August 27, 2012

Michael T. McRaith  
Director,  
Federal Insurance Office  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington DC, 20220

RE: Public Input on the Report to Congress on the U.S. and Global Reinsurance Markets

Dear Director McRaith:

The Property Casualty Insurers Association of America (PCI) is pleased to respond to the Treasury Department’s request for comments on the study the Federal Insurance Office (FIO) is to conduct pursuant to the Dodd-Frank Act on the global reinsurance market and the role it plays in supporting the U.S. insurance market. PCI is composed of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write more than $190 billion in annual premium, 40 percent of the nation’s property casualty insurance. Member companies write 46 percent of the U.S. automobile insurance market, 32 percent of the homeowners market, 38 percent of the commercial property and liability market, and 41 percent of the private workers compensation market. PCI’s membership also includes a number of property casualty companies that have subsidiaries or affiliates that write reinsurance, including several top global reinsurers.

PCI offers the following responses to Treasury’s specific requests as set forth in the June 27, 2012 Notice and Request for Comments.

**The purpose of reinsurance**

Simply put, reinsurance is insurance for insurers. It is a form of insurance that insurance companies often buy for their own protection from greater than expected losses and in order to write additional business by reducing their net exposure to loss on existing business. By ceding (or transferring) a portion of a risk or risks to a reinsurer, the insurance company buying the reinsurance (often referred to as the “ceding insurer” or “cedent”) reduces its own maximum possible net loss on the risk. In particular, reinsurance is critical to those insurers needing protection against catastrophic losses, such as natural disasters. The purpose is to serve the
time-honored maxim that responsible insurers must “spread the risk” to avoid a single loss event or losses to a portfolio of business from crippling any one insurer. By helping insurers reduce volatility, reinsurance also helps insurers have a more diversified portfolio of risks that stabilizes underwriting results and increase underwriting capacity. Reinsurers also provide specialized underwriting and risk management expertise to insurers. Indeed, state insurance regulators allow insurers to take “credit for reinsurance” on their statutory financial statements for that portion of risks they cede to reinsurers that regulators determine are creditworthy or that have collateralized their financial performance by providing the ceding insurer with a letter of credit or funds held in trust.

Reinsurers themselves also often purchase reinsurance or “retrocessional” coverage to protect their own liabilities from catastrophic events typically exceeding $5 billion or more in losses. By doing so, they themselves are protected from volatile loss experience and their own underwriting capacity is preserved.

The breadth and scope of the reinsurance market and the role that the global reinsurance market plays in supporting insurance in the United States

Importance of the Reinsurance Market. For PCI members, many of which are ceding insurers, the availability of reinsurance is critical to their ability to meet the needs of the U.S. insurance market. While some very large insurers are sometimes financially able to support at least some of their underwriting obligations without ceding risks to reinsurers, most depend on reinsurers at least to some degree and small and medium sized insurers would find it impossible to function without available and affordable reinsurance. Insurance rating agencies and credit rating agencies (for insurers issuing stock or debt to the public) insist on a prudent reinsurance program. This means that a vibrant reinsurance market is essential to ensuring that adequate insurance underwriting capacity exists to meet the needs of the U.S. market. It is worth noting that roughly 60% of the losses related to the terrorist attacks on September 11, 2001 were paid by various reinsurers around the world. A similar percentage of the 2005 hurricane losses (Katrina, Rita, and Wilma) were also paid by global reinsurers.

