it is not discriminatory against non-US reinsurers. However, this focus on unauthorised reinsurers misses the essential point, made on page 24 of the report in the "pro-reduction" arguments concerning collateral as a trade issue. Namely, that an unauthorised US reinsurer has the ability to become an "accredited reinsurer" and thus become authorised, whilst a non-US reinsurer has no means of becoming accredited and thus becoming authorised, even if it is subject to supervision in its home member state.

Geographic concentration – The reinsurance market analysis section of the paper includes a breakdown based on NAIC annual data by country of premium ceded to and recoverables from non-US reinsurers. This data indicates that the vast majority of non-US reinsurance activity is limited to a small number of countries. This observation has important implications for potential short and medium term solutions that could be sought to resolve the collateral issue successfully. In particular, it would be valuable to assess to what extent the pro-maintenance arguments stand-up when applied on a case-by-case basis to reinsurers based in these key jurisdictions, as we believe the balance of the arguments would change significantly in many cases. Particularly given that, as highlighted on page 26 of the White Paper, many of the oldest, largest and financially strongest reinsurers are located outside the US.

Over-Funding of Liabilities: Gross vs. Net – Both US and European reinsurers would normally seek to manage their business on a net liability basis. The requirement on non-US reinsurers to post collateral equal to 100% of gross liabilities inevitably results in the inefficient use of capital. The gross funding requirements are in contrast with the net reserving requirements on US authorised reinsurers, and from a supervisory perspective effectively force non-US reinsurers to give preferential treatment to a particular class of policyholder.

International Harmonisation of Reinsurance Supervision – On page 18 of the White Paper in the "pro-maintenance" section regarding mutual recognition a number of assertions are made regarding the EU Reinsurance Directive. For example, the paper states that "it is far too early to tell how the Reinsurance Directive will be implemented in practice". The EU Reinsurance Directive introduces broadly the same rules for reinsurance undertakings that were already in place for direct insurance undertakings. Thus Supervisory Authorities already have considerable experience of applying these rules to insurance undertakings. Indeed, the rules are already applied to reinsurance business conducted by a direct insurance undertaking. It is therefore misleading to

suggest that it is far too early to say how the rules will be implemented in practice, particularly in those Member States where reinsurers are already subject to supervision (See comments on Appendix II).

The paper also states that "there are many solvency measures evident in the US reinsurance regulations that appear to be lacking in the minimum regulatory requirements in the EU Reinsurance Directive". The EU Reinsurance Directive sets out minimum regulatory requirements that Member States agreed amongst themselves were essential, necessary and sufficient for mutual recognition purposes and are consistent with internationally agreed standards produced by bodies such as the IAIS (International Association of Insurance Supervisors).

The intention was not to mirror the US requirements line-by-line. Nevertheless, the EU Reinsurance Directive compares favourably with the standards set out in the NAIC Financial Regulation Standards and Accreditation program. The vast majority of which are clearly and comprehensively covered by the directive.

The White Paper claims that the EU Reinsurance Directive does not include limitations on risk exposures (10% of surplus), a requirement for financial statements to be audited, a requirement that a certified actuarial opinion concerning adequacy of reserves is obtained, no specific requirements on the disclosure of material transactions, and that solvency charges are not risk based.

The statement that reinsurance undertakings do not have to have their financial statements audited is unfounded. The EU re/insurance regulatory framework does not provide for a particular regime, however reinsurance companies are subject to audit under the 4th and 7th Company Law Directives and under the Insurance Accounts Directive. Furthermore, the Re/Insurance Directives, as all the others dealing with financial institutions, require auditors to communicate to competent authorities any possible infringement to the rules they may find whilst carrying out their duties.

On the other points raised, although there are not rules in the EU Reinsurance directive that exactly mirror those in the US rulebook, there are rules that address the underlying risks that these US rules are designed to mitigate against. For example, the Directive contains rules on the establishment of technical provisions, including the use of accepted actuarial methods for the purposes of calculating (mathematical) provisions. It lays down rules on required solvency margins, which can differ from business line to business line depending on the level of risk. Reinsurance companies are also obliged to report regularly to the supervisory authorities in accordance with their instructions and they are required to ensure that they have sound administrative and accounting procedures and adequate internal control mechanisms.

