August 21, 2012

Via Federal Rulemaking Portal:
www.regulations.gov
The Honorable Michael McRaith
Director, Federal Insurance Office
US Department of Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Subject: Consultation: Report to Congress on the US and Global Reinsurance Market

Dear Director McRaith:

On behalf of the 22 members of the Association of Bermuda Insurers and Reinsurers (ABIR), we file these comments in response to your US and Global Reinsurance Market consultation. ABIR represents 22 insurance groups which have principal underwriting operations in Bermuda. ABIR members at year end 2011 wrote global group gross written premiums of $65 billion on a capital base of nearly $90 billion US. The ABIR members collect insurance and reinsurance premium from more than 100 countries around the world. In the US our members have 142 domiciled legal entities in 18 states. In the rest of the world ABIR members have licensed entities in 61 jurisdictions and holding companies in 12 jurisdictions. Collectively our membership globally has 34,000 employees with 15,000 of those in the United States.

Our membership is known for writing high layer excess liability insurance coverage and for writing property catastrophe insurance and reinsurance. ABIR members' generally are viewed by investment analysts as being willing to write business with volatility that deters other insurers. Specifically with regard to property catastrophe reinsurance, ABIR members are known to have helped re-invent this business in the 1990's following paradigm-shifting events such as Hurricane Andrew in the US. Bermuda's property catastrophe specialist reinsurers would now be viewed as the leading experts on property catastrophe risk and Bermuda is the place where global business leadership resides in this market. The ABIR members illustrate perfectly the global nature of the (re)insurance business and epitomize international insurance groups.

In addition to the Bermuda Monetary Authority's (BMA) commitment to international insurance regulatory standards, Bermuda has been cited as a cooperative partner on various matters by the US Treasury, the US Securities and Exchange Commission, the US State Department and the US Justice Department. We provide other market data and group underwriting results for our members twice a year and they are posted on our web site at www.ABIR.bm. Bermuda insurance company legal entity financial statements for our members can be found on the BMA's web site at www.BMA.bm. What follows are our responses to the consultation questions.

1. The purpose of reinsurance.

The purpose of reinsurance is to transfer risk from one insurer to another. The reinsurer is paid a fee by the ceding insurer to assume the risk. Reinsurance helps an insurer manage risk and the reinsurer takes the risk that the insurer doesn't want to keep for itself. There are many examples of how this can work. For policy makers the bottom line is that reinsurance: 1) makes domestic insurance markets more stable; 2) contributes to more consistent earnings and surplus positions for ceding insurers; 3) allows more insurance to be written at better prices than otherwise would be the case; and 4) contributes to economic recovery following disasters. In this letter we will focus on the 2011 global cat losses and the US experience with managing catastrophic risk to explain the value of reinsurance. We will particularly focus on the economic contribution to the US of non-US reinsurers. We will defer to others the textbook review of purposes of reinsurance.

2. The breadth and scope of the global reinsurance market.

Two measures of the size of the reinsurance market are provided by reinsurance brokers Aon/Benfield and Guy Carpenter. Aon's measurement includes in its figure the total amount of capital at an insurer that engages in reinsurance (making the assumption that an insurer can allocate capital to reinsurance given the right market opportunity) and includes non-traditional sources of capital. Aon reports global reinsurance capital at $470 Billion at the end of the first quarter 2012[i]. Capital is a proxy for capacity in its measure. Guy Carpenter's measure focuses on the capital available in the traditional reinsurance company markets. Carpenter estimated in its 2012 mid-year reports that the total available reinsurance capital was $184 Billion[ii].

Reinsurance markets are elastic. Capital flows into the market freely when there is demand increase. Within the last 30 years, the US experience is that so-called shortages of supply of (re)insurance is really better classified as increased demand for (re)insurance and markets have responded with increased capacity following: the mid 80's liability crisis, the 1992 and 1994 Hurricane Andrew and Northridge earthquake; the 2001 9/11 terrorism losses; and the series of seven hurricanes in 2004 and 2005 including Katrina. More recently this is illustrated by the estimated $7 Billion in hedge fund and investor capital that has flowed into Bermuda in part to capitalize three new reinsurers; and to invest in "side cars" and catastrophe bonds. Thus it would be incorrect to count reinsurance capital as finite and limited to a single annual report of available capital. Moreover, ABIR members are investor owned. If current market dynamics leave capital unused, then the company returns the extra capital to shareholders via dividends or stock buybacks. If the market dynamic changes and more capacity is sought then, as noted, capital would flow back into the markets. Thus in essence both broker numbers "undercount" available reinsurance capacity.

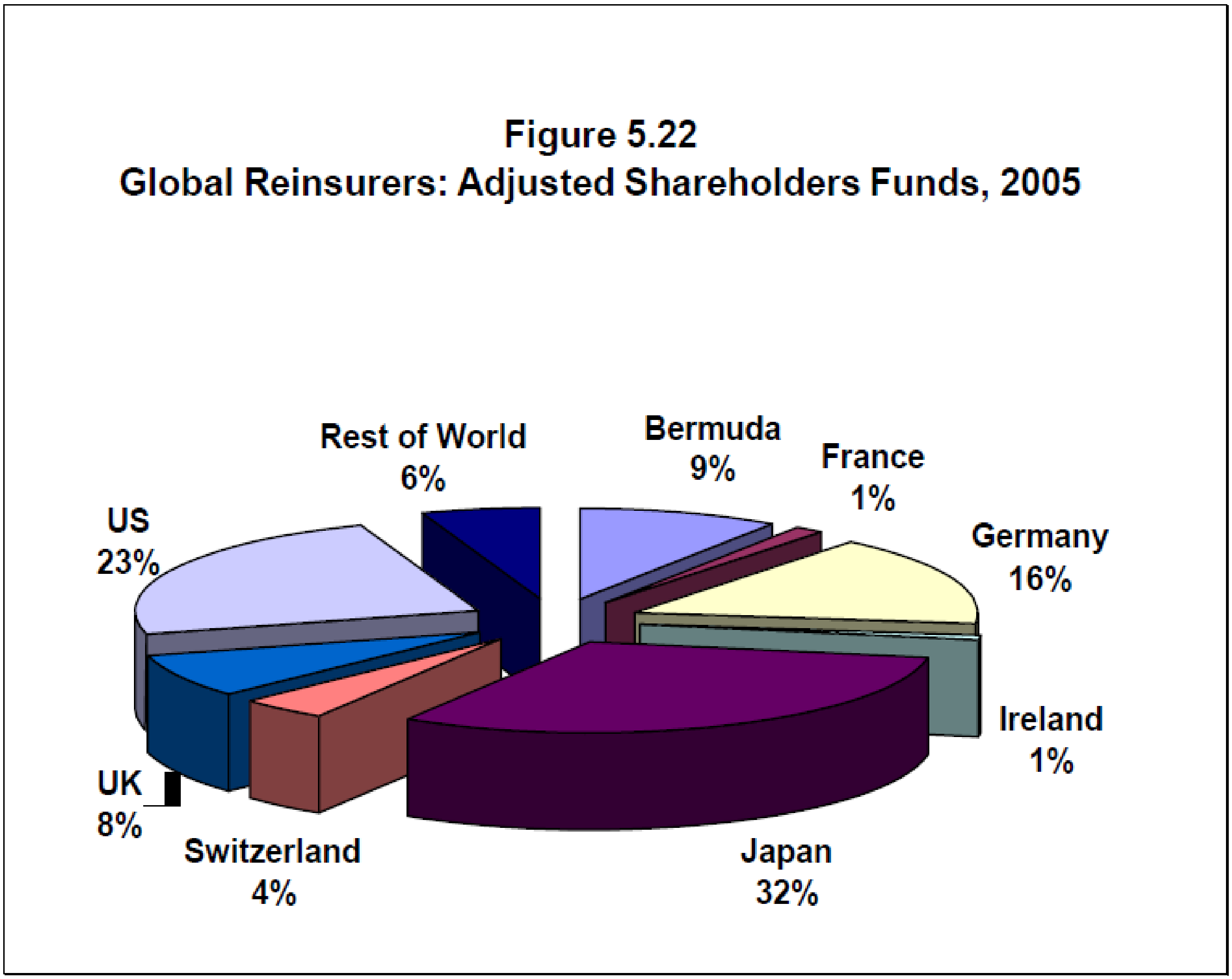
Regulation which avoids rate and form regulation has encouraged this freely functioning market. Reinsurance markets thus demonstrate effectively the value of open and competitive markets in quickly allocating capital to meet consumer market needs. Bermuda's regulatory authority (the

Bermuda Monetary Authority), while maintaining a robust solvency regulation regime, provides a comparatively quick vetting and licensing approval process which encourages company formation in Bermuda. Regulatory restrictions that impose local capital requirements, collateral, seasoning, or domestic company formation rather than branching will impede the flow of capital into these markets.

Reinsurance has always been an international market. Some of the biggest payers of San Francisco earthquake claims in the great quake of 1906 were non-US reinsurers. Today's Standard and Poor's report of the Top 40 reinsurers in the world demonstrates the international spread of reinsurers[iii]. Notably, as in most large global reinsurance markets, reinsurers can operate on a cross border basis so it is not necessary for a non-US firm to have a US licensed insurance entity as a pre-condition to market reinsurance to US clients. This regulatory practice has encouraged cross border commerce and diversification through cross border risk-sharing. This has enormously benefited consumers in the US. Therefore regulations which discourage this cross border commerce should be discouraged by policy makers as being counterproductive to the needs of US consumers.

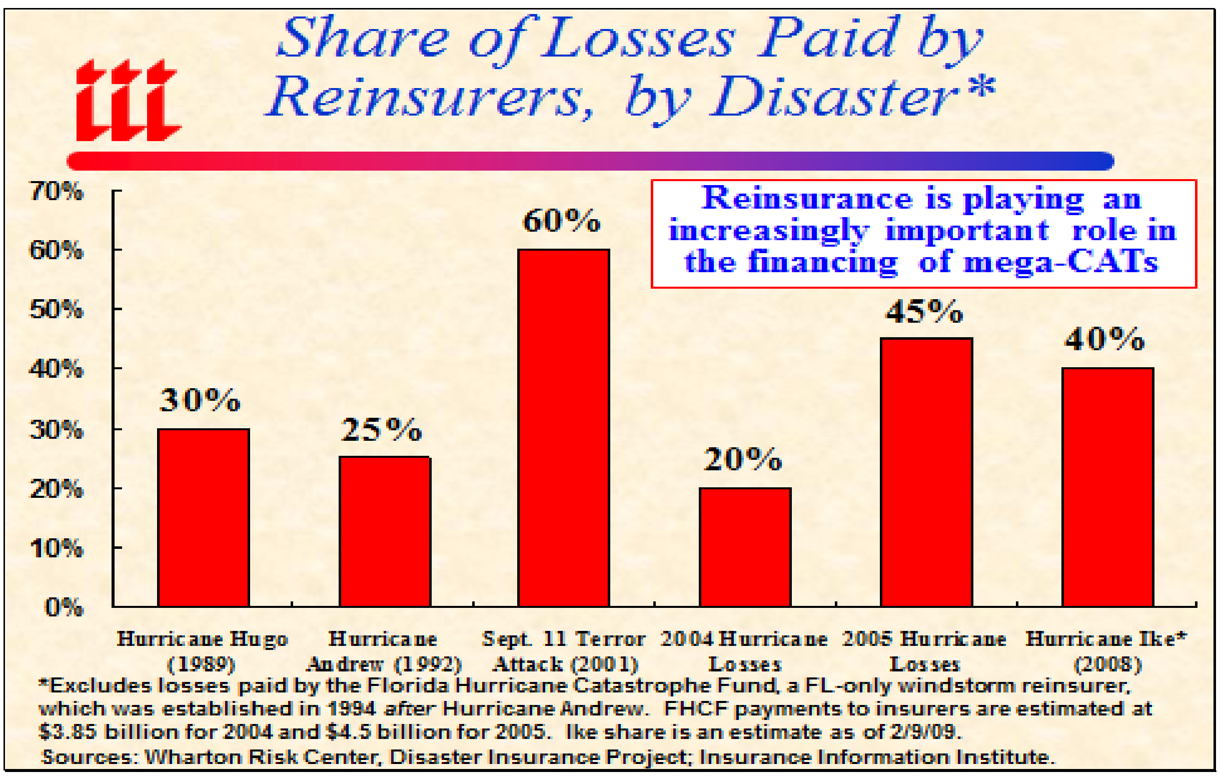
With regard to reinsurance, according to the Standard and Poor's Global Reinsurance Highlights (2011 Edition) the top five largest domiciles of reinsurers (measured by premium; listed in order) are Germany (4 reinsurers in the S & P top 40), the United States (6 reinsurers in the top 40), Switzerland (2 reinsurers in the top 40), Bermuda (16 in the top 40) and the United Kingdom (2 in the top 40). Other jurisdictions with two or more reinsurers in the top 40 include: France (2), and Japan (3). While Bermuda is notable for its headcount, it should be stated that each of the top five reinsurers in the world have two times or more premium than the largest Bermuda reinsurer. Notably, the two largest reinsurers in the world have five times as much premium as the largest Bermuda reinsurer. Bermuda's contribution to the global market is the underwriting expertise and specialization that it has provided in catastrophe reinsurance (excess liability and property); and the fact that many companies in Bermuda provide cumulatively, significant capacity to meet insurers' needs. It's the collection of companies in Bermuda that has served to spur additional capacity, innovation and competition in global reinsurance markets that otherwise would have been dominated by the very largest historical global players in the field. Bermuda's regulation has encouraged this company formation in Bermuda and we will discuss that more in the answers to questions that follow. Lastly, due to Bermuda's proximity to the US, the US market was initially the biggest beneficiary of this Bermuda insurance capital formation.

