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September 5, 2014

Mr. Daniel Schelp
Managing Attorney
Reinsurance Task Force
Financial Condition (E) Committee
National Association of Insurance Commissioners

Re: Comments on the Reinsurance Task Force's exposure draft "Securities Listed by the Securities Valuation Office"

Dear Mr. Schelp,

On behalf of the American Academy of Actuaries'¹ Reinsurance Committee, I would like to submit the following observations in response to the National Association of Insurance Commissioners' (NAIC) Reinsurance Task Force's request for comments on the exposure draft "Securities Listed by the Securities Valuation Office." Our comments specifically address the security provided for the purpose of collateralizing reinsurance obligations.

Before considering the types of invested assets acceptable for reinsurance collateral in trust, it is important to review the purpose of the collateral. Collateral is not a substitute for the reinsurer's contractual obligation to pay amounts due. Rather, it is a source of funds to supplement such a contractual obligation by covering any delay in payments by the reinsurer or any ultimate shortfall due to financial difficulties. Since payments by the reinsurer normally are scheduled over many years, it is unlikely that the full collateral will be needed at one time to cover a reinsurer's current contractual obligations or that a shortfall of the full amount will occur due to financial difficulties. This has been recognized explicitly by the NAIC in recent rule changes allowing a reduction in collateral below the full level of reserves for certified reinsurers.

The Credit for Reinsurance Model Law was developed with the idea that collateral does not need to be liquid at all times. In general, any asset admissible on the balance sheet of U.S. insurers has been acceptable as reinsurance collateral in order to create parity with the assets backing reserves in licensed U.S. insurers. Such assets are valued at market value for purposes of collateral so that they are equivalent to cash. The task force has expressed concern that it may not be possible to sell some Securities Valuation Office (SVO) listed assets immediately for cash. Given the intended use described above, any possible delay likely will not be a problem, because the entire

¹ The American Academy of Actuaries is an 18,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

amount is not needed as cash immediately. As such, eliminating parity with invested assets admitted on U.S. licensed insurers' balance sheets will not enhance reinsurance security materially.

Reinsurance collateral originally was structured to serve another purpose. In the unlikely situation where the reinsurer could not meet its obligations, the existence of collateral with a market value equal to the ceded reserves would maintain the integrity of the ceding company's balance sheet. If the ceding company had to reinstate the reserve liability on its balance sheet, it also could label the entire amount of trust as collateral and post the invested assets (at market) to balance the liability. For this use of reinsurance collateral, it was immaterial whether the assets could be immediately converted to cash. This is similar to admitted assets held by U.S. licensed insurers used to back un-reinsured reserves.

Therefore, we suggest that any proposed changes be studied carefully to ensure the longstanding parity between acceptable reinsurance collateral and admissible assets on U.S. licensed insurers' balance sheets.

Thank you for this opportunity to comment on the "Securities Listed by the Securities Valuation Office" exposure draft. If you have any questions or would like to discuss any of these comments in more detail, please contact Lauren Sarper, the Academy's senior policy analyst for risk management and financial reporting, at 202.223.8196 or sarper@actuary.org.

Sincerely,

Jeremy Starr, MAAA, FSA
Chairperson, Reinsurance Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries