New York Insurance Risk Exchange ("NY–IREX")

-- D R A F T --

Plan to Implement the Recommendations of the Industry Working Group

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Presented by:

The Insurance Risk Exchange Organization Committee

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Introduction

In June 2010 the Insurance Exchange Working Group assembled by the New York Superintendent of Insurance, James J. Wrynn, presented its preliminary recommendations for re-establishing an operating insurance exchange under existing Article 62 of the New York Insurance Law. Following the issuance of the Working Group recommendations, several key supporters of the exchange concept, working with the New York Insurance Department, engaged in informal discussions with regulators, legislators, rating agencies, potential investors, underwriters, managers, brokers, intermediaries, financial institutions, and service providers to explore the climate for and feasibility of establishing an efficient, technically advanced syndicated exchange market in the US.

The positive feedback from these discussions, coupled with changing market conditions, supported the decision to move forward with the development of an action plan for the implementation of the Working Group recommendations and the re-establishment of an insurance risk exchange facility under Article 62.

The following presentation sets forth the background and current landscape for a new exchange, a summary of the recommendations of the various working subgroups, the assumptions that guide the implementation of the recommendations, the regulatory and business framework for the new exchange, and the course of action proposed to bring the exchange into existence on a sustainable, working basis. The presentation also provides an overview of the benefits and value of a syndicated insurance risk exchange market in the US for each constituency – whether an investor, underwriter, manager, broker, intermediary, rater or regulator.

The objective of this plan is to provide a road map for interested elements in the financial and insurance industries, their service providers, insurance consumers, and regulators and rating agencies, to establish a new US insurance risk exchange on a proper and sound basis through implementing the Working Group recommendations.

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1. Why an Insurance Risk Exchange?

An insurance risk exchange is a platform for the underwriting of insurance risks through the syndication of capital and concentration of underwriting and management expertise in a common market. The most preeminent example of a successful, sustainable exchange market is Lloyd's of London with its three plus centuries of operations. An insurance risk exchange presents a number of benefits and advantages to its users and its customers over many stand-alone insurance companies including the concentration of diverse capital sources, underwriting and supporting expertise, flexibility of product and efficiency of operations.

Although several attempts at creating an exchange market in the US have occurred in the past,[1] US market constraints, regulatory inflexibility and bad timing, *inter alia*, hindered these efforts. Most importantly, however, the efforts occurred before the explosion of alternative risk vehicles, including offshore excess vehicles, captive insurance companies, risk retention and risk purchasing groups, catastrophe bonds, side-cars, and similar risk-spreading devices. ***The lessons of the past and the dramatically different environment today – particularly in the area of technology – offer the opportunity to create a modern, efficient syndicated exchange marketplace.***

2. The Working Group Project

The effort to find common ground for establishing a new US based insurance risk exchange commenced in earnest with the creation of the Insurance Exchange Working Group by New York Superintendent of Insurance James Wrynn in 2010, who brought together over 75 senior representatives of the constituents necessary to create a successful exchange – insurers, capital providers, legislators, regulators, brokers and intermediaries, insurance purchasers, and service providers. The working Group was divided into sub-groups focusing on the following topics:

- Markets
- Capitalization and Security
- Regulatory Oversight
- Operations and Technology
- Taxes
- Government Relations
- Multi-State issues

Following meetings of each of the sub-groups, recommendations were distilled into a summary presentation by the New York Insurance Department and distributed to the full Working Group.[2]

3. Target Benefits for Exchange Participants, Customers & Regulators

For a new exchange to be successful, it must provide value to all its participants: investors, managers, service providers, as well as to its customers and regulators nationally. These value propositions are necessary benchmarks for setting the goals and providing the context for the recommendations and any plan for their implementation. Therefore, ***before reviewing the recommendations and detailing a plan of action for their implementation, it is important to review the key benefits to each constituent group that were considered in developing the recommendations and the planned steps for their implementation.*** Some of these value propositions are common to most interested constituents, such as a technically advanced and efficient platform, but others are of a more targeted benefit.

1) **To the customer (cedants and/or commercial or high-risk insurance buyer):**
   a) Competitively priced product;
   b) Diversification through syndication;
   c) Counterparty diversification;
   d) 50-state access for reinsurance and excess and surplus lines business;
   e) Exceptional security through a central fund;
   f) An A- rating for all qualified syndicates; and
   g) An efficient, cost-effective and technically advanced platform for processing contract issuance and claims.

2) **To the exchange broker or intermediary:**
   a) A single point of contact for placing risk across multiple counterparties;
   b) Advanced technology enabling ease of risk placement, contract issuance and claim processing;
   c) Assurances of security for its customers;
   d) Compliance with current or changing local or national regulatory or filing requirements;
   e) Premium tax apportionment; and
   f) Real-time statistical and other support services.

3) **To the Underwriting Syndicate Member:**
   a) Immediately upon admission to the exchange:
      i) Passport access to all states for reinsurance and E&S business; and
      ii) A- rating without stand-alone company aging requirements;

   b) Immediate access to underwriting opportunities without counterparty concentration through syndication;
   c) Greater access for non-traditional capital providers;
   d) Economies of scale for shared services; and
   e) Prudent and flexible oversight and management.

4) To the provider of syndicate capital:
   a) Immediate access to the US and global insurance markets;
   b) Opportunity to invest in risks not directly correlated to capital markets;
   c) Increase capacity through a syndicated marketplace;
   d) Reasonable ease of exit;
   e) Potential for significant returns in a changing market; and
   f) No legacy issues.

5) To the provider of start-up capital for the exchange facility:
   a) Potential long term returns from:
      i) Fees for exchange services; and
      ii) Sale of data generated by exchange and syndicate operations;
   b) Involvement in design and structure of the facility; and
   c) Potential ownership interest in the facility or its support organization.

6) To the Syndicate Manager:
   a) Potential for Turn-key Operation;
   b) Access to major risks through syndication;
   c) Ability to develop broad-based or niche underwriting expertise; and
   d) Economies of scale for shared services.

7) To the Regulator:
   a) A highly capitalized, fully secure market;
   b) Prudent internal management structure;
   c) Significant security through a central fund;
   d) Collection point for premium and for allocation of taxes;
   e) Transparency through accessible data;
   f) On-shore market for high volatility risks; and
   g) Diversification through new sources of capital.

4. Working Group Recommendations

In order to maximize the value propositions for each exchange constituent, the Working Group determined those guiding principles that would be essential to establish a viable and sustainable facility. These central principles are summarized as follows:

> ***A. Provide a strong and secure capital base to support regulatory and rating agency acceptance;***
> ***B. Provide for prudent and flexible oversight;***
> ***C. Provide an efficient, cost-effective and technologically advanced platform for the facility and its members.***
> ***D. Achieve 50 State access for syndicates on both a reinsurance and surplus lines basis; and***
> ***E. Provide as expansive a market as possible through legislative and regulatory support.***

These five guiding principles and the proposals for their implementation and achievement are set forth in the following sections of this presentation. Each of these principles is equally important for the success of the exchange market. However, the first two – strong and secure capital requirements, and prudent and flexible oversight -- are essential to achieving the last two and are therefore dealt with first.

A. Strong and Secure Capital

One of the key common elements among each subgroup to the Working Group was the need to insure a strong capital base for the exchange. There is universal recognition of the need for a strong and secure capital base, although the perspective of each interested constituency may be different. Customers and their representatives (brokers and intermediaries) want assurance they are dealing with a financially sound market; regulators and rating agencies need to ensure the exchange is meeting their standards and requirements for acceptance or a positive rating; and investors, syndicates and their managers want to make sure that under-capitalized or poorly managed operations do not deteriorate the value of their own participation.

The recommendations for achieving a strong financial base cover several areas including high minimum capital requirements for underwriting syndicates, the establishment of a significant and responsive security fund, sound business planning requirements, and diligent but flexible oversight. This section will discuss the target capital and security requirements, and the next section will expand on the proposed structure for the implementation and regulation of the capital and financial requirements.

The target minimum capital for syndicate members on the opening of the exchange is $500 million with a total of $1 billion by the end of the second year of operation.[3] ***The minimum capital for individual syndicates will be $50 million, with an anticipated average size of $75 million during the first three-year phase of the exchange's growth.*** Although $50 million is a minimum, the actual required capital and ongoing policyholder surplus for an operating syndicate will depend on its business plan and model, including details of the types of risks intended to be underwritten. (See ***Prudent and Flexible Oversight*** below).

Each syndicate, upon applying for membership on the exchange, will submit a detailed business plan including proprietary internal models to determine a proposed minimum capital level. The exchange will review the syndicate's business plan and capitalization models for reasonableness and consistency. The syndicate will be required to update its business plan and capitalization model annually (or as required by the exchange) and maintain sufficient capital to support its ongoing underwriting activities.

A syndicate's insurance/reinsurance obligations will be secured at three levels:

(1) The syndicate's own invested assets;

(2) Trusteed assets comprising a percentage of premium collected depending on the nature and volatility of the risk; and

(3) ***A central security fund funded through an initial assessment on new members, written premium assessments, and a backstop reinsurance arrangement.***

The rate of assessments and amount of trusteed assets will be determined by the exchange's Board of Governors from time to time based on such factors as market conditions, volatility of the business written, and the concerns or requirements of regulators and rating agencies.

The goal of the capital and security requirements is to provide confidence to the insurance buyer and their representatives, and the investment community that the exchange is a viable, secure market. Further, the strong capital and security requirements are a necessary element in achieving a derivative A rating for the exchange syndicates from the rating agencies, and in securing regulatory recognition and approval nationwide by exceeding U.S. risk based capital or similar international standards.

To make sure that these goals are achieved, it will be necessary to develop a strong but prudent regulatory structure that is also flexible enough to attract and maintain capital sources for its syndicates.

B. Prudent and Flexible Oversight

The exchange will be established under existing Article 62 of the New York Insurance Law with certain modifications to bring the statute in line with today's marketplace and recent Federal legislation. These modifications, which deal primarily with the scope of business that can be written on the exchange, are discussed under the **"*Expansive Market*"** section below.

Under Article 62, the full text of which is attached as **Appendix A**, the exchange will operate and function under a constitution and by laws. The provisions of this governing document, including any amendments, are subject to approval by the New York Superintendent of Insurance,[4] who has broad discretion in establishing the regulatory environment for the exchange. The Insurance Department will establish a dedicated Insurance Risk Exchange Bureau that will provide Department oversight and liaison with the exchange, and will promulgate regulations integrating the insurance law with the exchange operations.[5] ***The primary regulator of the exchange facility and its members, however, is the exchange's board of governors, consisting of underwriting, broker and public members, with the Insurance Department in a supervisory role to ensure that the exchange's self-regulation is functioning pursuant to the approved requirements.***

The exchange will have two primary and separate functions: a financial review and enforcement division overseeing the membership application process, financial and security requirements, monitoring and enforcement; and an operational division to manage the operation of the exchange platform, including placement services, contract issuance and term certainty, claims processing, data collection and reporting. The principal oversight arm of the exchange will be under the Financial Review and Enforcement Committee of the Board of Governors, which will operate separately and independently from the operational side of the exchange.

Figure 1 below shows the relationship of the Board of Governors, the Insurance Department and the two primary functional units reporting to the Board; and **Figure 2** shows the basic structure of the Financial Review and Enforcement function:

