Testimony of the National Association of Insurance Commissioners

Before the
Subcommittee on Oversight and Investigations

Committee on Financial Services
United States House of Representatives

Regarding:
Catastrophic Bonds: Spreading Risk

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Introduction

My name is Michael Moriarty. I am Director of the Capital Markets Bureau for the New York Department of Insurance. In addition, I am closely involved as a participant in the work of the NAIC's Insurance Securitization Working Group on behalf of New York Superintendent Greg Serio. I am pleased to be here today to provide the Subcommittee on Oversight and Investigations with an update of state regulatory practices that deal with reinsurance and the related use of securities to transfer insurance risk.

The Subcommittee asked NAIC to address specific questions in our testimony today. Those questions and the NAIC's responses are presented below –

What is the regulatory role of state insurance departments over reinsurers and reinsurance transactions?

State regulators are responsible for supervising the marketplace behavior of all insurers that sell insurance products to the public in the United States. As regulators, we focus our efforts on monitoring the financial condition of these companies, as well as their ability to satisfactorily meet their obligations to policyholders and claimants. Many of the insurers licensed by states are in the business of providing reinsurance to primary insurers. As reinsurers, they are generally subject to the same financial regulation standards that apply to primary insurers.

Insurers that obtain reinsurance from other insurers are called "ceding companies" because they transfer part of their insurance risks to others in return for sharing part of the premiums received from policyholders. In supervising reinsurance transactions, the regulator's primary concern is solvency and the impact of reinsurance on the ceding company's financial condition. There are two underlying factors behind this approach:

- First, there exists some relative equality of negotiating leverage between the buyer and seller of reinsurance products; thus regulators need not oversee the terms and conditions of the reinsurance product.

- Second, much of the reinsurance ceded by U.S. companies goes to reinsurers domiciled outside the U.S.

The NAIC and the states have established Credit for Reinsurance laws and statutory accounting procedures that apply to reinsurance transactions in order to provide regulators with an effective method of supervising the reinsurance activities of U.S. companies. A complete explanation of the manner in which state insurance departments supervise reinsurance is included with this testimony as Attachment A, together with copies of the NAIC model laws on recognizing reinsurance.

While there is nothing to prevent a company from transacting reinsurance business with another company anywhere in the world, a U.S. ceding company will not be permitted to take statutory credit (reduce its liabilities by the amount ceded to reinsurers) or claim amounts recoverable from reinsurers as an asset on its balance sheet unless such reinsurers meet one of the following requirements:

1. The reinsurer is licensed in the same state of domicile as the ceding company for a like kind of business.

2. The domiciliary insurance department of the ceding company accredits the reinsurer. Requirements of becoming an accredited reinsurer include:

    a. Submitting to domestic state's jurisdiction.
    b. Submitting to domestic state's examination authority.

c. Reinsurer must be licensed in at least one state.

d. Reinsurer must file its annual financial statement in ceding company's domiciliary state.

e. Reinsurer must maintain policyholder surplus of at least $20 million.

3. The reinsurer is domiciled and licensed in a state with substantially similar credit for reinsurance laws as the state of the ceding company.

4. The reinsurer maintains sufficient trust funds in the U.S.

The focus on financial credit given for reinsurance recoverables remains the cornerstone of state reinsurance regulation. Mutual recognition or reduction in collateral requirements for non-U.S. reinsurance will require some time, as more transparency in regulatory and accounting systems in non-U.S. jurisdictions is necessary.

How would the States' roles change or grow if insurance-linked bond issuance was brought onshore?

The NAIC formed a working group on Insurance Securitization in 1998 to "investigate whether there needs to be a regulatory response to continuing developments in insurance securitization, including the use of non-U.S. special purpose vehicles, and to prepare educational material for regulators." As a result of its deliberations, the NAIC has taken the position that U.S. insurance regulators should encourage the development of alternative sources of capacity such as insurance securitizations and risk-linked securities, as long as those developments are compatible with the overriding goal of consumer protection. The NAIC believes one of the goals should be to encourage and facilitate securitizations within the United States. If transactions that are currently performed offshore were brought back to the United States, they would be subject to direct onshore supervision by state regulators.

