

Capital and finance: Credit where Credit is due

BRAVE Partners looks at the November announcement from the NAIC of changes to the collateral requirements for non admitted insurers.

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Relaxing in Maryland

The National Association of Insurance Commissioners (NAIC) announced at their fall meeting held in Maryland in November that it had decided to adopt a new model law on collateral for foreign reinsurers after a decade of debate. Most commentators applaud the move and think it is not before time; moreover Reinsurance Association of America President Frank Nutter said the model law would help to modernize reinsurance regulation.

The Devil is in the Detail

As most people in the Industry are aware, until this announcement credit would only have been given for non-admitted reinsurance either through a sizeable US trust or by posting collateral in the form of letters of credit or other admitted assets.

Under the new proposals credit will be allowed to a ceding company where (i) the reinsurer is certified by the relevant State insurance regulator and (ii) security is provided in accordance with a sliding scale which may be less than 100% of the liabilities ceded. Carriers will need to be domiciled in a qualifying jurisdiction and according to the NAIC press release the some of the criteria to be applied are:

The cogs of regulation can move slowly, but progress is being made on the required security for offshore reinsurance out of the USA.

- A State will evaluate a reinsurer that applies for certification, and will assign a rating based on the evaluation. A certified reinsurer will be required to post collateral in an amount that corresponds with its assigned rating (0%, 10%, 20%, 50%, 75% or 100%), in order for a U.S. ceding insurer to be allowed full credit for the reinsurance ceded.
- Each State will have the authority to certify reinsurers, or a commissioner has the authority to recognize the certification issued by another NAIC-accredited state.
- The NAIC will publish a list of qualified non-U.S. jurisdictions. The commissioner must document any reasons for approving a jurisdiction not on this list.
- A new notification provision was added requiring a U.S. ceding insurer to notify its domestic regulator if reinsurance ceded to an individual reinsurer or group of affiliated reinsurers exceeds certain specified amounts.

The tables below set out the security assigned to difference rated reinsures and the collateral requirement for that level of security.

Ratings	Best	S&P	Moody's	Fitch
Secure – 1	A++	AAA	Aaa	AAA
Secure – 2	A+	AA+, AA, A-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure – 3	A	A+, A	A1, A2	A+, A
Secure – 4	A-	A-	A3	A-
Secure – 5	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB
Vulnerable – 6	B, B-, C++, C+, C, C-, ,D,E,F	BB+, BB, BB-, B+, B, B-, CCC, CC, C,D,R	Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C	BB+, BB, BB-, B+, B, B-, CCC+, CC, CCC-, DD

Ratings	Security
Secure – 1	0%
Secure – 2	10%
Secure – 3	20%
Secure – 4	50%
Secure – 5	75%
Vulnerable – 6	100%

Don't hold your breathe

In theory, all of this should lead to lower cost and better liquidity for reinsurers but the key question is whether it will really happen. First of all it is dependent upon each State regulator implementing the proposals. There have already been murmurings in the press about how this is not favorable to US insurers or reinsurers. Implementation could be a slow and contentious process.

The offshore reinsurance market has long argued that the collateral needs are less about security and more about business protection.

Secondly, primary insurers may not like the idea of less collateral. Collateral is not only a risk mitigant but it eliminates any jurisdictional issues in dealing with foreign reinsurers. It may be that smaller companies may not have the influence to insist on collateral being maintained; but large primary insurers, and smaller ones with profitable books of business, may well be able to insist on current collateral levels being maintained regardless of the regulatory environment. At BRAVE Partners we will be watching developments with interest.

Expertise

Over the years, the BRAVE Partners have amassed considerable knowledge and experience in collateralizing offshore transactions out of the USA. Often, this is the most complex piece of the transaction.

BRAVE Partners services

BRAVE Partners is a boutique investment bank that specialises in the (re)insurance and alternative energy sectors. The firm is currently working on a number of transactions in the insurance sector. In particular the firm is mandated to develop uses for a provider of alternative collateral. This product has been used in the USA and is NAIC approved.

Interaction

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- BRAVE Partners is a boutique investment bank with specific expertise in the reinsurance sector.
- The firm has considerable experience in structuring collateral to support offshore reinsurance out of the USA.
- BRAVE Partners LLP believes that the USA rules will reduce the amount of collateral needed over time. However this will take time and collateral is an important commercial issue – so the need will never disappear.
- BRAVE Partners can advise on and arrange collateral for most offshore reinsurance from the USA.

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