

New York Insurance Exchange

Sub-Group Recommendations

June 28, 2010

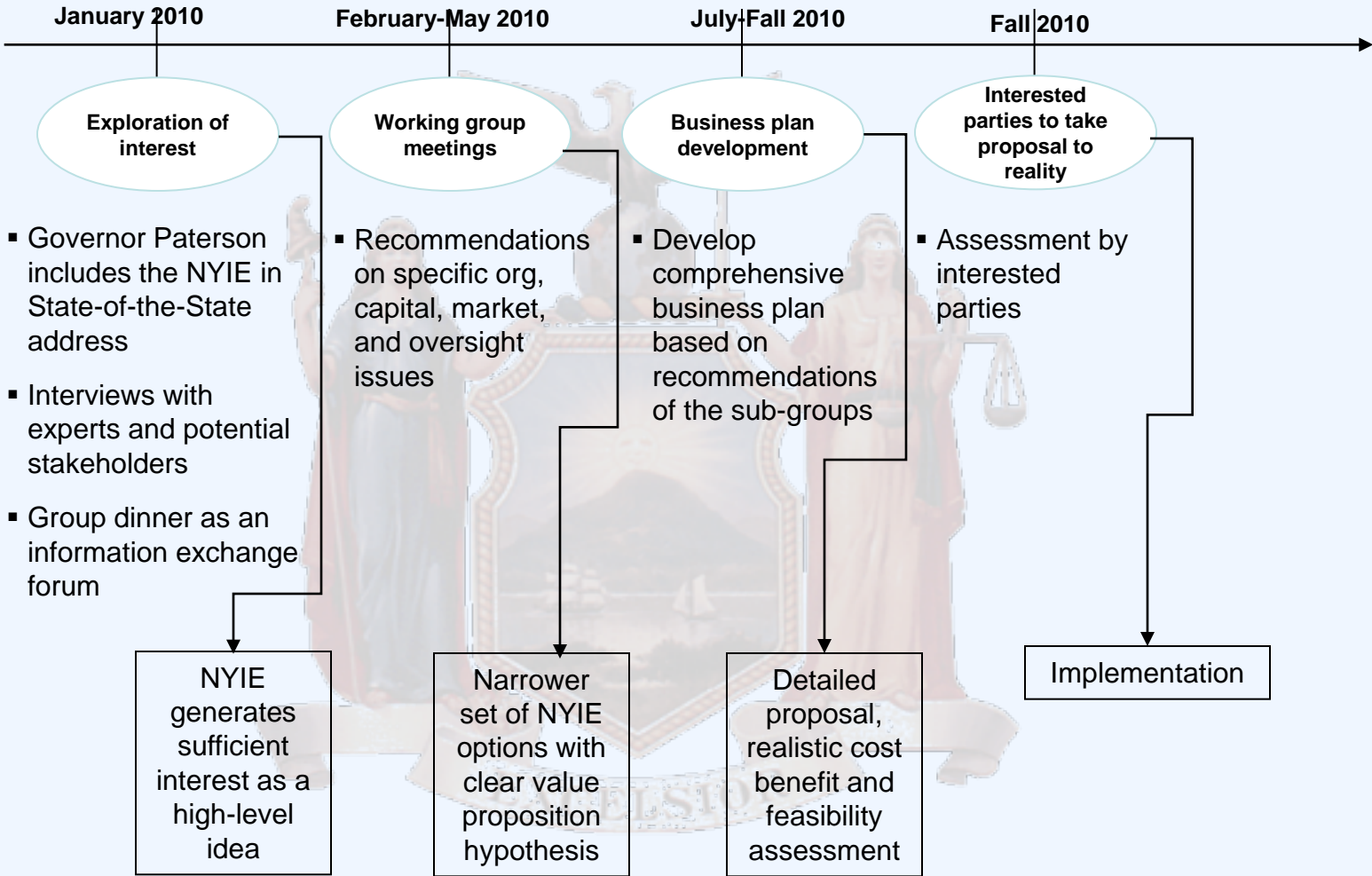
NYC, NY

New York State Insurance Department

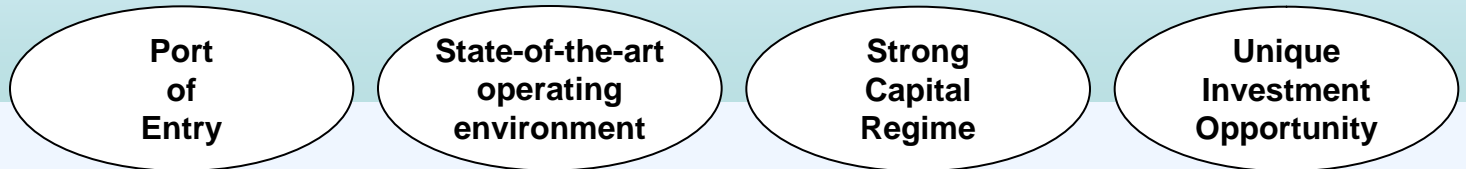
Context

- New York is exploring the merits of reviving the New York Insurance Exchange (NYIE)
- Chief aims are
 - To reinforce the US and New York's position as a leading global financial center
 - To stem and reverse the flow of insurance capital covering US exposures that is migrating to foreign and offshore domiciles
 - To make the NYIE a viable marketplace a competitive value proposition should be defined along the dimensions of regulatory framework, tax regime, operating environment, and capital structure
- Following preliminary discussions with potential stakeholders, the NY State Insurance Department created several working sub-groups focused on
 - Markets
 - Government Relations
 - Taxes
 - Operations and Technology
 - Capitalization
 - Regulatory Oversight
 - Multi-State Issues
- The purpose of this document is to summarize the preliminary recommendations of the sub-groups and define next steps

NYIE Timeline