Conclusion – In the conclusion of the report it is suggested that "there is a fine balance between eliminating inefficiencies in any cross-border reinsurance transaction countered by potential solvency concerns". We strongly disagree with this statement. Particularly when one considers the current asymmetry in the treatment of US and non-US reinsurers; the geographic concentration of the non-US reinsurers active in the US market, which has important implications for potential short and medium term solutions that could be sought to resolve the collateral issue successfully; and the introduction of the EU Reinsurance Directive, which provides the basis for agreement on a longer-term solution to the collateral issue based on mutual recognition.

2. Appendix II - Reinsurance regulatory requirements in other major markets

Regarding Appendix II, which includes descriptions of the EU Reinsurance Directive and a number of countries' regulatory regimes including France, Germany and the UK, we would like to propose the following amendments or give some more information.

EU Reinsurance Directive

We propose the following text describing the Reinsurance Directive to replace the current description on page 32:

"In October 2005, the European Union adopted a Directive on reinsurance. The Directive extends to reinsurance undertakings the existing system for EU insurance undertakings under which the authorisation and financial supervision is the responsibility of the supervisory authority of the Member State in which the reinsurance undertaking has its head office ('home country control') in accordance with harmonised reinsurance supervision rules. On this basis, reinsurance undertakings are able to operate throughout the EU ("single passport"), either by establishing themselves in other Member States, or by providing services directly from their home or another Member State.

The EU Reinsurance Directive sets out minimum regulatory requirements that Member States agreed amongst themselves were essential, necessary and sufficient for mutual recognition purposes and that are consistent with internationally agreed standards produced by bodies such as the IAIS (International Association of Insurance Supervisors).

The EU Reinsurance Directive prohibits Member States from introducing or keeping rules requiring EU reinsurers to post collateral. Rules requiring reinsurers to post collateral were prohibited, because it was felt that they represented both a barrier to the creation of an internal market and because a system based on mutual recognition was more appropriate for today's international reinsurance markets than a system that relies primarily on the posting of collateral.

Under the Directive, the home Member State will require every reinsurance undertaking seeking a license to limit its object to the business of reinsurance and related operations, to submit a scheme of operations and to possess the capital to fulfil the minimum guarantee fund requirement. The persons running the reinsurance company shall be of good repute and with appropriate professional qualifications or experience.

The Directive also sets out prudential rules for the supervision of reinsurance undertakings. These prudential rules are similar to those already applied in the Insurance Directives. It contains rules on the establishment of technical provisions, including the use of accepted actuarial methods for the purpose of calculating (mathematical) provisions, and rules on the investment of assets covering those technical provisions. It also lays down rules on required solvency margins and minimum capital requirements as well as rules on measures to be adopted by regulators if reinsurance undertakings are in financial difficulties. Reinsurance companies are obliged to report regularly to the supervisory authorities in accordance with their instructions. They shall ensure that they have sound administrative and accounting procedures and adequate internal control mechanisms.

Furthermore, under EU law, the financial statements of reinsurance undertakings have to be audited and auditors are required to communicate to competent authorities any possible infringement to the rules they may find whilst carrying out their duties.

Also, under the EU Reinsurance Directive, reinsurers as part of an insurance group are subject to supplementary supervision in accordance to the EU Directive dealing with Insurance Groups. Under the directive dealing with the supervision of financial conglomerates reinsurance companies are also included in the supplementary supervision."

France

We propose the following text to replace the third paragraph of the current text describing the French supervisory regime on page 32:

"French reinsurers are submitted to authorisation and are supervised by the CCAMIP. In the present regulation, the supervision and solvency requirements applying to reinsurers are lighter than those applying to direct insurers. However these requirements will be reinforced by the implementation in France of the EU Reinsurance Directive."

Germany

We propose the following text to replace the current text describing the German supervisory regime on page 33 of the paper:

"Pure reinsurers have to meet the same standards as primary insurers concerning capital requirements. A respective amendment (sec. 119 to 121e and sec. 123b) of the German Insurance Supervision Law (Versicherungsaufsichtsgesetz - VAG) has been adopted at the end of 2004. Pursuant to sec 53c in connection with sec 123b VAG, reinsurance companies have to have an amount of unattached equity capital, which enables them to fulfill their contractual obligations at any time. This amount has to be, as a minimum, at least as high as the required solvency margin; the solvency margin is determined by the overall business volume. With respect to defining solvency margin requirements, sec. 121d VAG refers to the respective European Community Directive ("Solvency I"). Insurance undertakings that carry on both reinsurance and primary insurance business have to subject their entire technical insurance and reinsurance business to the solvency requirements applicable to primary insurers – also based on the above mentioned sections of the VAG and on the Solvency I Directive. Moreover, reinsurers are to be taken into account in the calculation of the adjusted solvency margin of an insurance group and of a financial conglomerate.