The NAIC has adopted separate model acts to facilitate onshore securitizations using two different methods. These are the Protected Cell Company Model Act and the Special Purpose Reinsurance Vehicle Model Act. Copies of both are included as attachments to this testimony.

The first method of securitization is laid out in the Protected Cell Company Model Act. It provides that a segregated unit of the insurance company, called a "protected cell," would issue the insurance-linked bond. The protected cell can only accept risk that is written by the general account of the insurer, which then securitizes it through the protected cell mechanism. The act provides that securitizations must be both indemnity-based and fully-funded – meaning that the transaction must be based upon the insurer's own losses and that collateral must be on hand for the full exposure to possible loss. There is a placeholder in the act to allow for non-indemnity based transactions once the NAIC has adopted rules to govern such transactions.

The second method is set forth in the Special Purpose Reinsurance Vehicle Model Act, which enables fully-funded, indemnity-triggered securitizations to take place through a special reinsurance entity, whose only function is to transfer insurance risk to the capital markets via investment securities. The Special Purpose Reinsurance Vehicle (SPRV) reinsures risk from an insurer, and then securitizes that risk for sale to investors in the capital markets. As such, the SPRV does not retain the risk, but acts as a conduit to transform a reinsurance risk into a capital markets product. Like the Protected Cell Company Model Act, the SPRV Model Act contains a placeholder to allow for non-indemnity based transactions once rules governing them are promulgated.

It is important to consider the impact of U.S. taxes when trying to facilitate onshore securitization of insurance. For the Special Purpose Reinsurance Vehicles, a "cut-through" federal tax treatment for investors may be necessary to permit them to operate on a level playing field with offshore vehicles. For the protected cells, the federal tax code may need to recognize the cell as part of the insurance company, and not as a separate entity.

Does the NAIC have any concerns about offshore special purpose reinsurance vehicles issuing bonds?

Yes, to the extent that off-shore insurance securitizations are not subject to direct U.S. regulation. NAIC members believe that Special Purpose Vehicles must be used appropriately. At present, there is no evidence of improper use of offshore Special Purpose Vehicles in insurance securitization transactions. However, recent cases such as Enron demonstrate how inappropriate use of special purpose vehicles can endanger solvency. The NAIC believes Special Purpose Reinsurance Vehicles, when properly used and structured, can provide extra capacity and more competition, leading to a reduction in the cost of insurance for the public. The NAIC further believes that onshore SPRVs, regulated by state insurance regulators, would be preferable to the current situation where most securitizations are conducted offshore.

There is no present requirement that an offshore SPRV be fully-funded and collateralized. In the case of traditional offshore catastrophe reinsurance, this uncertainty is handled in part through the use of onshore trust funds that serve as collateral for the reinsurance coverage provided. There is also no current requirement that the overall securitization transaction in an offshore SPRV be subject to review by U.S. insurance regulators. Both the NAIC's Special Purpose Reinsurance Vehicle Model Act and the Protected Cell Company Model Act require that at least one state insurance commissioner review each transaction in depth and set the appropriate standards. We believe that using an onshore SPRV under state supervision would provide greater certainty and transparency for these transactions.

Does the NAIC have similar concerns about traditional reinsurance provided by offshore entities?

Traditional offshore catastrophe reinsurance involves similar potential problems of credit risk and adequate collateral. The sufficiency of collateral provided by offshore reinsurers can only be known for certain after a catastrophic loss has occurred. The NAIC does not believe that offshore reinsurers providing catastrophic coverage are inherently unsafe, but the issue of sufficient capital to pay claimants after a major catastrophe does exist. Consequently, state regulators and the NAIC pay close attention to monitoring the security posted by offshore reinsurers. Credit and collateral risks are clearly reduced by the use of fully-funded onshore securitization.

