

LETTERS OF CREDIT FOR REINSURANCE TRANSACTIONS

No domestic insurer may reinsure with an insurer which is not authorized to transact insurance or reinsurance unless it has the commissioner's written approval in advance. NRS 681A.110. Even if the domestic insurer obtains the commissioner's approval, it will be penalized in its annual statement for ceding business to an unauthorized reinsurer. The penalty is the amount of loss reserves and unearned premium ceded to the reinsurer and is charged against surplus. This penalty could be reduced by a letter of credit (LOC) issued by a bank in favor of the ceding insurer. The ceding insurer may then take a credit to the extent of the LOC.

To allow the ceding insurer credit, LOCs are acceptable if the banks are listed on the National Association of Insurance Commissioners' Security Valuation Office list (SVO-NAIC). See: Section 6 of SVO-NAIC, Purposes and Procedures of the Securities Valuation Office, (1990). It is each insurer's duty to determine the current status on this list for the bank before accepting LOCs from reinsurers. If a bank is not on, or has been deleted from the list, its LOC is not acceptable for reinsurance transactions.

In addition, LOCs must comply with the reinsurance standards set forth in the NAIC Examiner's Handbook. See: Part 5(III) of the NAIC Financial Condition Examiners Handbook, (1990). At a minimum, the standards require LOCs to be clean, irrevocable, and have an evergreen clause with a one-year minimum time certain. It is each insurer's duty to determine whether the LOC is in compliance with current NAIC reinsurance standards. If a LOC is not in compliance with such standards, it is not acceptable for backing reinsurance transactions.

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