This table from Wharton Professor J. David Cummins provides a breakout of reinsurance capital allocated by domicile. It demonstrates the distribution of reinsurance capital globally.[iv]



3. The role that the global reinsurance market plays in supporting insurance in the United States.

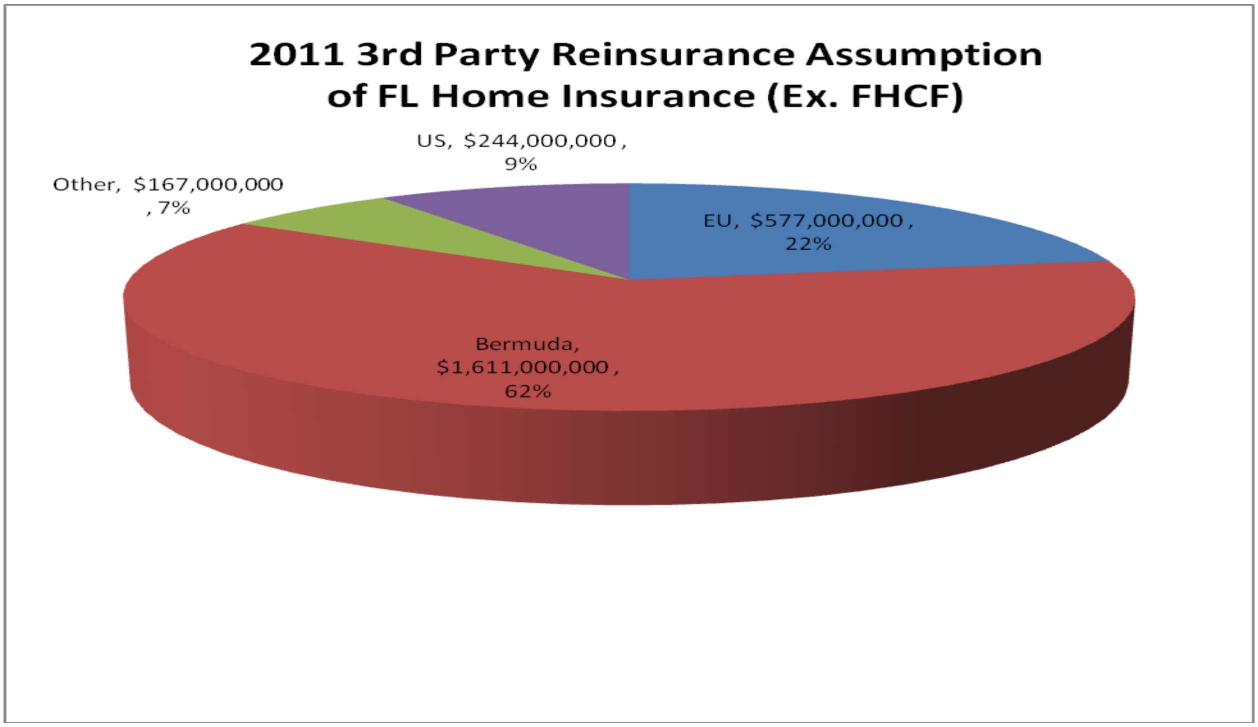
The Insurance Information Institute (III) has published data from a series of large US catastrophes that documents the contribution to US insurers of claims paid by reinsurers. The table below documents that for six major cat events in the last 25 years that reinsurers' share of cat loss has ranged from 20% for the Florida quartet of hurricanes in 2004 to a high of 60% for the September 11, 2001, terrorism attacks. ABIR research on US tornado events in 2011 showed that 20% of these "mega tornado" events were also reinsured. Generally, the larger the loss the greater share of insurance claims that will be passed onto reinsurers. In this discussion of averages it should be noted that some insurers use more reinsurance, while others use less. The reinsurance buying decision is tied to company specific determinations and reinsurance is simply one risk management tool available to ceding insurers.



ABIR's research further documents that a very large share of the reinsurance payments come from non-US reinsurers. The non-US reinsurers' share if measured on an ultimate parent base can include the US subsidiaries of foreign insurers.

The following illustration notes that more than 90% of the private market reinsurance support for Florida's domestic home insurers comes from non-US reinsurers.

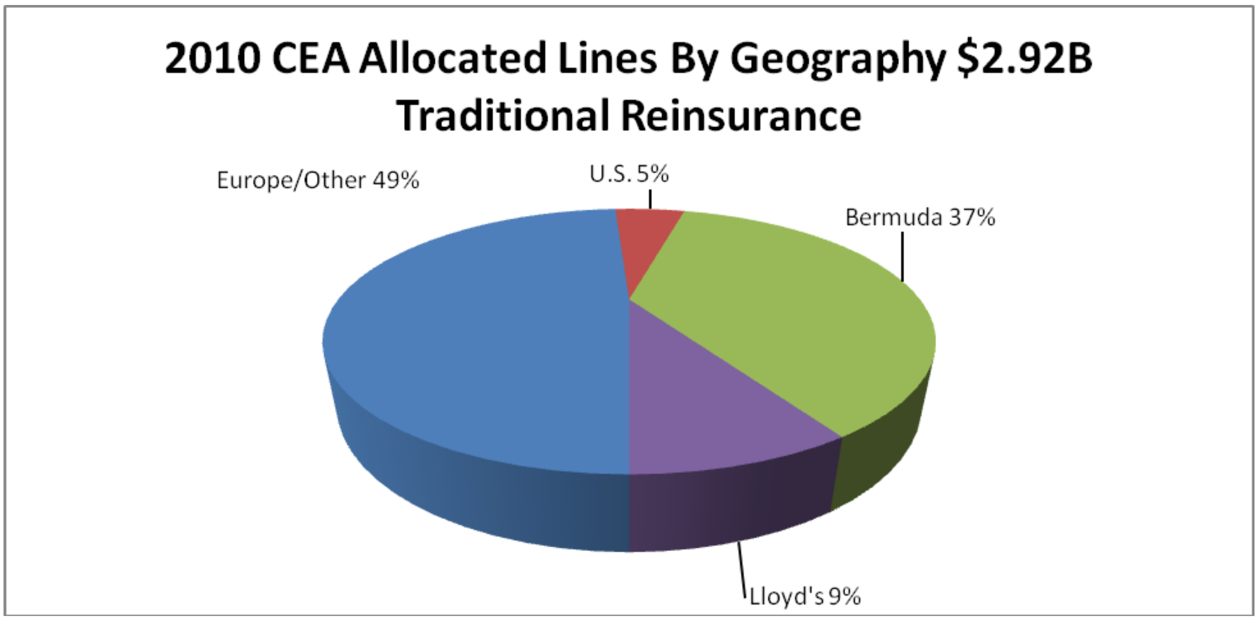
Florida Insurers: 91% Private Reinsurance is Non-US



Source: ScheduleF.Com: Dowling & Partners Securities, L.L.C. 4/23/2010; private sector reinsurance, does not include Florida Hurricane Catastrophe Fund; Home insurance defined to be Florida domesticated insurance companies

A similar illustration is provided below for the California Earthquake Authority (CEA). Since this research was completed both the Citizens Property Insurance Corporation (CPIC) Florida and the CEA have created Bermuda special purpose insurers to issue catastrophe bonds to provide them with reinsurance.

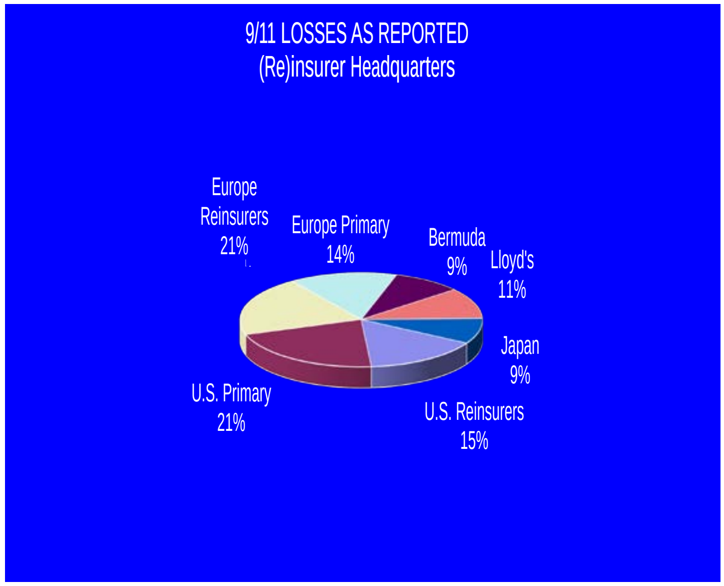
95% of California Earthquake Authority (CEA) Reinsurance Is Provided By International Reinsurers



Source: CEA, D&P Analysis, IBNR September 10, 2009

CEA Reinsurance Mix	2010	%
Europe/Other	1695.9	58%
Bermuda	1076	37%
US	146.3	5%
Total	**2918.2**	**100%**