What initiatives does the NAIC have underway, particularly in regard to balance sheet treatment and capital requirements?

Proponents of insurance-linked bonds and securities say the purpose of these instruments is to provide an alternative product that is functionally similar or equivalent to reinsurance. They want properly structured insurance securitizations to be recognized in the income statement in a way that is similar to regular reinsurance. The NAIC has already promulgated rules for protected cell companies that would achieve this end for fully-funded indemnity-based securitizations.

The appropriate accounting treatment of non-indemnity based transactions has been controversial. Nonetheless, the NAIC working group and industry representatives have come to a compromise that would allow income recognition to the extent that an index-based transaction successfully reduces risk. This recommendation has been sent to the NAIC's Statutory Accounting Principles working group for consideration and possible adoption through a Statement of Statutory Accounting Principles.

At present, insurance risks ceded to offshore SPRVs are treated exactly like offshore reinsurance. No credit is given to the transaction on the books of U.S. insurers unless state credit for reinsurance rules are followed by posting adequate collateral. The Risk Based Capital charges for the U.S. insurers also contain a charge for reinsurance placed with non-U.S. insurers. The NAIC expects to examine the appropriate level of Risk

Based Capital for onshore SPRVs in the future, especially as this may relate to non-indemnity transactions.

The NAIC is also active on the international front. Director Ernst Csiszar of the South Carolina Department of Insurance is currently serving as Chair of the Subgroup on Insurance Securitization and Other Related Forms of Alternative Risk Transfer for the International Association of Insurance Supervisors (IAIS). The subgroup is meeting in Santiago, Chile this week to consider a comprehensive issues paper on securitization issues. A copy of that paper is included as an appendix to this testimony.

Conclusion

The NAIC supports creating an environment that facilitates a more fluid transfer of insurance risk to the capital markets. Given the amount of capital in the property/casualty industry, a major catastrophe or series of catastrophes could strain the ability of the industry to respond to its customers. The capital markets, because of their sheer size, can better absorb such events. There are precedents in the securitization of other risks, such mortgages and other receivables, which indicate securitization of risk can lend capacity and liquidity to a marketplace.

Securitization of insurance risk is not a panacea for the funding of catastrophe risk. We see it as an addition, rather than a replacement, to traditional reinsurance. We cannot gauge the appetite of capital market investors for these securities. However, the NAIC believes it is important to enable the marketplace to make that determination. Other initiatives to address the capacity needs for catastrophe and other coverages should continue to be explored.

ATTACHMENT A

THE REGULATION OF REINSURANCE AND REINSURANCE TRANSACTIONS IN THE UNITED STATES

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Background

In the United States the regulation of insurance takes place at the state rather than at the national level. State insurance regulators are charged with the responsibility for controlling the marketplace behavior of companies and individuals licensed to sell insurance products to the public, and for monitoring the financial condition of the companies and their ability to satisfactorily discharge the insurance obligations they have undertaken. State insurance departments require that reinsurers domiciled in the U.S. are subject to the same financial regulation standards as would apply to any primary insurer. U.S. reinsurers file quarterly and annual financial statements, are subject to financial examinations, pay licensing fees, and comply with the full spectrum of corporate and regulatory laws concerning insurance companies nationwide.

The Regulatory Approach to Reinsurance

The regulatory approach to reinsurance in the United States has traditionally been focused on the ceding company's reinsurance arrangements and the specific provisions in its reinsurance agreements. From the regulator's perspective, the overriding concern has to do with solvency and the impact of reinsurance on the ceding company's financial condition. The regulator attempts to ensure solvency for the benefit of ceding insurers, creditors, and ultimately consumers of insurance products.