The supervisory authority may take any precautions and orders which are necessary to ensure that reinsurance undertakings are able to meet their obligations arising from reinsurance relationships at all times. The funds of reinsurers have to be adequate in order to fulfill all obligations under the existing reinsurance contracts."

United Kingdom

We propose the following text to replace the current text describing the UK Supervisory regime on pages 34:

"The FSA requires that a firm must at all times maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to the

amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. The U.K. does not differentiate between insurers and reinsurers for these purposes.

Firms must, as a minimum, meet the European Community Directive requirements. The EC requirement is based on the higher of a percentage of premiums or a percentage of claims calculation, with a minimum. In addition, the FSA requires firms to make their own assessment of the capital it needs given the nature of risks and risk mitigation that the firm has. The FSA reviews these firm assessments and may then give guidance to the firm as to the amount of capital the FSA considers it should hold. If the firm does not meet this level of capital, the FSA is able to restrict the amount of business the firm writes, or take other regulatory action. In addition firms are required to report the result of a risk based capital calculation with percentages applied to premiums, claims, and assets, with the percentages depending on the line of business, and generally expected to explain how their own capital assessment differs from this risk based calculation.

Lloyd's is also subject to the capital assessment framework described in the previous paragraph. For Lloyd's, the same principles apply, but the nature of this unique market means that there are differences in application. Each member has to hold a level of capital as assessed by Lloyd's annually. Each managing agent is required to assess, for each of the syndicates, the amount of capital required to support the risks that the syndicate is exposed to. The level of capital is subject to the EC minimum and regulatory review by the FSA."

Italy

We propose adding a section on the Italian supervisory regime into Appendix II:

"Reinsurance companies are authorized and supervised by the Istituto per la vigilanza sulle assicurazioni – ISVAP.

Currently the solvency requirements for primary insurers are not applicable to pure reinsurers that undertake exclusively reinsurance business. However the reinsurance undertakings are required to own a minimum capital requirement that varies from a minimum of 1 million euro to a maximum of 5 million euro according to the classes pursued.

Moreover the submission of a scheme of the operations that the reinsurance undertaking intends to pursue is one of the conditions for granting the authorization. The scheme of operations shall be accompanied by a technical report explaining the criteria according to which the scheme has been drawn up.

The members of the board of directors and supervisory board (Italian collegio sindacale) as well as managing directors must meet fit and proper requirements i.e. they must be of good repute and possess adequate professional experience and qualification.

Shareholders are subject to the requirements of good repute and financial soundness.

The reinsurance undertakings are obliged to set up technical provisions and to cover them with appropriate assets even though current regulations do not envisage any quantitative or qualitative limit for assets representing technical provisions.

ISVAP has the same powers of supervision and sanction as for insurance undertakings and – based on the examination of the annual accounts of reinsurance undertakings – may request information and documents, make remarks, raise objections and conduct inspections on the reinsurance companies' premises and on all aspects of their activity.

The regulations in force do not require collaterals to the reinsurance undertakings that operate in Italy in freedom of establishment or freedom of services."

3. Appendix III – Disclosure and Transparency

Regarding Appendix III, which includes descriptions of the disclosure requirements in a number of countries including France, Germany and the UK, we would like to propose the following amendments or give some more information.

Germany

We propose the following text to replace the current text describing the German system on pages 39 and 40:

"External Accounting

Reinsurers and insurers have to prepare financial statements in accordance with general rules and specific regulations. These financial statements are based on the German accounting standards set forth in the German Commercial Code and other regulations. These focus very much on the creditor and not on the investor. The principle of prudence has top priority.

Within 10 months of the financial year end, reinsurers have to draw up their annual accounts as well as an annual report. This generally happens much earlier. These documents must be submitted to the supervisor as soon as they have been drawn up, i.e. before they are made public.

The consolidated financial statements (balance sheet, income statement, cash flow statement, stockholder equity, comprehensive income, and retained earnings) include informative notes with details on their assets, market value investments, and liabilities; premiums, investment results and expenses. For the sample of reinsurers reviewed, companies offer information on their financial products business, including useful comments on their market, credit and liquidity risks, including ratings. Fair value of financial instruments is also available.