International Insurers and Reinsurers Paid 64% of US 9/11 Claims



DOWLING & PARTNERS

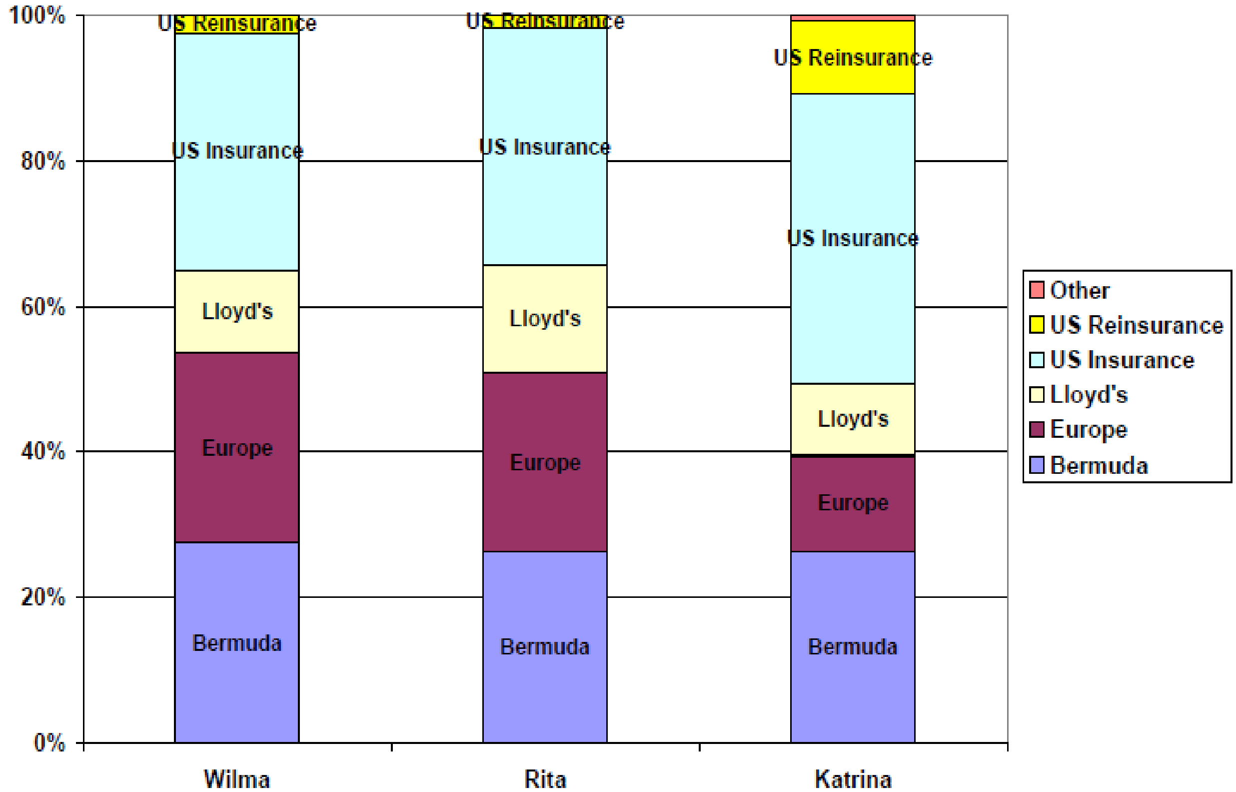
WTC LOSSES

By Co Headquarters	$,MM
U.S. Reinsurers	$4,109
U.S. Primary	$5,659
Europe Reinsurers	$5,506
Europe Primary	$3,865
Bermuda	$2,479
Lloyd's	$2,844
Japan	$2,338
Total Announced	$26,799

The US 9/11 terrorism losses show the same distribution of loss payments outside the US. Although this slide includes both insurance and reinsurance it illustrates the point that a majority of the losses were paid by non-US (re)insurers.

The slide below makes the same point for the loss payments from Hurricanes Katrina, Rita and Wilma. The non-US share is more than 50%.[v]

Figure 6.9
Regional Distribution of 2005 Hurricane Payments: Wilma, Rita, and Katrina



The ABIR members' contributions to the 2005 recovery from Hurricanes Katrina, Rita and Wilma can be measured another way. Research conducted by independent economic consulting firm GSP in 2007 found:

- Bermuda's (re)insurers paid $17 billion in property claims in 2005 for hurricane damage, representing 25% of the total property damages covered;
- Helped rebuild 87,042 homes (based on median home values), – 45,419 homes in Louisiana and more than 24,000 homes in Mississippi;
- Helped over 14,000 workers return to their jobs -- 9,564 in Louisiana, and 4,607 in Mississippi.[vi]

The slides that are embedded in these pages provide a graphic illustration of the importance of non-US reinsurance capacity to US insurance markets. One could argue that regulatory or tax incentives (catastrophe reserves) could lead to a greater share of reinsurance being provided by US based reinsurance companies with ultimate US parents. While that may be true, it would not necessarily create the most desirable outcome since it would neglect the value of a non-US reinsurer support for US markets. Non-US reinsurance capacity provides these benefits to US markets:

- Non-US reinsurers are not exposed to the same US macro-economic impacts that US reinsurers are exposed to thus a degree of financial contagion is mitigated; this independence affords the opportunity for the non-US reinsurers to have a more limited exposure to US economic impacts;

- Non-US reinsurers are not exposed to the same underlying insurance losses as would be US reinsurers; for example, the 9/11 terrorism losses led a number of major US insurers to conclude that they had inadvertently "doubled down" on their terrorism losses by absorbing losses as both an insurer and a reinsurer; as a result in the years following this terrorism event major US insurers including: Hartford, St. Paul, Chubb and C N A sold (or put into runoff) their reinsurance affiliates;

- US insurers have long purchased catastrophe reinsurance from non-US reinsurers; these ceding insurers understood that if their solvency was jeopardized by the direct losses from a US catastrophic event they didn't want their reinsurer to also be exposed to the same level of catastrophic loss; thus purchasing reinsurance from a non-US reinsurer provided greater financial security due to the diversification of risk held by the non-US reinsurer;

- Non-US reinsurer payments provide external capital that speeds recovery in the US domestic economy from events that have otherwise put constraints on domestic capital.

Finally, we conclude this section with a report on the lessons learned in 2011. In 2011, largely unnoticed in the US, we witnessed the largest catastrophe losses in history—they were unnoticed because the mega-loss events occurred in Australia, Japan, New Zealand and Thailand. The world's leading associations of reinsurers (ABIR, Insurance Europe and the Reinsurance Association of America) submitted a letter entitled: **Global Reinsurers, 2011 Record Catastrophe Losses; Strong, Reliable, Dependable Reinsurance Market Support for Global Catastrophe Risk,** to the IAIS Reinsurance Subcommittee on the lessons learned and raising issues pertinent to the IAIS and insurance regulators generally.

Here's the data excerpt from that letter:

> "Global Catastrophe Losses, 2011
>
> The 2011 global insured catastrophe losses were the highest ever recorded. Of the $105 Billion (US) in total insured losses, the bulk of these fell in Asia and Oceana. What was extraordinary about the 2011 losses were that they were dominated by "mega cat" events that occurred in several cases in relatively small jurisdictions as measured by market size or GDP. The lesson to insurance underwriters continues to be that extraordinary losses can occur in places where catastrophe losses are unexpected (Thailand) and can occur on a scale in multiple jurisdictions larger than expected (New Zealand).
>
> Despite this extraordinary loss record insurance capital remained ample and for many insurers active in these international markets, the losses recorded were an earnings and not a capital event. On an aggregate basis, according to Aon Benfield global reinsurance capital in 2010 was $470 billion and after the 2011 loss events it declined by only 5% to $445 billion. According to published sources including major reinsurance brokers, capacity remains abundant and capital sufficient in spite of record setting losses.
>
> Reinsured Share of 2011 Catastrophe Losses
>
> Reinsurance is well known as a risk management tool to manage large catastrophe losses. Generally the larger the loss, the greater the share of the loss reinsured. Although reinsurance premiums when measured as a percentage of global insurance premiums can be very small, the loss amounts born by reinsurers from large loss events can be very large. For example, the IAIS in its November 2011 paper "Insurance and Financial Stability" notes that only 5% of global premium is ceded to reinsurers.[vii]
>
> 1. Of the $105 billion in global cat losses it is estimated that 45% ($47.5) of this loss amount was ceded to reinsurers.
> 2. With regard to the largest events, the "mega events", the share that was reinsured rose to 54%.
> 3. The reinsured share of the very largest incurred losses of 2011 (Australian flooding and windstorms, New Zealand earthquakes, Japanese earthquakes, Thai flooding) were very heavily reinsured. The larger the loss, generally the greater share of the loss that flows into reinsurance markets. The share of the 2011 mega event cat losses that were reinsured ranged from 40% to 73%. The Chilean earthquake, which occurred in 2010, had a reinsured share of 95%.
> 4. The reinsurers of these incurred losses were generally not located in the jurisdiction where the loss event occurred. Thus the losses were exported to "foreign" reinsurers who then made claims payments to the local insurers in the economy where the event occurred. The impact of this is to improve speed of recovery in the disaster-affected

economy since the loss is not largely born by the local business and insurance community. Of the reinsured share of the losses, the amount sent to non-domestic reinsurers from these events ranged from 90 to 100%.

5. Although the US and Europe were spared large loss events in 2011, previous evidence (Hurricane Katrina, Windstorm Xynthia) demonstrates that for mega events, a large share of incurred losses are distributed to non-domestic reinsurers.

The table below summarizes the jurisdiction, the type of loss and the insured and reinsured amounts. The data is taken from publicly available sources and is based on liabilities assumed and not necessarily claims that have been paid to date.

Jurisdiction	Insured Losses (Mega Cats)	Reinsured Losses (Mega Cats)	Estimated Reinsured Share	Non-Domestic Reinsured Share
Australia:[viii]	**$ 8 B**	**$ 3.5 B**	**44%**	**90%**
New Zealand:[ix]	**$17 B**	**$12.5 B**	**73%**	**100%**
Japan:[x]	**$35 to $40 B**	**$12 to $14 B**	**40%**	**98%**
Thailand:[xi]	**$15 to $20 B**	**$12 B**	**60%**	**95%**
Chile[xii]	**$ 8.5 B**	**$ 8 B**	**95%**	**100%**
2011 Summary:	**$75 to 85 B**	**$40 to 42 B**	**54% average**	**96% average**
Summary (with Chile 2010):	**$83.5 to 93.5B**	**$48 to 50 B**	**62% average**	**97% average**

Thus the 2011 global cat losses make the same point as we've made with regard to US loss experience. Domestic insurance markets benefit enormously from a robust, vibrant, global reinsurance market that can operate free of regulatory restrictions such as rate and form regulation, localized capital requirements, localized purchase requirements and discriminatory taxation. Reinsurers point out that this global distribution of their premium and risk means that they can provide more capacity on the same capital base than they could if their risk was concentrated in fewer jurisdictions and subdivided into different "capital buckets". The principles of diversification allow for greater amounts of risk to be assumed than otherwise would be the case since the losses are known to be disconnected by peril, geography and time. To a large degree the reinsurance business model depends on the ability to assume risk from a large pool of diverse, potential customers. Ill-conceived constraints on this approach will restrict capacity which inevitably has an impact on consumer prices.

4. <u>The effect of domestic and international regulation on reinsurance in the United States.</u>

Two of the primary drivers that have shaped the US reinsurance market have been:

- The unique market need in both liability insurance and property insurance for a great supply of reinsurance; this is driven by macro-economic issues, the legal system and the aggregate real estate values in areas exposed to natural disasters;

- A state based regulatory system that complicated licensing for domestic insurers and allowed cross-border reinsurance as long as collateral was supplied to the domestic ceding insurer.

The complexity and inefficiency of the state based system of regulation has encouraged reinsurers to start their businesses outside of the US. Once a critical mass is reached, or new lines of business become part of the company business plan, US subsidiaries are established. The US tax law's high corporate tax rates and mandates to tax global income on a US basis is also a deterrent to formation of new internationally focused (re)insurers in the US.

The NAIC's state based collateral model law and regulation framework was substantially revised in 2011. As of this date 10 states have adopted laws and regulations based on that new framework. The new models allow for collateral requirements to be reduced based generally on two findings: 1) the nature of regulation in place in the reinsurer's non-US domicile; and 2) qualitative and quantitative findings about a specific reinsurer. Non-US reinsurers view this new framework as a small step in the right direction. But we find the framework still to be cumbersome, expensive, counterproductive with certain downgrade requirements and fraught with the potential for state inconsistencies. For example, the NAIC's reporting framework compels global groups to collect and report data that in some cases is already reported by US cedents; and in other cases is not currently reported by the global reinsurers. Reinsurers generally would desire a system which would establish one national standard for qualifying a domicile and a reinsurer. We would encourage a US national or federal system that would recognize Bermuda's robust regulatory regime and cooperative stance; and as a result recognize Bermuda's qualifying international reinsurers as being able to do business with US customers without posting collateral. ABIR members have many reasons to establish a US insurance subsidiary and more than two thirds of our members have them; regulatory change to allow a US reinsurer to "passport" through all states without further licensure would create an incentive to locate a subsidiary in the US. But even with that subsidiary ABIR members would continue to do business on a cross border basis for a variety of reasons. Among those reasons are:

- Location of the underwriting experts; the business gets placed where the knowledgeable underwriters are located;
- Balance sheet, if the largest balance sheet is with the non-US reinsurer, the customer often prefers to have the contract placed directly with that legal entity;
- Affiliated business gets pooled together to maximize available capital (capacity) and to make the retrocession purchase more efficient; a single retro contract for the business can then be placed for the group;
- Market expertise dictates often where the cedent looks for reinsurance, property cat and excess liability business often goes to Bermuda because of the market experts located there; marine and aviation and EU business often goes to London for a similar set of reasons; clusters of underwriters become market centers where brokers know they can conveniently shop for their clients by walking door to door rather than flying all over the world.

We believe that the existing state by state licensing system of US reinsurers is unnecessary and expensive. The Dodd Frank Act provisions that recognize that a ceding insurer's state of domicile should set the financial standards for that company (and have the rest of the jurisdictions recognize it); and a companion provision for the assuming reinsurer; sets the precedent for a passporting system that should be created in the US to create efficiencies for US reinsurers. A US reinsurer should be able to "passport" across the country and serve ceding insurers without needing to be licensed (or post collateral) in the ceding insurer's state of domicile. Similarly, for the non-US reinsurers, we'd envision and encourage a system where a single state or a federal body would assess the non-US reinsurer, based on the aforementioned evaluation of the domicile and the reinsurer, and then authorize it do business with US cedents on a cross border basis without posting collateral. These two changes together will maximize reinsurance market capacity and substantially reduce the reinsurance regulatory compliance costs which in turn will have some effect on reinsurance pricing.