The basis for this approach is twofold: there is first a presumption that there exists some relative equality of negotiating leverage between the buyer and seller of reinsurance products; this may not be entirely true in every instance, but the assumption that the buyer of reinsurance is less in need of regulatory intervention or protection than the average buyer of personal auto or homeowners or life insurance coverage is probably not unreasonable. Market conduct concerns are therefore not a primary concern for regulators in the context of the reinsurance marketplace.

The second element in this rationale lies in the fact that much of the reinsurance ceded by U.S. companies goes to reinsurers domiciled outside the U.S. Many of the largest, oldest, and financially strongest reinsurers are located abroad, and the capacity they provide is very important to U.S. ceding companies. Since they are effectively beyond the regulatory reach of U.S. regulators, however, statutory accounting rules and the laws regarding credit for reinsurance require that all amounts recoverable from such reinsurers must be properly collateralized, usually by means of letters of credit issued by authorized U.S. financial institutions, or by a trust account established in this country for the benefit of U.S. ceding insurers. Any amounts not collateralized may not be deducted from the ceding company's balance sheet, and therefore represent a direct deduction from the company's statutory surplus. Due to the size of the U.S. insurance marketplace, questions of availability and affordability are not entirely irrelevant. Inexpensive reinsurance, however, whether purchased domestically or via non-U.S. reinsurers, which fails to respond when called upon should not be considered favorably. This is not just a theoretical concern; unrecoverable reinsurance has been a major ingredient in some of the largest insurance insolvencies in recent years.

The ultimate recoverability of reinsurance balances by the ceding company and the timeliness of recoveries have also become a matter of regulatory concern over the last several years. Reinsurance balances recoverable from the company’s reinsurers should be evaluated just as any other receivable would be: based on the perceived financial condition of the reinsurer, what is the likelihood that the company will recover all of the amounts recoverable from that reinsurer in a timely manner, consistent with the actual payment of claims under the polices reinsured, or as respects aggregate or catastrophe reinsurance protections, with the terms of the reinsurance agreement? Several revisions to the annual statement reinsurance schedules serve to provide strong motivation to ceding companies to do everything possible to accelerate the collection process. Recoverables that are in excess of 90 days overdue will incur a 20% penalty. In addition, overdue recoverable amounts that exceed 20% of all recoverables on paid losses create an annual statement penalty of 20% of those recoverables. These penalties will directly impact the company's surplus position. The ceding insurer can draw on a trust fund or other collateral in order to avoid the penalty. The statutory penalties for delinquent reinsurance recoverables appears to have had the intended effect of accelerating cash recoveries, as measured by the total penalty amount for all companies reporting, expressed as a percentage of industry surplus. However, if the regulators find evidence of difficulty in making timely recoveries, the company’s overall exposure to potentially unrecoverable balances should be thoroughly investigated.

The Regulatory Framework

The Credit for Reinsurance laws[1] and statutory accounting requirements and procedures applicable to reinsurance transactions serve to provide regulators with an effective method of controlling the reinsurance activities of U.S. companies. While there is nothing to prevent a company from transacting reinsurance business with any other company anywhere in the world, a U.S. ceding company will not be permitted to take

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1 See NAIC Credit for Reinsurance Model Law and Regulation.

statutory credit, that is to reduce liabilities by the amount ceded to reinsurers, or claim amounts recoverable from reinsurers as an asset on its balance sheet, unless such reinsurers meet one of the following requirements:

1. The reinsurer is licensed in the same state of domicile as the ceding company for a like kind of business.

2. The domiciliary insurance department of the ceding company accredits the reinsurer. Requirements of becoming accredited include:

    a. Submitting to enacting state's jurisdiction
    b. Submitting to enacting state's examination authority
    c. Reinsurer must be licensed in at least one state
    d. Reinsurer must file its annual financial statement in ceding company's domiciliary state
    e. Maintain policyholder surplus of at least $20 million.