Emerging Value Proposition Strategy



Reasons why competitive position should be sought

- Key competitors (Bermuda, Lloyds) have a structural disadvantage relative to a US based location

- Reduction in frictional costs by minimizing “bricks-and-mortar” aspect
- Ease of access will maximize participation

- Prerequisite for acceptance of NYIE syndicates by other jurisdictions and commercial insurance marketplace

- Insurance risks are not correlated to the bond, stock or credit markets
- More cost effective and efficient entry into insurance marketplace

Reasons why competitive position should not or cannot be targeted

- Stringent capital requirements necessary to gain acceptance by other states may discourage participation
- Other states may require limiting the parts of the market open to syndicates as a price of admission

- Initial start-up cost for technology infrastructure

- Cost of capital

- Possible need for restrictions on withdrawal of capital

Value Proposition

- 50-State access (All or most US jurisdictions)

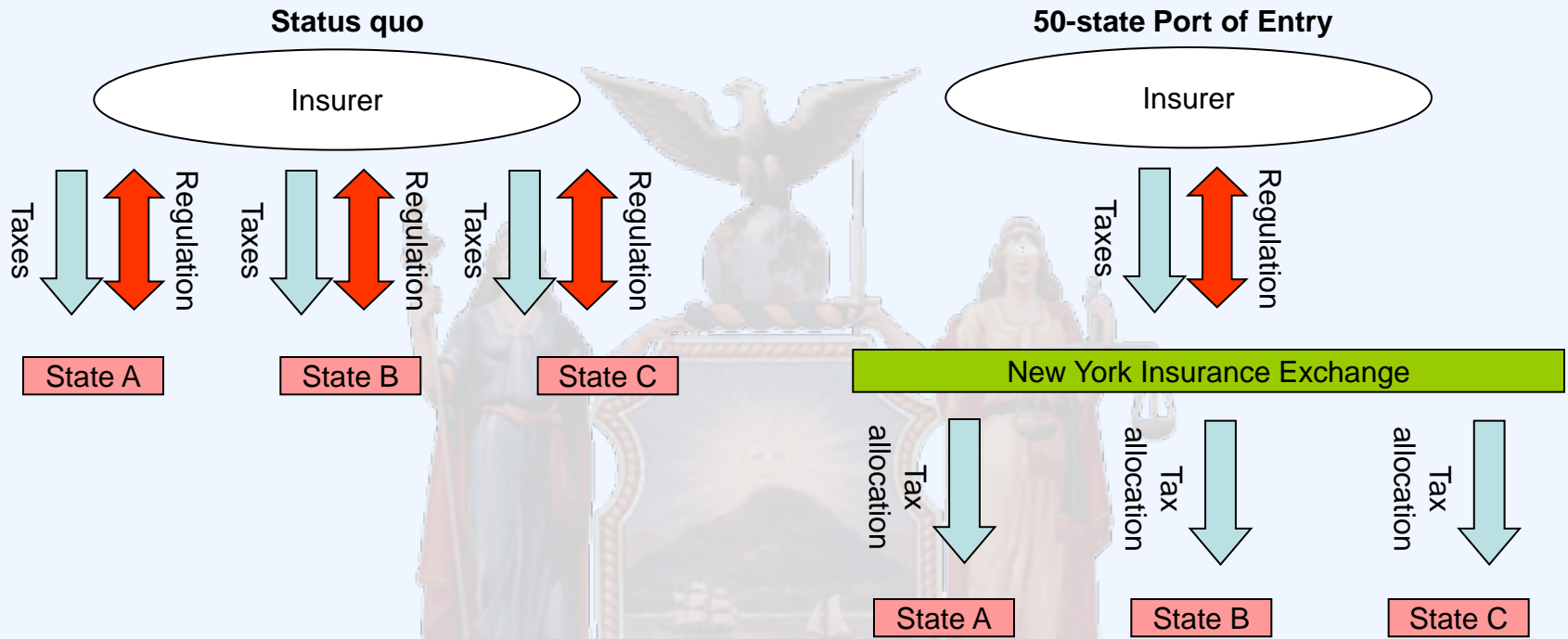
- Full online access and state-of-the-art service support model

- At least “A” rating

- Ability to allocate capital to specific insurance risk

50-State Port of Entry

The single port of entry could provide significant frictional cost relief to insurers and help state regulators streamline their tax collections

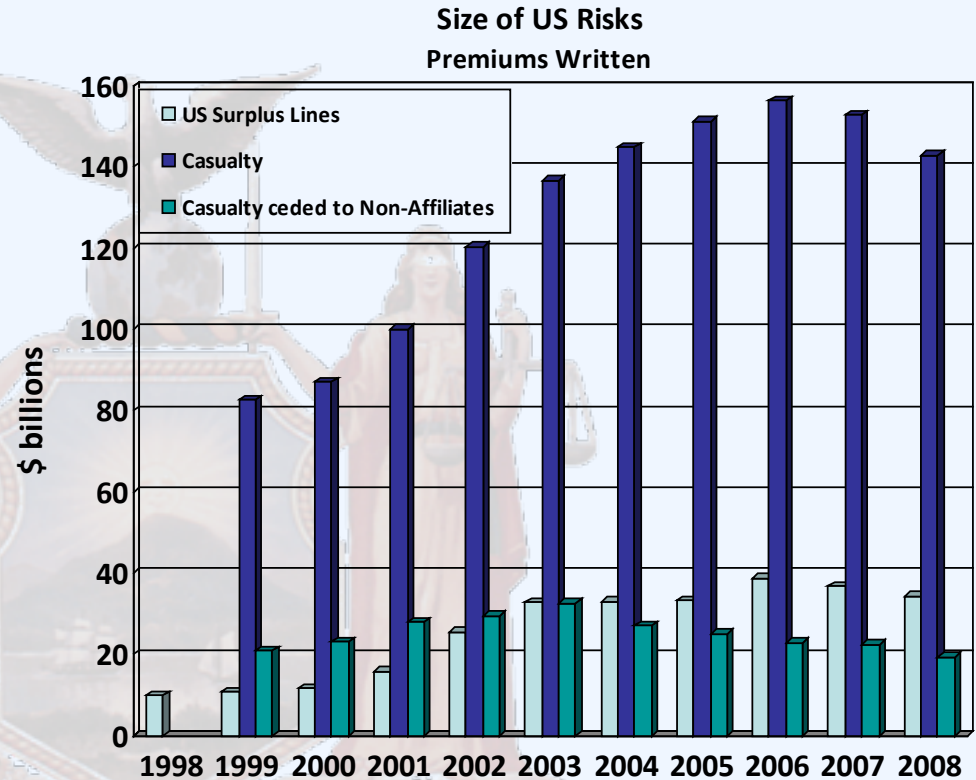


Benefits

- Eliminating regulatory redundancies reduces frictional cost of doing business for NYIE participants
- Streamlined tax allocation provides for effective and efficient revenue collection for the states