Global Nature of the Market/Barriers to Domestic Reinsurers. The total net written premium volume of global reinsurers was about $160 billion in 2010.¹ In its response to this request for comment, the Reinsurance Association of America (RAA) has submitted detailed figures to Treasury on the extent of U.S. insurance risks that are ceded to reinsurers, both in the U.S. and throughout the world. We call particular attention to the RAA’s report that, in 2011, non-US reinsurers accounted for roughly 75% of US reinsurance premiums while U.S. reinsurers accounted for roughly 25% of U.S. premiums. This is reflective of a recent trend in which the reinsurance market has migrated away from the U.S. and towards other countries. According to Standard & Poor’s Rating Services, the vast majority of reinsurance is provided by a relatively small number of large, international reinsurers writing roughly 70% of the global reinsurance business. These reinsurers are domiciled in roughly 10 countries. Of the 10 largest reinsurers, three are based in the U.S. while the rest are non-U.S. reinsurers domiciled in Bermuda, France, Germany, Switzerland, and the United Kingdom. In addition, Australia, India, Japan, Korea, Nigeria, and Spain all have reinsurers in the top 40. Thus, non-U.S. reinsurers have become increasingly important to the U.S. insurance market. PCI urges both Congress and the FIO to

¹ Standard & Poor’s “Global Reinsurance Highlights,” 2011.
recognize the increasing importance of the global reinsurance market to U.S. ceding insurers and also the need to ensure the ability of U.S. insurers to collect reinsurance claims from overseas insurers not regulated in the U.S. is adequately protected.

At the same time, PCI also urges FIO to consider current impediments to the creation of domestic reinsurers. This is in part because of high corporate tax rates in the U.S. and in part because the state licensing process in the U.S. is cumbersome, which makes it difficult, if not impossible, for domestic reinsurers to gain rapid entry to the U.S. market. To become a licensed reinsurer in the U.S., a company would face a complicated array of application requirements, many of which are designed for primary insurers and are irrelevant to reinsurers. These include seasoning requirements for certain classes of business, anti-fraud plans, required participation in a number of insurance funds such as mine subsidence and workers compensation second injury funds, required affiliations with rating bureaus, etc.

Opportunities for new U.S. reinsurance operations often follow major catastrophes, which tend to result in a hardening of rates. However, because of the barriers noted above, this new capital now usually comes from reinsurance operations based outside of the U.S. The last U.S. domestic reinsurer was formed in 1989. The most recent U.S.-owned reinsurer that is still in operation is Transatlantic Re, which commenced reinsurance operations in 1978.

PCI believes that the non-U.S. reinsurance market is very important to domestic insurers, and that the U.S. should encourage a more robust domestic reinsurance market as well by streamlining the process for the licensing of reinsurers and making that process more appropriate to the reinsurance market. This could lead to the formation of more U.S. domestic reinsurers, which would in turn provide for a more competitive market for reinsurance. PCI therefore urges FIO to: (1) take a proactive role in encouraging a reassessment of current tax policies that provide disincentives for the creation of domestic reinsurers; and (2) explore with state regulators how they might facilitate a more efficient and effective reinsurance licensing procedure. PCI believes this would lead to a stronger domestic reinsurance market, which would benefit both domestic insurance companies and ultimately consumers.

The effect of domestic and international regulation on reinsurance in the United States

U.S. State Regulation. Most U.S. reinsurers are licensed in at least one state, and often more. These reinsurers are subject to direct solvency regulation in the same way that a licensed primary insurer is. However, a key tool in regulating reinsurance transactions is credit for reinsurance laws under which regulators grant financial statement credit to insurers that cede risks to licensed or accredited reinsurers. In the U.S., most state credit for reinsurance laws and regulations are based on a model law and regulation published by the National Association of Insurance Commissioners (NAIC). This promotes some degree of uniformity among state reinsurance laws, though some state-by-state differences do persist.

Impact of Dodd-Frank Act. Title V of the Dodd-Frank Act included provisions known as the Non-Admitted and Reinsurance Reform Act (NRRA), which among other things, streamlines state regulation of reinsurers and reinsurance transactions. The NRRA provides that reinsurers may be regulated for solvency only by their domiciliary state and that credit for reinsurance requirements for any cession may be imposed only by the domiciliary state of the ceding insurer. The purpose is to help eliminate duplicative requirements applicable to reinsurers
doing business throughout the country and to transactions on multi-state risks where numerous states might otherwise claim regulatory authority. PCI strongly supported the NRRA and believes that it has the potential to make regulation of insurance and reinsurance in the U.S. more efficient, effective, and less costly. We applaud the NAIC for having adopted revisions to its models that appropriately reflect the new NRRA requirements. We note, however, that some state regulators have historically had an inclination to find ways to resist federal efforts to help facilitate greater uniformity and unfortunately we have seen evidence of this again in the reaction of some states to the NRRA. Some have sought to interpret various provisions of the NRRA extremely narrowly in order to preserve as much power as they can to impose their own laws extraterritorially. PCI urges the states to adhere to both the letter and the spirit of the NRRA.

**Reinsurance Collateral Requirements.** Historically, reinsurers not licensed in the U.S. have been required to post collateral to support their underwriting obligations to U.S. cedents. The purpose of this requirement is to help ensure that claims non-U.S. reinsurers owe to U.S. cedents can be collected. Because U.S. insurers cannot always be certain that foreign law will adequately support their ability to enforce foreign judgments against non-U.S. reinsurers (should they need to go to a foreign country to collect), the presence of collateral in the U.S. provides confidence that U.S. insurers can safely cede risks to non-U.S. insurers and collect reinsurance recoverables in the U.S. In addition, differences between the accounting systems used in other countries and in the U.S. can sometimes complicate the ability of a ceding insurer to assess the financial condition of the reinsurer. Collateral is an important tool in protecting U.S. insurers from that uncertainty.

In recent years, however, non-U.S. insurers have brought considerable pressure to bear on Federal officials and state regulators to eliminate the collateral requirements. This ultimately led the NAIC to revise its Model Credit for Reinsurance Law and Regulation in November of 2011 to reduce (but not entirely eliminate) collateral requirements. PCI voiced numerous concerns throughout the debate that the reductions threatened to weaken solvency regulation in the U.S. because reinsurance collateral can be a considerable asset or reduction in liability for ceding insurers. Nevertheless, recognizing that the NAIC felt the need to address pressures from overseas, PCI worked cooperatively with the NAIC and with representatives of foreign reinsurers to secure amendments to the model that helped ensure that the final models protected the interests of U.S. ceding insurers to the greatest extent possible. PCI then committed not to oppose state legislation and proposed regulations that are consistent with the models.

PCI is aware that pressure is being brought to bear on the FIO and Treasury to exercise authority under Title V of the Dodd-Frank Act to negotiate international agreements with foreign governments on reinsurance collateral requirements and then to preempt and thus completely eliminate state collateral requirements that are inconsistent with such agreements. We trust FIO and Treasury will recognize the need to resist such pressure. The changes to the NAIC models are less than one year old. A number of states acted this year to amend their statutes to reflect the new model law and others will follow next year. Few states have yet made much progress on amending their credit for reinsurance regulations. It will take some time for the both the U.S. and international markets to fully implement the new rules and then to gain experience with them and determine how well they work and whether unanticipated problems will arise. In particular, we note that the presence of collateral has in the past worked as an incentive for foreign reinsurers to pay valid claims and to not resist enforcement in their home
The role and impact of government reinsurance programs

PCI believes that government intervention in insurance and reinsurance markets is inadvisable as long as the private markets are capable of meeting consumer needs for coverage.

Government involvement in providing reinsurance arises most often in the contexts of natural catastrophe risks and terrorism risks. Because the ability of private markets to provide coverage for each of these risks differs, we will address each risk separately.

Natural Catastrophe Risks. PCI believes that the private market is well-equipped to provide reinsurance coverage for natural catastrophe risks and that government intervention in the reinsurance market, especially via the creation of government reinsurance mechanisms, is inadvisable. From time to time, Congress has considered proposals usually put forward by some of its members representing hurricane-prone, coastal areas to provide some form of government natural catastrophe reinsurance in an effort to increase the availability and affordability of insurance coverage for natural disaster risks. However, limitations on the availability of primary natural catastrophe coverage are not attributable to any lack of reinsurance capacity, but are instead more often attributable to state efforts to artificially control insurance rates and/or to inappropriately shift costs. Risk carries costs, and risks located in areas prone to natural disasters will therefore cost more to insure than risks elsewhere. While it is understandable that consumers located in such areas are unhappy to have to shoulder such risk costs, it is unfair to transfer those costs to other consumers in areas not subject to significant natural catastrophes. Yet this is the result of most existing or proposed government reinsurance programs. Government efforts to shift risk costs are counterproductive. As noted above, the private insurance reinsurance markets help to facilitate the responsible spreading of risk, but in those markets risks are spread to insurance and reinsurance entities that choose to accept them for a premium. Government programs, on the other hand, tend to concentrate risk in the government program, and to the extent such programs spread risk, it is spread unfairly to other consumers/taxpayers in the form of artificially high premiums that amount to a cross-subsidy benefitting others. It is therefore unhealthy for governments to implement such reinsurance programs absent a need to fill a gap (currently non-existent) in the private reinsurance markets.

One example of such an unhealthy program is the state-run Florida Catastrophe (CAT) Fund, which acts as a high-level financial backstop by providing reinsurance to both private market insurers and to Florida’s Citizen’s Property Insurance Corporation. Operating at a deficit for three of the last four years, the CAT Fund poses enormous risk to Florida’s economy and its taxpayers. In anticipation of a major storm in the near future, an advisory panel to the CAT Fund has urged Governor Rick Scott and other state officials to borrow money to cover the CAT Fund’s potential shortfall.
To be sure, there can be a role for government in addressing the issues that can arise in high-cost, high-risk areas, such as in providing assistance to low-income policyholders in making premium payments and in imposing strong natural catastrophe loss mitigation requirements. PCI has developed a Natural Catastrophe Handbook, designed primarily for members of Congress and their staffs, which provides insights on which forms of government involvement in natural catastrophe planning are helpful and which are not. We have attached a copy and hope that it will be helpful to the FIO as it considers this issue in the context of its study of reinsurance markets. PCI urges all federal and state policymakers to make a realistic assessment of the costs of risks and of the dangers of governments assuming such risk unnecessarily – and imposing it perhaps inequitably on the undeserving -- instead of spreading it globally via the efficient and effective private reinsurance market.

**Terrorism Risks.** Unlike natural catastrophe risks, the private reinsurance market is unable to provide fully for the needs of consumers for coverage for acts of terrorism. The nature of terrorism risks is very different from natural catastrophe risks and poses very different and more difficult challenges to insurers and reinsurers. Natural events are generally predictable, even if specific events cannot be predicted with precision. Based on considerable historical experience, markets have learned how to measure and predictably model the likelihood of natural catastrophe risks as to time, location, and magnitude. The markets do not have the same knowledge or tools to deal with terrorism risks. This is because terrorism risks are caused entirely by man, are not random in nature, are essentially a “war risk,” and their nature and likelihood changes constantly. They often relate to other events such as government foreign policy or national security actions. Insurers and reinsurers have worked to improve their understanding of terrorism risks since 2001 and while somewhat more private terrorism coverage is available now than was available a decade ago, it is still the case that certain terrorism risks especially in urban, high-profile areas where risks are perceived to be great cannot be insured against in the private market. The President’s Working Group on Financial Markets noted in its 2010 Report to Congress that the ability to predict the frequency and severity of acts of terrorism is likely to remain a key challenge over the long term.

It was in recognition of these challenges that Congress passed the Terrorism Risk Insurance Act (TRIA) in 2002 and has reauthorized it twice since then. The program is now scheduled to expire at year-end 2014. Because the need that TRIA met in 2002 still exists today, PCI urges that it be reauthorized.