1. The reinsurer is domiciled and licensed in a state with substantially similar credit for reinsurance laws as the state of the ceding company

2. The reinsurer maintains trust funds in the U.S.

3. To the extent that the ceding company withholds funds or security from the reinsurer

The Credit for Reinsurance Model Regulation provides additional details to the credit for reinsurance model law. It contains guidance on valuing assets and additional trust fund requirements.

Non-U.S. reinsurers have a variety of options aside from posting collateral when seeking to assume reinsurance business from U.S. ceding insurers. These options include:

- Obtaining a license to conduct insurance/reinsurance in the U.S. by establishing a separate affiliate entity or by directly "entering" the U.S. through a particular state and establishing a branch in the U.S.;

- Establish a multiple beneficiary trust fund which secures its obligations to all U.S. cedents plus a surplus amount which is, for an individual assuming insurer, U.S. $ 20 million (for Lloyd's the joint and several surplus amount is $ 100 million); or

- Provide individual collateral (through a trust, letter of credit or other acceptable security) to each of its ceding insurers without the necessity of a surplus amount in additional to its obligations.[2]

[2] Debra J. Hall, *Reinsurance Regulation in a Global Marketplace: A View from the United States,* pg. 7.

The collateral required for credit for reinsurance purposes most commonly takes the form of letters of credit issued on behalf of an unauthorized reinsurer, or a separate trust account established by an unauthorized reinsurer, with the ceding company in either case designated as the "beneficiary."

A letter of credit (LOC) is a document issued by a bank at the request of the unauthorized reinsurer (the "account party"), which stipulates that the bank will honor any draft presented by the beneficiary pursuant to a reinsurance agreement between the account party and the beneficiary. The LOC must be "clean" (i.e., not subject to any other documents conditions or to any limitations, other than its face amount, and not dependent on reimbursement from the account party), irrevocable (not cancelable prior to its stated expiration date), and must contain an "evergreen clause" (provides for automatic extension for a further twelve months unless at least 30 days advance notification of intent not to extend the LOC has been provided to the beneficiary), and must be issued or confirmed by a qualified U.S. financial institution (the Securities Valuation Office (SVO) of the National Association of Insurance Commissioner's (NAIC) maintains a listing of such institutions).

LOCs have been simple and reliable method of securing the obligations of unauthorized reinsurers. In reviewing the company's collateral arrangements, U.S. regulators verify that the LOC issued on behalf of any unauthorized reinsurer is an amount at least equal to the amount of annual statement credit taken as respects reinsurance ceded to that reinsurer, and all LOCs bear an effective date no later than the date of the most recent financial statement on which credit for reinsurance ceded to the unauthorized reinsurer has been taken.

As an alternative to LOCs, a trust account, in an amount sufficient to cover its obligations to the ceding company may be established by an unauthorized reinsurer (the "grantor"). The trustee must be a qualified U.S. financial institution (listed by the SVO), and the trust agreement must designate the ceding company as sole beneficiary, with unrestricted right to withdraw assets from the account without prior notice to the grantor and without any required documentation or conditions apart from those stipulated in the trust agreement itself.

The trust agreement often stipulates the nature and the type of assets, which may be deposited into the account; U.S. regulators verify that all assets held in such accounts are consistent with normal standards for admitted assets. The agreement should stipulate that it cannot be terminated unless at least 30 days prior notice has been given to the beneficiary, and that upon termination any assets not previously withdrawn by the beneficiary may be returned to the grantor only with the approval of the beneficiary.

From 1997-2001, non-U.S. reinsurers have written an increasing percentage of U.S. ceded reinsurance premiums. In 1997, non-U.S. reinsurers wrote approximately 38.4% of the total ceded premiums with U.S. unaffiliated cessions accounting for 61.6% of premiums. In 2001, the non-U.S. share had increased to 48.0% with the domestic reinsurers comprising 52.0% of the total.[3] An obvious question would be that if indeed the non-U.S. market share of U.S. ceded reinsurance premium has been increasing, then how can current U.S. regulations be considered unduly onerous to non-U.S. reinsurers?