According to the Corporate Sector Supervision and Transparency Act (KonTraG) reinsurers have to set up a risk management system which identifies potential risks. Companies have an obligation to disclose information about such risks and the structure of the system. Additionally all reinsurers have to meet the requirements of the German Accounting Standard 5-20. Reinsurers have to prepare a risk report under the rules of this standard.

For the sample of reinsurers reviewed, disclosure includes details on the type, maturity, currency, and regional allocation of their assets and investments. Information on their provisions, debt (with some information on the characteristics of the instruments), and other liabilities is provided. Details on the class, claims, ratios, and regional allocation of premiums are available.

General information on their risk management, business strategy, affiliated and subsidiary companies and principal officers can be found.

Auditor's report

Reinsurers and insurers must have their annual accounts and the annual report audited by an auditor. BaFin has to be informed before his appointment and before the audit takes place. The contents of audit reports is stipulated in the 'regulation on auditor's reports' published by BaFin. Two copies of the audit report are to be sent to BaFin, together with the relating comments of the managing and the supervisory boards. Finally, the auditor's report on the managing board's statement about the relations with affiliated companies also needs to be presented.

Internal accounting

The term internal accounting refers to information an insurer has to submit to the supervisory authority only. The provisions applying to internal accounting are similar to the provisions for non life insurers. They were laid down in a regulation in 1995¹ and last amended in 2005. The changes are part of a continuous improvement process at the BaFin aiming at a reduced administration effort and further risk oriented supervision. For this purpose some statements were omitted (compare the Global Reinsurance Market Report 2003) and some newly introduced (see below). The present provisions require all reinsurers to submit the documents mentioned below, which have to have a certain format. The documents which insurers have to put forward provide not only a more detailed break-down of the external accounts. They also allow a closer look into the reinsurer's business.

The documents that are to be submitted:

- balance sheet (statement 100)
- profit and loss account (statement 200) - (excerpts for the technical account)
 - for the entire insurance business
 - for the entire reinsurance business accepted by domestic ceding insurers
 - for the entire reinsurance business accepted by foreign ceding insurers
 - for each class of insurance – (very detailed split)
- development of investments (statements 101)
- income from and expenses for investments (statement 201)
- Statement 203 (newly introduced) additional information with respect to reinsurance, including details about individual technical profits and losses relating to the accepted reinsurance business (former statement 250). And information on inward and outward

1 Accounting in accordance with the ordinance concerning the reporting by insurance undertakings to the Federal Insurance Supervisory Office.

reinsurance business, by every direct insurer and reinsurer dealt with (former sample 1).

- Statement 251 (newly introduced) information about covering technical provisions.
- Statement 252 (newly introduced) information about the insurance-business and the contracts, and in particular details about technical claims provisions. Moreover, information about individual technical profits and losses relating to the accepted reinsurance business (former statement 250).
- Statement 604 (newly introduced) quarterly information about the technical reinsurance business.
- Statement 671 (newly introduced) every six months information about technical provisions and details about the assets of reinsurers.
- Statement 688 (newly introduced) forecasting with a yearly cut-off date (30.06.) the respective development of the following months in advance.

Finally, reinsurers also have to supply informal statements such as an outline of the methods they use for setting up the provision for claims outstanding.

Where applicable, the reinsurer has to present the consolidated financial statements, which may be prepared on the basis of either IAS or US GAAP, including an auditor's report.

The reinsurer is subject to the rules applicable to group supervision, if a primary insurer is involved also.

In addition to information delivered on a regular basis, the supervisor may request from the reinsurer any other information it requires."

Italy

We propose adding a section on the Italian supervisory regime into Appendix III:

"The primary information concerning reinsurance undertakings, available to any stakeholder is, generally speaking, contained in official company acts (accounts, annual report, internal and external auditors' reports, etc), regularly published by undertakings in conformity with existing domestic legislation.

Reinsurers as well as insurers must have their financial statements checked by an auditor.

As concerns financial statements, based on the Civil Code, insurance undertakings are obliged to file their financial statements with the Chamber of Commerce and also, based on sector regulations, to file the audit report from the auditor.

The deadline for the approval of the balance-sheet for pure reinsurers is 30 June (i.e. six months after the end of the year. On a reinsurance undertaking's request based on specific reasons, the deadline may be postponed up to 30 September."