With the implementation of the NAIC's Solvency Modernization Initiative, and with the benefit of the FIO's research, it should be possible to recommend that regulation of commercial insurance markets, or a subset – the reinsurance market—be regulated at the federal level. As already reported, with regard to reinsurance, according the Standard and Poor's Global Reinsurance Highlights (2011 Edition) the top five largest domiciles of reinsurers (measured by premium; listed in order) are Germany, the United States, Switzerland, Bermuda and the United Kingdom. Similarly, in the US Surplus Lines market, 13 of the top 25 US groups (AM Best 2010 report, 2009 premium) are ultimately part of foreign controlled groups. For these companies, the parental domiciles in premium volume order are the United Kingdom, Switzerland, Bermuda, Germany, Australia and Ireland. This is a finite group of countries with cooperative and complimentary legal, regulatory and trading frameworks. It should be feasible for such a group of jurisdictions to work together with regard to bi-lateral or multi-lateral regulatory cooperation agreements that would enhance the efficiency and effectiveness of regulation. Such agreements drafted to focus either on group prudential supervision and regulatory cooperation, or to cover reinsurance collateral, would strengthen US insurance supervisory knowledge and create regulatory cooperation mechanisms with those non-US supervisors of international insurance groups.

Furthermore, at the federal level prudential supervision of insurance companies in the commercial markets should be feasible since these are not lines of business affected generally by rate and form regulation. Regulation of these enterprises at the federal level would also recognize the commercial reality that in the property casualty insurance sector large international insurance groups, whether US based or not, are the major global providers of commercial insurance and reinsurance and they are regulated by multiple jurisdictions around the world. This market reality should encourage development of regulatory cooperation agreements which will enhance prudential oversight of these international insurance groups thus meeting the major G 20 concern about financial stability, while minimizing inefficiency and avoiding duplication and contradiction.

Bermuda is one of three jurisdictions that have been accepted by the European Commission and the European Insurance and Occupational Pension Agency (EIOPA) for assessment as an equivalent jurisdiction under Solvency II. The preliminary conclusion of EIOPA is that for the international insurance group sector the BMA does qualify for an equivalence finding subject to certain caveats. Bermuda has completed a series of regulatory and policy changes recommended in the first EIOPA review and it is expected that a second EIOPA equivalence assessment will take place yet in 2012. A final Commission assessment on equivalence is now expected in 2013.

Due to the design of Solvency II certain regulatory penalties would accrue to international insurance groups if the insurers are not domiciled in equivalent jurisdictions. Examples of these penalties could include: a. requirements for capital "add ons" or ring fencing of European operations; b. designation of a European jurisdiction as a group supervisor for the European component of the group; and c. imposition of reinsurance collateral requirements on cross border providers of reinsurance to EU ceding insurers.

Although we do not endorse jurisdictions, or trading blocs, creating protectionist measures or compelling compliance with extra territorial standards, ABIR supported the goals of the BMA to pursue equivalence with the EU under Solvency II due to the importance of the EU as a regulator of ABIR member subsidiaries and due to important client trading relationships. We also deemed it to be important since Europe's Solvency II was being used as a prototype for the developing IAIS supervisory standards. We recognize that the US states chose a different path on how to deal with Solvency II.

ABIR members believe that Solvency II is one step on a longer road to an international regulatory standard that will be applied to international insurance groups. This is the logical extension of the IAIS principles for prudential supervision under which the IMF today evaluates jurisdictions. We believe that international insurance regulatory standards will continue to evolve from IAIS standards to more explicit regulatory cooperation and coordination for international insurance groups.

The US is the world's largest insurance market; as such it can play a leading role in development of international regulatory standards. The creation of the FIO enhances the ability of the US to lead in the development of these standards. We welcome the new role for the US FIO. We'd encourage the US to reach out bi-laterally to major trading partners, including Bermuda, to exercise regulatory cooperation agreements.

<u>Risk Spreading, Pooling and Diversification</u>

Of particular concern in reinsurance regulatory frameworks is protectionism. Protectionist policies limit:

- Risk spreading, which
- Results in locally concentrated risk, which
- Results in greater risk of insolvency, which

- Damages consumer markets and risks the consumer claim going unpaid.

Global reinsurance markets functioned well because the 2011 flooding, typhoon (cyclone, hurricane), earthquake, tsunami, brush fire, and tornado events were pooled effectively by the reinsurance business. Reinsurers of large events rely on the principles of diversification in underwriting the risk which they assume. Pooling risk from this spectrum of cat losses, from varying jurisdictions, from perils which are not interconnected, allows for reinsurance to be provided on a capital base that allows reinsurance to be priced on a basis lower than it otherwise would be priced if capital had to be held to support only a specific risk, or a specific jurisdiction's risk exposures. This is why "ring fencing" of capital through locally mandated jurisdictional reinsurers or through government funds leads to higher reinsurance costs and less capacity when viewed over the long time horizon.

Reinsurance markets are characterized as being free of rate and form regulation and thus reinsurance capital flows quickly into markets unrestrained by barriers to entry. In 2010 and 2011, though, two jurisdictions imposed stringent regulatory controls on the ability to conduct cross border reinsurance business and imposed provisions to compel localized capital to be held by locally licensed reinsurers. Brazil's reinsurance regulations were designed to support a "national champion" in the IRB which is expected to be sold by the government to private investors. The Brazilian measures are in two parts, continuing a mandate that 40% of all risk be reinsured with local reinsurers, and imposing a 20% limit on the amounts of affiliated reinsurance that can be ceded by a Brazilian local (re)insurer to a non-Brazilian affiliate. Argentina's regulations require all reinsurance purchased by insurers of Argentine risk up to a value of USD 50 million to be placed with local reinsurers. A number of jurisdictions continue to impose mandatory cessions to local reinsurers (India, Thailand and China). Other jurisdictions, namely the US, have considered special taxes intended to penalize cross border affiliated reinsurance transactions.[xiii]

Collectively these measures are protectionist in nature and have been the subject of protests by insurers, trade experts and governments to the jurisdictions that have imposed these market barriers. If the United States were to adopt similar measures, we would see concentrations of risk developing; which will lead to a greater risk of insolvency; and in turn higher consumer prices.

Since affiliated reinsurance is central to the business function of international insurers, we want to comment specifically on the counter productive outcomes of regulatory or tax policy that limits the use of affiliate reinsurance. The mandates to use local insurers would compel more capital to be held in the US and -- absent the ability to freely use affiliated reinsurance from a non-US insurer parent -- insurance costs would likely rise. This is the conclusion of Wharton Professor Dr. David Cummins[xiv] and the Brattle Group which were asked to review the impact of tax penalties which the US Treasury has recommended to penalize US to non-US affiliated reinsurance transactions. Excerpted below are two slides from Dr. Cummins's presentation at the US NAIC Winter Meeting in December, 2009. The slides summarize the value and function of affiliated reinsurance.