Reinsurance Intermediaries

Reinsurance intermediaries, or brokers, play an important role in the reinsurance marketplace, and are also subject to regulatory control.[4] Nearly all of the states have implemented licensing requirements for reinsurance brokers. The Reinsurance Intermediary Model Act:

- Provides for licensing requirements for reinsurance brokers, managers and intermediaries.
- Establishes requirements regarding proper documentation of reinsurance transactions
- Requires insurers to employ licensed brokers, intermediaries and annually review their financial statements.
- maintenance of records and accounts, and timely remittance of funds held by the broker in a fiduciary capacity
- Requires a written contract with the reinsurance intermediary or broker.

Reinsurance contracts that are negotiated via intermediaries must include an Intermediary Clause, which states that the:

- Credit risk for the intermediary is on the reinsurer. Payment from the ceding company to the broker is deemed paid to the reinsurer.
- Payment to the broker from the reinsurer does not relieve the obligations of the reinsurer to the ceding company.

Assumption Reinsurance

While regulatory treatment has historically been somewhat inconsistent from state to state, it is expected that to the extent that states adopt the major elements of the NAIC Assumption Reinsurance Model Act[5] there is likely to be greater uniformity in future regarding policyholder notification, disclosure and prior regulatory approval of such transactions. Since long-term non-cancelable policies are preponderantly found in the life and health sector, assumption transactions are utilized much more extensively there than in the property-casualty sector.

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[3] Reinsurance Association of America, Alien Reinsurance in the US Market 2001

[4] See NAIC Reinsurance Intermediary Model Act

[5] See NAIC Assumption Reinsurance Model Act

- This act is not as widely passed by the states.

- Assumption reinsurance contracts have a novation in the contract, meaning the assuming company is deemed to step into the place of the company that originally issued the policy.

- Approval by the insurance department is required.

- Policyholder notice and acceptance or rejection of the transfer is also required.

Disclosure of Material Transactions

The Disclosure of Material Transactions Model Act[6] requires insurers to file a report with their domiciliary state that discloses material:

- Acquisitions and disposals of assets that represent more than 5% of admitted assets.

- Renewals, cancellations or revisions of ceded reinsurance agreements (> 50% of ceded premium or >50% ceded loss and LAE reserves).

- Material new ceded reinsurance agreements.

- An authorized reinsurer representing more than 10% of total cession is replaced with unauthorized reinsurers or collateral requirements are reduced.

  No report is required if:

  - The company cedes less than 10% of total written premium or

  - Less than 10% of reserves or

  - The transaction has already been submitted for approval of the insurance commissioner.

<u>Accounting Practices and Procedures Promulgated by the NAIC</u>

The NAIC, through its committees and working groups, facilitates many projects of importance to the insurance regulators, industry, and users of statutory financial information. The mission of the Accounting Practices and Procedures Task Force is to identify, investigate and develop solutions to accounting problems with the ultimate goal of guiding insurers in properly accounting for various aspects of their operations and to modify the Accounting Practices and Procedures Manuals. However, these Manuals are not intended to preempt states' legislative and regulatory authority. It is intended to establish a comprehensive basis of accounting recognized and adhered to, if not in

[6] See NAIC Disclosure of Material Transactions Model Act

conflict with state statutes and/or regulations, or when the state statutes and/or regulations are silent.

To carry out the mission, the Accounting Practices and Procedures Task Force is charged with carrying out the following initiatives:

- Provide authoritative guidance to insurance regulators on current statutory accounting issues.

- Continue evaluation of statutory accounting principles for purposes of development, expansion and codification.

- Extend evaluation of statutory accounting principles to address areas specific to health entities.

- The Statutory Accounting Principles Working Group maintains codified statutory accounting principles by providing periodic updates to the guidance which address new statutory issues and new generally accepted accounting principles (GAAP) pronouncements as they develop.