Preliminary Recommendations of the Markets Sub-Group

- Types of Risks to be Underwritten on the NYIE
 - Focus on commercial insurance
 - Casualty
 - Excess / Surplus lines
 - Reinsurance
- Alternative Risk Transfer Mechanisms
 - Continue to consider how to incorporate into the NYIE framework
 - Consider expansion of underwriting authority under Article 62 to allow for a broader range of acceptable risks



Source: AM Best

* Casualty figures shown include Worker's Comp, Medical and other Professional Liability, Product Liability

Preliminary Recommendations of the Tax Sub-Group

The NYIE is unlikely to differentiate itself from its competitors through a more favorable tax regime

Competitive bar very high

- Bermuda already has a very favorable tax regime and is still losing business to Ireland

- The example of Ireland demonstrates how important an attractive regulatory and market access value proposition can be

Political climate not conducive to perceived “tax gifts” to the financial services sector

- Substantial portions of total tax burden are under control of the Federal government

- Non-tri-state area voters possibly not keen to extend tax breaks to NY-based financial service providers

Not viewed as a critical differentiator

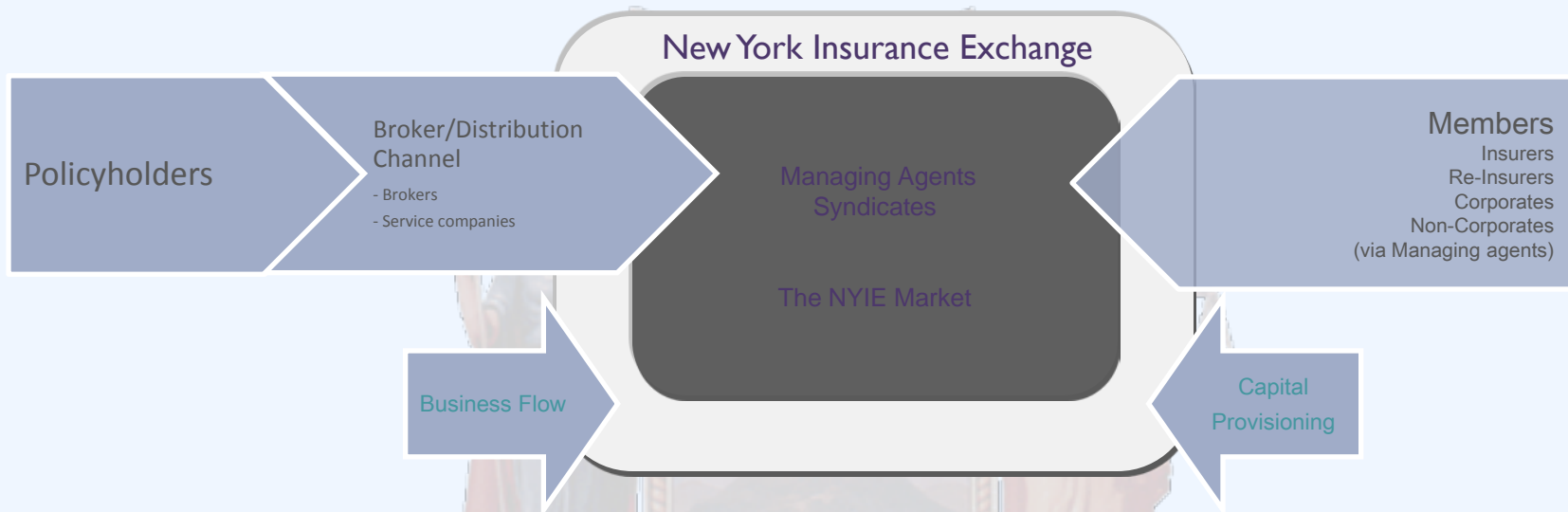
- Participants of discussions “not sold” on criticality of favorable tax treatment

- Lower taxes “always help” but other elements may be equally critical to the overall value proposition

Preliminary Recommendations of the Operations & Technology Sub-Group

- Corporate form of the NYIE – to be determined among for-profit entity, not-for-profit entity, public corporation
- Requires amending Article 62 to enhance flexibility as regards to corporate form
- Internal corporate governance structure:
 - Board membership
 - Internal Oversight and Enforcement Sub-Committee
 - Audit Sub-Committee
 - Appointments & Compensation Sub-Committee
 - Investment Reporting Unit
 - Market Guidelines & Performance Unit
 - Coverage Disputes & Appeals Unit
 - General Operations

Recommendations of the Operations & Technology Sub-Group

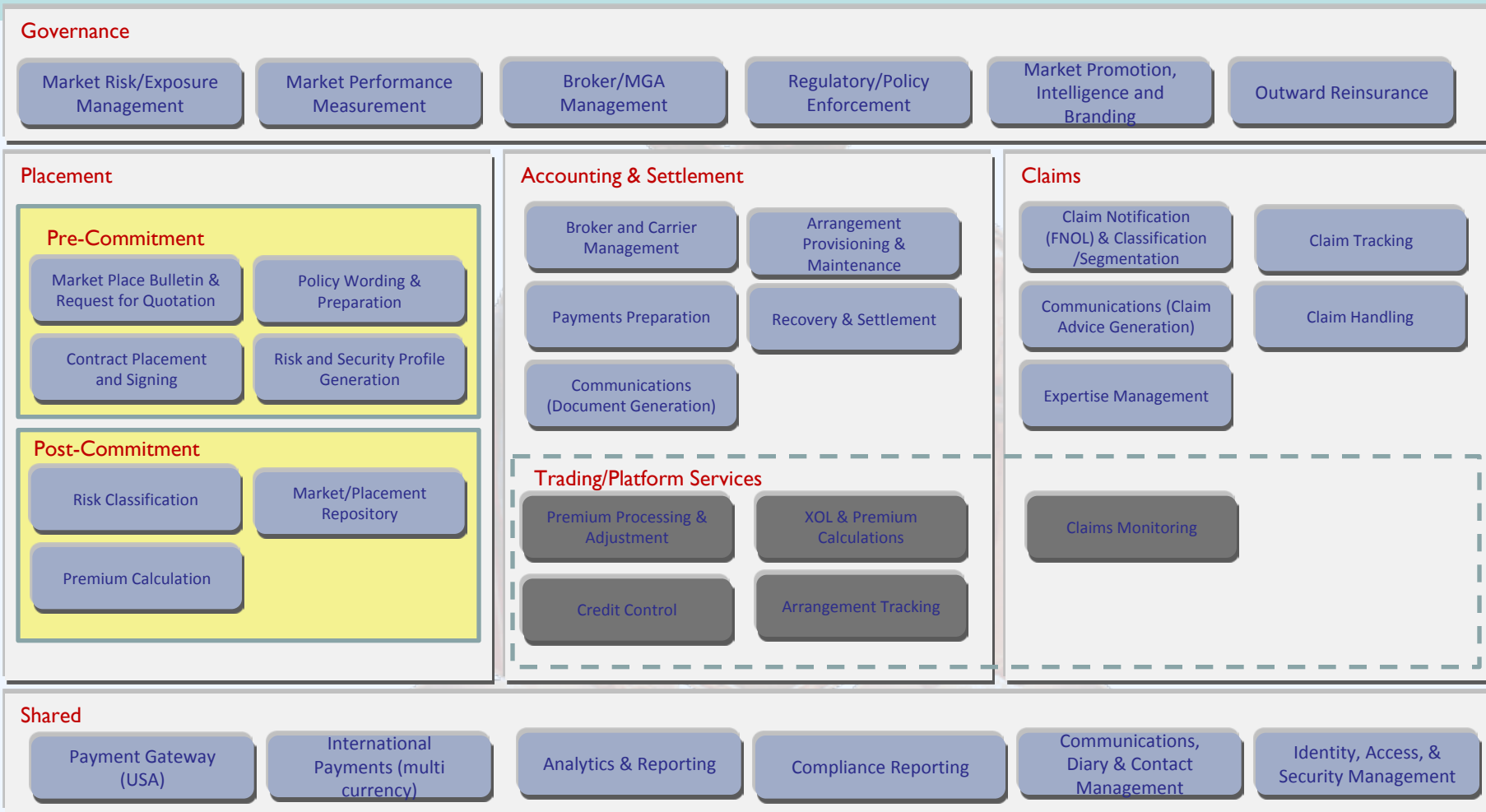


- A virtual insurance marketplace
- Delivering highly efficient processes and low operational costs
- Supported by real-time provision of market performance data
- Underpinned by recognized standards, offering ease of entry to new business