TRIA requires insurers to offer terrorism coverage in most commercial lines. In return, the Federal government requires insurers to shoulder all losses on smaller events that do not trigger the program and a significant portion of terrorism losses that do trigger the program, with the government providing a backstop for losses in excess of the insurer retention up to an aggregate limit of $100 billion. The insurer share consists of an aggregate industry retention and an individual insurer deductible or co-pay. The program has cost the Federal government very little so far beyond the minimal expense of running the Treasury office that administers it. In the event of a loss, the ultimate cost to the Federal government would be limited given a feature of TRIA under which government losses are to be recouped by means of policyholder assessments. Thus, TRIA provides an effective mechanism for ensuring the availability of terrorism coverage where it is critically needed while also significantly protecting taxpayers from costs of the program over time.
TRIA has proven vitally important to numerous sectors of the economy, but two in particular stand out. First, real estate and construction projects are very often dependent on the ability to obtain commercial insurance that includes terrorism coverage as a condition of obtaining financing. Without TRIA, many such projects would have been impossible to pursue, and their loss would have had a devastating effect on the national economy and on many local economies in particular. At a time when our country is still struggling to recover from the worst economic downturn since the Great Depression, it would be dangerous to create an additional obstacle to recovery by failing to reauthorize TRIA. Second, workers compensation insurers are prevented by state law from excluding terrorism coverage, even in the absence of TRIA. Thus, they are fully exposed to terrorism risks without a Federal backstop. This threatens to have negative impacts on the financial statements and financial ratings of such insurers. After a certified event, it would call into question their ability to meet the future needs of employers that are required by law to purchase workers compensation insurance.

As Congress considers the question of TRIA reauthorization over the next few years, PCI will be providing considerable additional information to Congress on the terrorism insurance and reinsurance markets and also intends to work constructively with Treasury and the FIO to help reach a consensus on this important issue.

The coordination of reinsurance supervision nationally and internationally

Reinsurance is a global business and primary insurance is becoming more and more global. For that reason, issues of international regulation are growing in importance to the U.S. market. While it is inevitable that U.S. and international regulators face an increasing need to coordinate their efforts, PCI is concerned that international developments on several fronts threaten to lead to an attempted imposition of international standards on U.S. insurers and reinsurers that are simply inappropriate to our market. For example, the International Association of Insurance Supervisors (IAIS), working in coordination with the Financial Stability Board (FSB), is working on standards for identifying financial firms that are systemically important to the global economy, but these proposed standards are not entirely consistent with those that have been promulgated for U.S. firms by the Financial Stability Oversight Council (FSOC). In addition, proposed global standards on group supervision put forward by the IAIS in its Common Framework for the Supervision of International Active Insurance Groups (ComFrame) are not fully appropriate for the U.S. market. The ComFrame contemplates a group-wide view of regulation, as opposed to the U.S. view under which each legal entity is regulated for solvency with an overlay of group-wide regulation for material transactions between group members.

The Dodd-Frank Act gave the FIO authority to help coordinate international insurance issues and PCI believes it is in this area that the FIO can make its most valuable and important contribution. FIO has already become active in IAIS and other international fora, and we encourage FIO to continue to help ensure that international standards imposed on U.S. insurers and reinsurers are the right ones for U.S. companies and consumers. PCI is proud of the current regulatory structure in the U.S. and we are not at all convinced that the international models would be an improvement.
**International Reinsurance Trade Issues**

PCI believes that an open reinsurance market is fundamental to the strength of primary insurers in local economies and for the globalization of risk. Yet some countries, most notably Brazil, have erected barriers to international reinsurance. PCI urges the FIO to be heavily engaged in efforts to roll back barriers to trade in reinsurance such as those now in effect in Brazil.

Again, PCI appreciates the opportunity to offer these comments on FIO’s study of reinsurance markets and their regulation, and would be pleased to provide any further information or assistance the FIO may require.

Sincerely,

Robert. W. Woody