Figure 1 – Exchange Oversight

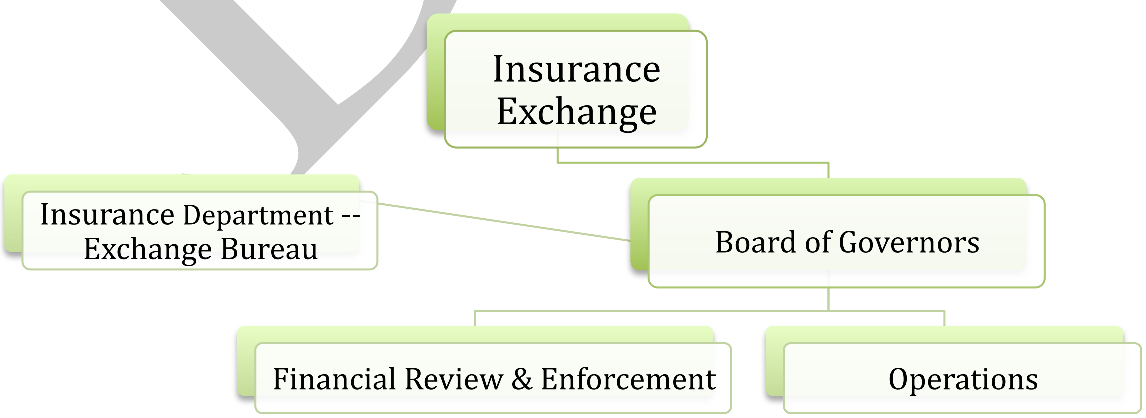


Figure 2 – Financial Review and Enforcement

The Financial Review and Enforcement Committee of the Board of Governors will be responsible review of all syndicate membership and manager applications, including review and approval of syndicate business plans, investment structure and risk assessment models for reasonableness and compliance with established capital and related standards. The Financial Review and Enforcement Committee will also be charged with monitoring ongoing compliance through comparing performance to approved business plans and models, which will be required to be updated and approved on a regular basis, and establish reasonable and flexible requirements for syndicate withdrawal from the market in an orderly manner while maintaining policyholder and claimant security.

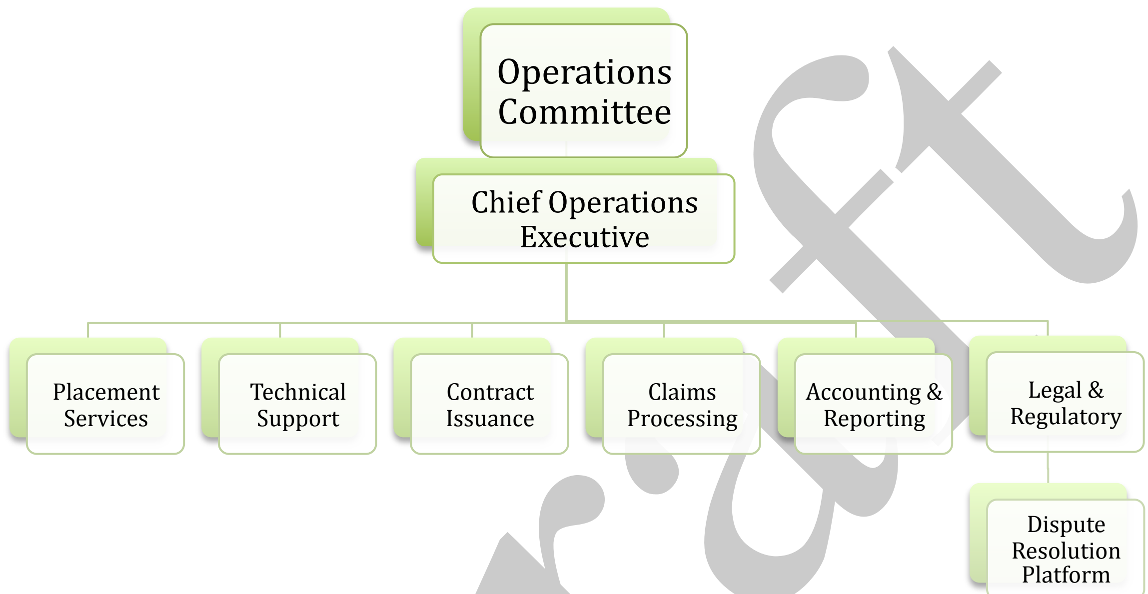
The specific structure, including other committees (*i.e.*, Audit, Compensation, Nominating, etc.), will be established by the Board of Governors as required or authorized by the exchange's constitution and bylaws (see also **Section 6, *Action Steps, and Section 7, Timeline***). The objective of the structure, however, will be to provide strong central governance to ensure that the exchange is managed as a single, separate entity with effective auditing, reporting and monitoring of risk and capital.

C. Efficient and Technologically Advanced Operations

The second, separate function of the exchange is the operation of the exchange facility for the benefit and promotion of its underwriting syndicates and participating brokers.

The primary responsibility for the operation of the exchange facility will be with the Operations Committee of the Board of Governors. The operating functions include, *inter alia*: the conduct of operations on the exchange platform; standardization of submissions and contract issuance; claim submission and processing protocols; collection of premiums and payment of claims; processing and payment of premium taxes; compliance with regulatory reporting and other requirements; and management of a dispute resolution mechanism (see Figure 3).

Figure 3. – Facility Operations



As a new entity the exchange has the opportunity to incorporate the most innovative and efficient technology available to provide a secure, web-based virtual operating platform while avoiding legacy issues of outmoded models. From a one-time initial data entry, the exchange platform will be able to perform and electronically capture all aspects of the insurance business chain, including:

- Pre-placement and placement recording;
- Contract issuance and maintenance;
- Electronic claim notification, reporting and payment; and
- Real time transactional accounting services, premium tax calculations and processing, and report generation for the oversight review and regulatory filings.

Although the exchange platform has the opportunity to use state of the art technology to deliver highly efficient processes with low operating costs, that does not mean that such a system needs to be built from scratch at an excessively high cost. ***There are a number of systems available today incorporating the essential elements for an appropriate exchange platform that can be modified for the exchange efficiently and cost effectively.*** The benefit the exchange provides is the ability to apply such a system to a new operation without the need to address existing system conversion or other legacy issues.

This misperception that the creation of a state of the art platform for the exchange would require building the platform from scratch contributed to a discussion in the Working Group of whether or not the exchange needed to be a for-profit entity. Some participants expressed the view that only a for-profit entity could generate the start-up capital necessary to create such a state-of-the art platform. However, although there may be benefits to the development of the exchange facility as a for-profit entity, the initial capital necessary to establish an appropriate platform should not be a consideration (see **Section 5, Projections**).