Operations & Technology Sub-Group – Architecture: Key Principles

- **Ease of Entry:** The technology should allow both traditional and non-traditional parties (Brokers, MGAs, Underwriters, service companies, etc.) to efficiently transact on the NYIE
- **Ease of Use:** The technology should allow for the seamless integration of heterogeneous platforms using the latest technology and industry standards (e.g. ACORD)
- **Low Cost :** The proposed architecture should operate on a low-cost basis without impacting the quality of the data, processes, and services provided. The reuse and integration of ‘best of breed’ components is preferred
- **Technology Excellence:** The NYIE platform architecture should use up-to-date technologies wherever possible and take advantage of web-based techniques such as virtualization and cloud to deliver services in a highly cost effective manner
- **Security:** The technology should offer a market directory and leverage a unified identity and security infrastructure to enable the flexible provisioning and enforcement of security policies. Data security and process traceability should be key attributes of the NYIE platform to underpin Contract Certainty
- **Governance & Market Reporting:** The technology architecture should support a strong regulatory and governance regime, offering real-time reporting of market performance information and its aggregation and assessment against market key performance indicators

Operations & Technology Sub-Group – Illustrative Business Capability Model



Preliminary Recommendations of the Capitalization Sub-Group

- Each syndicate will be required to produce an assessment of its own capital needs using an internal model. These assessments form a key input in determining syndicate-level capital requirements
- The NYIE will allow, to a certain extent, each individual syndicate to apply contingent capital sources to fulfill its unique capital requirements
- All individual syndicate level capital assessments (SLCAs) are subject to (at a minimum) annual reviews by the NYIE
- The reviews by the NYIE will be rigorous checks of each SLCA, including assessing the suitability of the methodologies and assumptions used
- The NYIE will rely on its own capital model benchmark number, plus potential risk load factor, to set syndicate capital requirements in the absence of acceptable SLCA
- The NYIE will require a higher level of capitalization if it is determined that the current level of capital is inadequate
- The NYIE will ensure each syndicate has the appropriate level of capital, so that each syndicate does not pose risk to the exchange as a whole
- **Acceptance by state insurance regulators and the credit rating agencies will be important in establishing capital standards**

Preliminary Recommendations of the Regulatory Oversight Sub-Group

The NYIE should be a self-regulatory entity with oversight by a dedicated unit within the NYSID

- Key Self-Regulatory features:
 - Develop entry standards and procedures for underwriters, capital providers, and brokers
 - Careful and thorough review of syndicate level capital assessments (“SLCAs”) and business plans
 - Stress and scenario testing of SLCAs
 - Automatic ongoing reporting by syndicates with any change in risk profiles, business climate, alteration of business plans, etc.
 - Regular business reporting to validate business plans and compliance with SLCAs
 - Access to real time information to monitor market activity
 - Establishment of a security fund
 - Protection of the assets of the security fund through rigorous oversight of the syndicates
 - Establishment of its own funding and personnel requirements
- Key features of the regulatory oversight by a dedicated unit within the NYSID will be to
 - Ensure NYIE abides by its own internal rules and regulations
 - Summary review of business plans and SLCAs of syndicates
 - Require higher levels of capital if deemed warranted
 - Conduct reviews of business plans and potentially require revisions to business plans
 - Access to real time information to monitor activity in the aggregate and at the syndicate level

Next steps

Based on the feedback from the sub-groups a detailed business case should be created by Fall 2010.

The business plan should specify

- Corporate form - A process to determine the initial corporate form
- Sizing – A more detailed identification of target market segments
- Economics of value proposition – A high level estimate of the savings from access to the US market through a single port of entry
- Feasibility of 50-state port of entry – Level of support and likely requirements by other state regulators to approve such a construct
- Rating agency support – Key requirements for rating agency acceptance
- Operating platform – Detailed design proposal
- Governance – Structure, including risk management, capital oversight, specific entry and exit requirements
- Financials – Start-up costs, initial capital requirements, and ongoing economics
- Benefit to the NY area – Value generation expected from the initiative