An Accounting Environment for Insurance Companies

Accounting is the process of accumulating and reporting financial information about an economic unit or group of units. Relative to commercial enterprises, the users of accounting information include management, investors, potential investors, lenders, investment analysts, regulators, and customers. Although customers of most commercial enterprises have no direct financial interest therein and generally are only concerned with the price to be paid for the product or service purchased, they may use accounting information to make choices as to the entity with which they engage in a business transaction. This is particularly relevant to purchases of insurance products inasmuch as insurance contracts involve a promise to pay, which may extend years into the future. Insurance products may provide benefits well in excess of the purchase price or premium. The benefits ultimately received are almost always greater than the price (premium) paid and can only be estimated at the time the product (policy) is purchased.

Insurance commissioners are charged with overseeing the financial condition of insurance companies doing business in their jurisdictions and they require meaningful financial, statistical, and operating information about the companies. This financial oversight is designed to help ensure that policyholders and claimants receive the requisite benefits from the policies sold, often times such products having been sold years or decades prior to when the benefits are due. Frequently, this regulatory perspective differs markedly from the perspectives of other users of insurers' accounting information. In recognition of these special concerns and responsibilities, statutory accounting principles have been established by statute, regulation, and practice.

Comparison Of GAAP And SAP

The objectives of GAAP reporting differ from the objectives of SAP. GAAP is designed to meet the varying needs of the different users of financial statements. SAP is designed to address the concerns of regulators, who are the primary users of statutory financial statements. As a result, GAAP stresses measurement of emerging earnings of a business from period to period, (i.e., matching revenue to expense), while SAP stresses measurement of ability to pay claims in the future. This difference is illustrated by the fact that statutory policy reserves are intentionally established on a conservative basis emphasizing the long-term nature of the liabilities. Under GAAP, the experience expected by each company, with provision for the risk of adverse deviation, is used to determine the reserves it will establish for its policies. GAAP reserves may be more or less than the statutory policy reserves.

- Some other differences between SAP and GAAP have included:

- GAAP has recognized certain assets which, for statutory purposes, have been either nonadmitted or immediately expensed. Policy acquisition costs are expensed as incurred under SAP since the funds so expended are no longer available to pay future liabilities. Insurance company financial statements prepared in accordance with GAAP defer costs incurred in the acquisition of new business and amortize them over the premium recognition period.

- Deferred income taxes have, historically, not been recognized under SAP.

The methods of accounting for certain aspects of reinsurance under GAAP may have varied from SAP, e.g., credit for reinsurance in unauthorized companies.[7]

The NAIC/SSO Role

The NAIC has undertaken, as part of the overall effort to strengthen the regulation of reinsurance, to provide a centralized resource, which states can turn to for assistance on technical reinsurance questions, or questions related to statutory accounting treatment of reinsurance transactions. Since reinsurance agreements are often very complex documents, many states take advantage of the services of the Reinsurance Department in the Financial Services Division of the NAIC for assistance in interpreting contract provisions, understanding their practical effects on the company's financial condition, and determining the extent to which statutory credit may appropriately be allowed.

Summary

Taken together, all of these regulatory efforts mean that reinsurance transactions are reported in much greater detail and with greater accuracy in company financial statements, which means that regulators and other users of these financial statements can place greater reliance on them. Companies have also been given positive motivation to

[7] NAIC, Accounting Practices and Procedures Manual, Preamble, Volume I (2002).

pay very close attention to the quality of the reinsurance protection that they buy, which means that unrecoverable reinsurance should be much less of a problem in future. The focus on financial credit given reinsurance recoverables remains the cornerstone of the U.S. reinsurance regulatory environment. Mutual recognition or reduction in collateral requirements will require some time until there is more transparency in regulatory systems and accounting systems in non-U.S. jurisdictions.

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