D. Fifty State Access[6]

One of the benefits of an exchange form of market is that once a syndicate becomes a member of the exchange it has automatic acceptance in all jurisdictions where the exchange is approved or authorized. This "port of entry" accessibility is considered an essential element to establishing a viable US exchange. The adoption last year of the Non Admitted and Reinsurance Reform Act (NRRA) as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[7] may help in eliminating overlapping and inconsistent 50 state approval to conduct business nationwide, and to the extent that the NRRA makes it easier to become admitted in all 50 states for surplus lines carriers and reinsurers, it also does so for the exchange and its syndicates. ***Coupled with the other advantages of exchange membership for its syndicates and their investors, immediate access to all 50 states, the District of Columbia and all US Territories upon acceptance on the exchange is a significant value proposition.***

The most important element of full market access is acceptance by the regulators nationwide. Through the proposed financial strength, effective oversight and real-time market performance data and reporting capability of the exchange, the exchange provides a significant and unique value to the regulators. Conveying this value to the regulators nationwide is a key element in the action plan for the exchange.

E. Expansive Market

Under New York Insurance Law Section 6201, the exchange syndicates are authorized to write the following kinds of business:

- ***A. Reinsurance of all kinds of insurance;***
- ***B. Direct insurance of all kinds on risks located entirely outside the US;***
- ***C. Direct insurance of all kinds on risks located in states other than NY on an excess and surplus lines basis (other than in NY) pursuant to the excess and surplus lines requirements of the jurisdiction in which the risk is located; and***
- ***D. Risks authorized by Article 63 of the NY Insurance Law ("Free Zone" risks), subject to certain certification requirements.***

(See **Appendix A** for the full text of the statute).

Although the existing statue is broad enough for the exchange members to operate, the Working Group and the Insurance Department recognized that certain modifications to the law would significantly enhance the competitiveness of the exchange to its members and to the financial community seeking new investment opportunities in the insurance business. The need to coordinate the Insurance law with the new Dodd-Frank bill has provided an opportunity to achieve these legislative changes. In particular, ***the Working Group and the Insurance Department support changing Section 6201 to allow syndicates to write direct risks for "exempt commercial purchasers" as defined in the Dodd-Frank bill, and to expand the surplus lines authority to cover New York risks.*** An industry Working Group proposed revision to Article 62 is attached as **Appendix B**.

With these changes the exchange should provide imaginative capital the opportunity to bring the underwriting closer to an expansive menu of risks in the US. It is expected that this opportunity will benefit the market in three overlapping phases:

- ***Phase one will provide the non-traditional insurance market the opportunity to write traditional risks on a syndicated basis;***
- ***Phase two will allow syndicates to create origination capability through, inter alia, insurance linked securities; and***
- ***Phase three will provide opportunities for private equity allowing for appropriate exit strategies (ease of exit to match ease of entry).***

To allow the exchange market to develop along these lines, however, will require demonstrating to insurance buyers and regulators that the financial requirements are more than adequate and the oversight meaningful and strong.

5. Model Projections

Following are three model spreadsheets. **Schedule 1** is an estimate of the start-up costs for the exchange, including the organizational costs and the cost of initial staffing at the time of opening, and for the first five years of operations. **Schedules 2** and **3** are consolidated income statements and balance sheets for the first five years of member syndicate operations. The principal assumptions used in preparing these schedules are as follows:

Key Assumptions:

- Ten to twenty (10 - 20) syndicate members on opening with a total capital of $1 billion.
- Net written premium of approximately $300 million in first year; increasing to $1.0 billion by end of the fourth year.
- A rating of B+ upon commencement of operations; upgrade to A- by the end of the fifth year.
- Authorization or approval to write reinsurance and surplus lines business in most states, including all major jurisdictions.
- An exchange staff of 25 upon opening of the facility primarily focused on the financial review functions and technical support for the platform.
- Expansion of staff to approximately 75 by end of first year of operations, with the expansion primarily in accounting, contract and claims areas.
- Average cost of initial 25 employees: $200,000 per employee. Average cost of subsequent employees: $150,000 per employee.
- Membership fee for new syndicates: 0.5% of initial committed capital; plus the purchase of a subvention certificate equal to 1% of initial committed capital with a $500,000 minimum (See Section 6 -- Action Steps, Phase 2 -- Organization, regarding proposed terms of subvention certificates).
- 5% of initial capital to be held in trust for the central security fund; plus 50% of net written premium to be held in trust as security for the syndicate's own business.
- Ongoing operational fees: 2% of gross written premiums.
- Ongoing security fund assessment: 1% of gross written premium.
- Organizational costs, including legal and other professional, initial staffing and technical cost of establishing electronic platform: $15 to $20 million.
- An average combined ratio by operating syndicates of 70% over the first five-year cycle, with an investment return of 2.5% to 3.5% per annum over this period.

Note: These assumptions are estimates for illustration purposes only and are not to be relied upon by any party considering investment in or membership on the exchange.

Schedule 1 – Estimated Exchange Revenue and Expenses: Pre-Opening Through Five Years of Operations (in $000s)

	Pre-Opening	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Revenue						
Subvention Certificates	$5,000	$1,000	$1,000	$1,000	$1,000	$1,000
Investor/Seed Funds	$15,000	$0	$0	$0	$0	$0
New Member Capital Assessment	$2,500	$500	$500	$500	$500	$500
Premium Assessment	$0	$6,000	$11,000	$15,000	$20,000	$22,000
Sale of Data/Services	$0	$0	$120	$50	$100	$150
Other	$0	$100	$100	$100	$100	$100
Total Revenue	$22,500	$7,600	$12,720	$16,650	$21,700	$23,750
Expenses						
IT Platform Construction	$15,000	$0	$0	$0	$0	$0
IT Expense/Licensing	$0	$1,500	$2,750	$3,750	$5,000	$5,500
Organization Expenses (legal, etc.)	$1,500	$0	$0	$0	$0	$0
Staff Salaries/Benefits	$1,000	$5,000	$6,500	$7,500	$8,000	$8,500
Interest on Sub Certs/Bonds	$0	$1,600	$1,600	$1,600	$1,600	$1,600
Legal/Accounting/Actuarial	$0	$750	$1,000	$1,000	$1,000	$1,000
Debt Repayment	$0	$0	$0	$0	$5,000	$5,000
Other	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000
Total Expenses	$18,500	$9,850	$12,850	$14,850	$21,600	$22,600
Revenue Less Expenses	$4,000	-$2,250	-$130	$1,800	$100	$1,150
Cumulative Revenue Less Expenses	$4,000	$1,750	$1,620	$3,420	$3,520	$4,670
Security Fund						
New Member Capital Assessment	$2,500	$500	$500	$500	$500	$500
Premium Assessment	$0	$3,000	$5,500	$7,500	$10,000	$11,000
Interest/Dividends	$0	$30	$43	$74	$99	$130
Less: Organ/Admin Expense	$100	$125	$150	$150	$200	$250
Total Security Fund	$2,400	$3,405	$5,893	$7,924	$10,399	$11,380
Cumulative Security Fund	$2,400	$5,805	$11,698	$19,621	$30,020	$41,400

Schedule 2 – Operating Syndicates: Model Five Year Consolidated Income Statements (in $000s)

	Year 1	Year 2	Year 3	Year 4	Year 5	5-Yr. Total/Average
Net Premiums Written	$300,000	$550,000	$750,000	$1,000,000	$1,100,000	$3,700,000
Net Premiums Earned	$150,000	$425,000	$650,000	$875,000	$1,050,000	$3,150,000
Losses	$60,000	$170,000	$260,000	$656,250	$420,000	$1,566,250
Acquisition Expenses	$10,500	$29,750	$45,500	$61,250	$73,500	$220,500
General Expenses	$30,000	$63,750	$58,500	$78,750	$94,500	$325,500
Exchange Expenses	$4,500	$12,750	$19,500	$26,250	$31,500	$94,500
Total Loss and Expense	$105,000	$276,250	$383,500	$822,500	$619,500	$2,206,750
Underwriting Gain (Loss)	$45,000	$148,750	$266,500	$52,500	$430,500	$943,250
Net Investment Income	$22,125	$34,159	$41,847	$60,700	$62,235	$221,066
Pre Tax net Inc (Loss)	$67,125	$182,909	$308,347	$113,200	$492,735	$1,164,316
Projected Tax	$16,781	$45,727	$77,087	$28,300	$123,184	$291,079
Net Income After Tax	$50,344	$137,182	$231,260	$84,900	$369,552	$873,237
Loss Ratio	40.0%	40.0%	40.0%	75.0%	40.0%	49.7%
Acquisition Expense Ratio	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
General Expense Ratio	20.0%	15.0%	9.0%	9.0%	9.0%	10.3%
Exchange Expense Ratio	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Total Expense Ratio	30.0%	25.0%	19.0%	19.0%	19.0%	20.3%
Combined Ratio	70.0%	65.0%	59.0%	94.0%	59.0%	70.1%
ROE on Average Equity	4.9%	12.4%	18.3%	6.2%	23.7%	13.8%
Average Equity	$1,024,172	$1,105,125	$1,260,844	$1,380,469	$1,561,594	$1,266,441

Schedule 3 – Operating Syndicates: Model Five Year Consolidated Balance Sheets (in $000s)

	Opening	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5
Invested Assets	$885,000	$1,138,625	$1,394,907	$1,734,282	$1,778,157	$2,384,032
Cash	$100,000	$50,000	$55,000	$55,000	$150,000	$40,000
Other Assets	$15,000	$25,590	$30,000	$37,500	$40,000	$45,000
Premiums Receivable	$0	$50,000	$75,000	$80,000	$95,000	$100,000
Total Assets	$1,000,000	$1,264,215	$1,554,907	$1,906,782	$2,063,157	$2,569,032
Loss Reserves	$0	$55,000	$95,000	$195,000	$350,000	$425,000
Unearned Premiums	$0	$150,000	$275,000	$290,000	$295,000	$300,000
Taxes Payable	$0	$8,871	$23,000	$60,000	$17,000	$120,000
Other Liabilities	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000
Total Liabilities	$1,000	$214,871	$394,000	$546,000	$663,000	$846,000
Consolidated Equity	$999,000	$1,049,344	$1,160,907	$1,360,782	$1,400,157	$1,723,032
Total Liab & Capital	$1,000,000	$1,264,215	$1,554,907	$1,906,782	$2,063,157	$2,569,032

6. Action Steps

The following action steps have been developed to implement the Working Group recommendations for re-establishing an insurance exchange under the guidance of The Insurance Risk Exchange Organization Committee. These action steps are divided into four phases:

- ***Phase 1 – Education and Promotion (Obtaining support for the exchange from regulators, rating agencies, insurance companies and investors)***
- ***Phase 2 – Organization (Structuring the exchange entity and funding, drafting of governing documents and regulations)***
- ***Phase 3 -- Pre-Opening (Syndicate and broker commitments, staffing and construction of platform)***
- ***Phase 4 – Opening***

Phase 1 – Education and Promotion

One of the critical determinations by both the Working Group and the Superintendent of Insurance was that the principal impetus for re-establishment of an exchange must come from the insurance and investment industries with the support of the regulators. The first phase, therefore, has two main elements.

The first step to carry out the Working Group recommendations is to establish an industry committee to oversee and work with the regulators to move the effort forward. This step has already commenced with the agreement by **Donald Kramer**, Chairman of Kramer Capital LLC, former chairman of Ariel Re, and a well-respected insurance investor and entrepreneur, to serve as chair of the committee (**The Insurance Risk Exchange Organization Committee,** or **IREX Organization Committee**). Mr. Kramer has begun the process of putting together a representative group of leaders from each significant discipline: underwriting, investment, brokerage, accounting, legal and technology. ***The purpose of the IREX Organization Committee will be to oversee the action steps necessary to implement the Working Group recommendations, and will marshal the expertise in each discipline that may be necessary to pursue each step toward re-establishing the exchange.***

The second step in the first phase is to inform and seek the support of regulators nationwide and the principal rating agencies for the exchange concept, structure and financial integrity. This step will be coordinated with and supported by the New York Insurance Department. In addition to informing regulators and rating agencies about the exchange project, however, an equally important function of this effort will be to learn the concerns and requirements of regulators in other key states and from the rating agencies, and modify the plans as necessary to address those concerns and requirements.

This educational and promotional effort will be ongoing throughout the entire implementation program, and will also be broadened to include insurance and financial industry leaders upon securing regulator and rating agency support. **However, only upon receiving significant support from regulators and rating agencies will the IREX Organization Committee move forward with the second and subsequent phases.**

Phase 2 – Organization

Once the Committee is satisfied that there is significant regulatory and rating agency support for an exchange, which support does not mean formal and final approval, it will move forward with the actual construction and organization of the exchange. This phase will include a number of activities as follows:

- Engagement of legal counsel and other professional service providers to assist with necessary corporate and organizational documentation (financing for the engagement of counsel and other professional service providers during this phase is discussed below).
- Preparing and filing corporate documentation creating the exchange entity.[8]
- Drafting or revising the exchange's constitution and bylaws consistent with Article 62 of the New York Insurance Law (See Appendix B).
- Coordinating with the New York Insurance Department on revising regulations 89, 89A and 89B (See endnote 3).
- Preparing and filing corporate documentation creating the exchange's security fund, if it is to be a separate entity.
- Considering the practicality of and options for structuring the exchange's electronic platform and data center as separate, for profit entities.
- Drafting of membership application and disclosure forms for syndicates, managers and brokers.
- Communicating with the insurance and investment communities regarding the development of the specific requirements, rules and regulations being developed.
- Working with the New York Insurance Department and the New York State Legislature to obtain changes to Article 62 (See Section 4.E., Expansive Markets).
- Drafting of initial financing instruments described below.

As a New York not-for-profit corporation, initial funding for the exchange must comply with Article 5 of the New York Not-For-Profit Corporation Law, through the use of capital certificates, subvention certificates, bonds or other secured borrowings. The initial funding to create the exchange entity, its corporate documentation and start-up costs will be raised through three initial financial levels of financing as follows:

- The issuance of secured bonds to potential syndicate investors, service providers, and any other interested party. Such bonds will pay market rate interest and, if possible, be convertible into ownership interests in the exchange's for-profit platform or data center.
- The issuance of two classes of subvention certificates as follows:
  - Class A redeemable only by the exchange with interest deferred until redemption. Any syndicate applying for membership will be required to purchase a Class A subvention certificate in a principal amount equal to 1% of the syndicate's proposed initial capitalization, but not less than $500,000. These subvention certificates will be part of a syndicate's admitted assets.
  - Class B certificates will be available to participating brokers, service providers or other interested parties, and will pay a regular dividend in an amount determined by the Board of Governors, and redeemable after 5 years by the holder.
- Membership application and use fees from syndicates, brokers and intermediaries and other exchange participants.

As the exchange governance and financial documentation develop, the IREX Organization Committee will communicate regularly with the Working Group, regulators and other interested parties on the progress of the exchange plans. The Committee will also seek to secure commitments from potential syndicate and broker members and participants, which commitments will be subject to achieving certain benchmark number of commitments.

Phase 3 – Pre-Opening

Upon obtaining the commitment benchmark, the focus of the IREX Organization Committee will be on preparing the exchange for opening, including addressing the following:

- Prepare and issue a request for proposal for an IT platform provider, which RFP will require bidders to address the Working Group recommendations for a state-of-the-art, secure virtual platform that can be integrated with the principal market players.
- Prepare and issue a request for proposal for other service providers as needed, including banking, accounting and other necessary independent services.
- Review and accept winning bids; prepare and negotiate acceptable contracts or engagement agreements for such services.
- Construct the exchange platform and facility.

- Together with the New York Insurance Department, determine and appoint the initial exchange board of governors, including underwriting, broker and public governors.
- Appoint a board of directors for the exchange's security fund, if the security fund is to be a separate entity.
- Meeting by the board of governors to elect exchange officers, create committees (including the Financial Review & Oversight and the Operations Committees. See Sections 4.B. and 4.C. above), approve actions of the Committee or the incorporators, and approve all agreements and contracts required to operate the exchange.
- Hire staff.
- Review and approve syndicate membership applications and initial business plans.
- Communicate operating procedures.
- Set and communicate date for opening the exchange.

Phase 4 – Opening

Based on the action points and the timeline set forth below, the IREX Organization Committee believes that an opening for the exchange facility in May 2012 is a reasonable target. Although the Committee believes that a firm and well-conceived basis of operations and over-sight is more critical than a particular set target date, a reasonable timetable is necessary to keep the project efficiently focused and on track.

7. Timeline

Following is a projected timetable for implementation of the action plan:

	2011					2012				
Action	**July/Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**
Phase 1 -- Education & Promotion										
Establish EOC	-----------									
Meet Regulators & Rating Agencies	-------------------------									
Meet Insurance & Financial Leaders	----------------------------------									
Phase 2										
Create Exchange Entity			--------							
Draft Governing Documents			-------------------							
Draft Investment Instruments			-------------------							
Communicate Progress				--						
Phase 3										
Issue RFPs for IT, Other Services					--------					
Accept Bids; Negotiate Contracts						--------				
Appoint Board of Governors							-----			
Appoint Committees and Officers							--------			
Hire Staff							---------------			
Construct Platform and Facility							-------------------------			
Approve Member Applications								--------------------------		
Phase 4 -- Opening										-------

8. Conclusion

As stated at the beginning of this presentation, an insurance risk exchange presents a number of benefits and advantages to its users and its customers over many stand-alone insurance companies including the concentration of diverse capital sources, underwriting and supporting expertise, flexibility of product and efficiency of operations. The objective of the plan set forth above is to provide a road map for interested elements in the financial and insurance industries, their service providers, insurance consumers, and regulators and rating agencies, to establish a new US insurance risk exchange on a proper and sound basis through implementing the recommendations of the Insurance Exchange Working Group.

This plan is an outline, and is not intended to address all issues that may arise or confront the planners going forward. It is the hope of the Working Group, the New York Insurance Department and the IREX Organization Committee, however, that this outline and the work behind it will evoke sufficient support for the project to move forward apace.

A properly conceived and constructed syndicated insurance market in the US, where 85% of insurable risks are insured or reinsured offshore or overseas, makes sense for commercial insurance purchasers, underwriters, brokers and regulators and is long overdue.

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Appendix A – New York Insurance Law Article 62

§ 6201. New York insurance exchange. (a) Notwithstanding the provisions of section six thousand one hundred sixteen of this chapter, the New York insurance exchange, shall be continued, subject to such regulations as may be promulgated by the superintendent.

(b) The purposes of the exchange shall be:

(1) to provide a facility for the underwriting of:

(A) reinsurance of all kinds of insurance;

(B) direct insurance of all kinds on risks located entirely outside the United States;

(C) direct insurance of all kinds on risks located in the United States other than in this state, provided that such risk qualifies for placement pursuant to the excess and surplus lines requirements of the jurisdiction in which the risk is located; the superintendent may permit the exchange or its syndicates, or both, to take such steps as may be necessary to qualify as an excess and surplus lines insurer in such jurisdiction;

(D) risks which shall have been submitted to and certified as having been rejected by a committee representative of insurers licensed by the superintendent under article sixty-three of this chapter, subject to conditions imposed by the superintendent pursuant to regulation; and

(2) to manage the facility authorized by this article, in accordance with regulations promulgated by the superintendent.

§ 6202. Constitution and by-laws. (a) The exchange shall function under its constitution and by-laws which it may amend pursuant to the terms thereof.

(b) Notwithstanding the authority granted to the exchange pursuant to the provisions of the constitution and by-laws to amend, replace or add provisions, the constitution and by-laws shall at all times provide for but not be limited to:

(1) the election of no less than six nor more than thirteen governors at least one-third of whom shall not be members of the exchange and who shall be public representatives;

(2) the location of the principal offices of the exchange and its members to be within this state for the purpose of the transaction of the types of business described in subsection (b) of section six thousand two hundred one of this article;

(3) the submission by members and all applicants for membership on the exchange of such financial information required by the superintendent;

(4) the establishment by the exchange of a security fund in a form and amount approved by the superintendent;

(5) the voting power of members who are underwriting syndicates;

(6) the voting power and other rights granted under the provisions of the not-for-profit corporation law to participate in the conduct and management of the affairs of the exchange by brokers, agents and intermediaries

transacting business on the exchange, each of whom shall be considered "members" only under the provisions of such law; and

(7) the rights and duties of exchange members, which may include but shall not be limited to the manner and form of conducting business, financial stability, dues, membership fees, mandatory arbitration and all other matters necessary or appropriate to conduct any business permitted by this article.

(c) Any amendments to the constitution and by-laws shall be subject to the approval of the superintendent.

(d) At least two-thirds of the governors shall be citizens of the United States.

(e) For the purposes of this section, a principal office shall be one where officers and qualified personnel who are engaged in the administration, underwriting, claims, policyholders' service, marketing, accounting, record-keeping and all supportive services shall be located.

§ 6203. Miscellaneous. (a) The New York insurance exchange shall not be subject to any state or local taxes or fees measured by income, premiums or gross receipts, except that for purposes of taxation under section one thousand five hundred ten of the tax law, direct premiums written, procured or received by a member or members through the exchange on risks located in this state shall be deemed written, procured or received by the exchange and the premium tax due on said premium shall be reported and paid by the exchange.

(b) The exchange shall reimburse the superintendent for any expenses incurred by him relating to the regulation of the exchange and its members.

(c) This chapter and regulations thereunder shall apply to the exchange, its members, and the insurance or reinsurance written through the exchange, except as may be exempted by the superintendent pursuant to regulation; provided that no such exemption shall be unfairly discriminatory or detrimental to the solvency of licensed insurers.

(d) The superintendent may establish limitations on investments in members of the exchange. The investment in any member by brokers, agents and intermediaries transacting business on the exchange, and the investment in any such broker, agent or intermediary by any member, directly or indirectly, all as defined by regulation, shall in each case be limited in the aggregate to less than twenty percent (or such lesser amount as determined by the superintendent) of the total investment in such member, broker, agent or intermediary.

(e) For purposes of paragraph nine of subsection (a) of section one thousand three hundred one of this chapter, reinsurance written by members of the exchange shall be deemed to have been written by an insurer authorized to transact insurance in this state.

(f) The performance of the contractual obligations of the exchange or its members entered into pursuant to section six thousand two hundred one of this article shall not be covered by any of the New York state security or guaranty funds.

Appendix B – Proposed Amendments to Article 62

§ 6201. New York insurance exchange. (a) Notwithstanding the provisions of section six thousand one hundred sixteen of this chapter, the New York insurance exchange, shall be continued, subject to such regulations as may be promulgated by the superintendent.

(b) The purposes of the exchange shall be:

(1) to provide a facility for the underwriting of:

(A) reinsurance of all kinds of insurance;

(B) direct insurance of all kinds on risks located entirely outside the United States;

(C) direct insurance of all kinds on risks located in the United States other than in this state, provided that such risk qualifies for placement pursuant to the excess and surplus lines requirements of the jurisdiction in which the risk is located; the superintendent may permit the exchange or its syndicates, or both, to take such steps as may be necessary to qualify as an excess and surplus lines insurer in such jurisdiction;

(D) direct insurance on risks located in this state that are exempt special risks ~~which shall have been submitted to and certified as having been rejected by a committee representative of insurers licensed by the superintendent~~ under article sixty-three of this chapter, subject to conditions imposed by the superintendent pursuant to regulation;

(E) direct insurance on risks located in this state and issued to an exempt commercial purchaser as defined in subsection (x)(2) of section two thousand one hundred one of this chapter, provided that the insurance comes within one or more of the kinds of insurance specified in subsection (a) of section one thousand one hundred thirteen of this chapter, except for:

(i) the kinds of insurance set forth in paragraphs one, two, three, thirteen with regard to medical malpractice insurance for physicians and surgeons, fifteen, seventeen, eighteen, twenty-three, or thirty-two (as a substantially similar kind of insurance) of subsection (a) of section one thousand one hundred thirteen of this chapter; or

(ii) personal lines property/casualty insurance; and

(2) to manage the facility authorized by this article, in accordance with regulations promulgated by the superintendent.

§ 6202. Constitution and by-laws. (a) The exchange shall function under its constitution and by-laws, which it may amend pursuant to the terms thereof.

(b) Notwithstanding the authority granted to the exchange pursuant to the provisions of the constitution and by-laws to amend, replace or add provisions, the constitution and by-laws shall at all times provide for but not be limited to:

(1) the election of no less than six nor more than thirteen governors at least one-third of whom shall not be members of the exchange and who shall be public representatives;

(2) the location of the principal offices of the exchange and its members to be within this state for the purpose of the transaction of the types of business described in subsection (b) of section six thousand two hundred one of this article;

(3) the submission by members and all applicants for membership on the exchange of such financial information required by the superintendent;

(4) the establishment by the exchange of a security fund in a form and amount approved by the superintendent;

(5) the voting power of members who are underwriting syndicates;

(6) the voting power and other rights granted under the provisions of the not-for-profit corporation law to participate in the conduct and management of the affairs of the exchange by brokers, agents and intermediaries transacting business on the exchange, each of whom shall be considered "members" only under the provisions of such law; and

(7) the rights and duties of exchange members, which may include but shall not be limited to the manner and form of conducting business, financial stability, dues, membership fees, mandatory arbitration and all other matters necessary or appropriate to conduct any business permitted by this article.

(c) ~~Any amendments to t~~The constitution and by-laws and any amendments thereto shall be subject to the approval of the superintendent.

(d) At least two-thirds of the governors shall be citizens of the United States.

(e) For the purposes of this section, a principal office shall be one where officers and qualified personnel who are engaged in the administration, underwriting, claims, policyholders' service, marketing, accounting, record-keeping and all supportive services shall be located.

§ 6203. Miscellaneous. (a) The New York insurance exchange shall not be subject to any state or local taxes or fees measured by income, premiums or gross receipts, except that for purposes of taxation under section one thousand five hundred ten of the tax law, direct premiums written, procured or received by a member or members through the exchange on risks located in this state shall be deemed written, procured or received by the exchange and the premium tax due on said premium shall be reported and paid by the exchange.

(b) The exchange shall reimburse the superintendent for any expenses incurred by ~~him~~ the superintendent relating to the regulation of the exchange and its members.

(c) This chapter and regulations thereunder shall apply to the exchange, its members, and the insurance or reinsurance written through the exchange, except as may be exempted by the superintendent pursuant to regulation; provided that no such exemption shall be unfairly discriminatory or detrimental to the solvency of licensed insurers.

(d) The superintendent may establish limitations on investments in members of the exchange. The investment in any member by brokers, agents and intermediaries transacting business on the exchange, and the investment in any such broker, agent or intermediary by any member, directly or indirectly, all as defined by regulation, shall in each case be limited in the aggregate to less than twenty percent (or such lesser amount as determined by the superintendent) of the total investment in such member, broker, agent or intermediary.

(e) ~~For purposes of paragraph nine of subsection (a) of section one thousand three hundred one of this chapter,~~ Insurance written by members of the exchange under subparagraphs (D) and (E), and reinsurance written by members of the exchange under subparagraph (A) of paragraph one of subsection (b) of section six thousand two hundred two of this article, shall be deemed to have been written by an insurer authorized to transact insurance in this state.

(f) The performance of the contractual obligations of the exchange or its members entered into pursuant to section six thousand two hundred one of this article shall not be covered by any of the New York state security or guaranty funds.

Endnotes

[1] For information on the history of insurance exchanges in the US, see Exchange: A Guide to an Alternative Insurance Market, by Peter H. Bickford (NILS Publishing Co. 1987-90). Also see Mr. Bickford's articles *"What Ever Happened to the New York Insurance Exchange (And Why Do We Care)?"*, Practicing Law Institute Conference on Run-offs and Commutations, November 2004; and *"The Once and Future New York Insurance Exchange,"* February 2010. These articles and other exchange related articles, studies, statutes and regulations, and operating documents from the original exchange are accessible in pdf format on Mr. Bickford's website at www.pbnylaw.com/ny_insurance_exchange.html. Superintendent Wrynn appointed Mr. Bickford as Special Advisor to the Exchange Working Group in February 2010.

[2] A pdf copy of the Insurance Department's PowerPoint presentation of the Sub-Group Recommendations dated June 28, 2010 can be accessed and downloaded online at www.pbnylaw.com/ny_insurance_exchange.html.

[3] For the model consolidated syndicate income statements and balance sheets in Section 5, Model Projections, the total capital at the beginning of the first year of the model is set at $1 billion.

[4] Under New York's Financial Services Merger Bill on March 31, 2011, the positions of Superintendent of Insurance and Superintendent of Banking are combined into a new Superintendent of Financial Services effective October 3, 2011. At that time all references in the New York Insurance Law to the Superintendent of Insurance are changed to Superintendent of Financial Services, and all references to the Insurance Department are changed to the Department of Financial Services.

[5] There are currently three promulgated regulations regarding exchange operations: Regulation 89, 89A and 89B. Regulation 89 details the applicability to or exemption from the provisions of the Insurance Law to the exchange and its members; Regulation 89A addresses investments in and among exchange underwriters and broker, and underwriting managers; and Regulation 89B establishes the criteria for public governors. These regulations will be modified to update the criteria and coordinate with the new exchange structure.

[6] "Fifty State Access" is used generically as a term of convenience to include all US jurisdictions -- the fifty states, the District of Columbia and all US territories.

[7] For a review of the terms of the Dodd-Frank bill and its effect on the exchange, see *"Dodd-Frank Wall Street Reform Act of 2010: What is the Impact on the Revival of the New York Insurance Exchange?"* by Francine L. Semaya (IRU Spring Conference, Bermuda, May 2011).

[8] The original New York Insurance Exchange, Inc., a New York not-for-profit corporation, was liquidated in 1993. However, the corporate entity was not dissolved and technically remains in existence, including on the New York Department of State's registry of active corporations.