Why Affiliate Reinsurance Matters

- Through efficient intra-group diversification a group of affiliates can reduce the total capital needed, lowering the cost of insurance
- Affiliate reinsurance more efficient than non-affiliate reinsurance – reduces costs of moral hazard and adverse selection
  - Adverse selection – insurer has incentive to transfer worst risks to reinsurer
  - Moral hazard – insurer has incentive to take on too much risk or loosen underwriting standards
  - Intra-group reinsurance "internalizes" these adverse incentives and reduces or eliminates their costs

Why Affiliate Reinsurance Matters II

- Affiliate reinsurance is central to the group structure of the insurance industry
  - Groups with subsidiaries around the world can diversify risk across widest possible geographical area
  - Affiliate reinsurance can be conducted more quickly and flexibly than non-affiliate reinsurance
    - Non-affiliate requires negotiations with third parties about terms and prices
    - Non-affiliate reinsurance usually must be renewed annually
  - Affiliate reinsurance less susceptible to price increases and supply restrictions over the hard market phase of underwriting cycle

Cummins' slides are extracted from a report he did in conjunction with the Brattle Group. That report noted: "affiliate reinsurance is central to the group structure of the insurance industry. Relative to non-affiliate reinsurance, affiliate reinsurance allows risk and capital to be moved more quickly and easily in response to changing market conditions." Affiliate reinsurance is not just an issue for non-US insurance groups. The Brattle Group concluded: "Because affiliate reinsurance addresses real problems in the market, U.S.-owned insurance groups use it extensively: in 2009, nearly half of U.S.-owned insurers ceded at least 40 percent of their premiums to an affiliate, and a third of them ceded at least 80 percent."

Among the report's significant conclusions is that such protectionist tax policies would:

- Reduce the supply of reinsurance (affiliate and non-affiliate) to the US by 20%;
- Substantially render the use of non-US affiliate reinsurance as non-economic;
- Raise aggregate consumer insurance prices by between $11 Billion and $13 billion annually;
- Reduce the supply of insurance by about 2%;
- Decrease the purchase of insurance in the US by 4 to 5%, but as much as 16% in some lines of business.

The following two Cummins' slides summarize the consumer price impacts by line of business and by state:

Primary Market: Price and Supply Effects III

- Price and supply effects would vary significantly by line of insurance
  - XOL liability reinsurance: +16% price increase
  - XOL property reinsurance: +8.4% price increase
  - Products liability occurrence: +6.6% price increase
  - Other liability claims made: +6.3% price increase
  - Aircraft: +4.9% price increase
  - Earthquake: +4.9% price increase
  - Other liability occurrence: +3.4% price increase

This Cummins' slide summarizes the impact by state:

Primary Market: Price and Supply Effects IV

- Effects would vary significantly by state
  - Hardest hit would be states with large, diverse economies and large exposure to property and liability losses
  - State with more "tail risk" also would be hard hit because they are more reliant on foreign reinsurance
  - Examples of high impact states: California, Florida, New York, Texas, New Jersey, Massachusetts, and Louisiana
  - Such states would suffer disproportionate price increases and supply restrictions

For example, the Brattle Group[xv] found that for states like Florida with "tail risk" for US hurricanes aggregate consumer prices would increase by $817.8 million. Rounding out the top five states in terms of consumer price increases:

- California annual consumer insurance price increase of $796.6 million;
- New York annual consumer insurance price increase of $579.3 million;
- Texas annual consumer insurance price increase of $573.6 million;
- Illinois annual consumer insurance price increase of $280.5 million.

The main impacts for Florida and Texas are hurricane related; the main impacts for California are earthquake and business liability; and the main impacts for New York and Illinois are business liability related coverages.

Furthermore, restrictions on affiliate reinsurance essentially force "ring fencing" capital which would compel risk to be financed locally without the broad support of a diversified pool of risk. As a result, diversification is restricted on a global basis. The amount of capacity available for catastrophe risk would be limited by the locally available capital. According to the researchers, this likely drives up prices for consumers.

5. The role and impact of government reinsurance programs.

The danger in any government (re)insurance program is that the program becomes manipulated for political gain. Noted economist Milton Friedman once said: "If you put the federal government in charge of the Sahara Desert, in five years there'd be a shortage of sand."

ABIR members are the largest providers of US natural disaster catastrophe reinsurance. Conservatively estimated, we provide 40% of the US property catastrophe natural disaster reinsurance protection, but in certain key hurricane prone states we provide a higher percentage of the coverage. Reinsurers have an excellent track record in meeting the needs of US insurers in managing natural disaster risk. Bermuda's Class 4 reinsurers paid more than $22 billion to our US clients for the 2004 and 2005 US hurricanes, including Katrina. From 2001 to 2011 Bermuda's reinsurers have paid more than $32 Billion to US clients to reimburse them for their natural disaster claims' costs. Dowling and Partners quoted Guy Carpenter in April as estimating a total of $240 Billion in property cat coverage being purchased globally for a total estimated premium of $19 Billion. Of that, $79 Billion of limit was estimated to be purchased in the US for a premium of $9.4 Billion[xvi]. As we noted earlier in this report, the reports on capital and size of market do not reflect the total available capital to support US risk. The supply is elastic and when capacity goes unused it is returned to shareholders. If there is an uptick in demand then the historical evidence shows that the capacity will return in even larger amounts.

Government reinsurance programs can drive out private (re)insurance capacity, if that is done then tax payer dollars are at risk in paying insurance claims which otherwise would be paid by the private sector. As the GAO reported to Congress in 2010:

> "… GAO identified public policy goals for government involvement in natural catastrophe insurance and applied those goals to potential changes in the federal government's role. Those goals were developed based on insights from past GAO work, a review of legislative histories, and interviews with public and private sector experts, and included (1) charging premium rates that reflect the risk of loss, (2) encouraging broad participation, (3) encouraging the private market to provide natural catastrophe insurance, and (4) limiting costs to U.S. taxpayers."[xvii]

The four goals seem logical and equitable. When evaluating pending federal legislative dealing with catastrophic insurance risk against these four goals, the GAO found:

> "We found that these proposals involve trade-offs that would have to be balanced. For example, while these proposals could lower premium rates for and increase public participation in state natural catastrophe programs, they could discourage private market participation and mitigation efforts and increase taxpayer exposure to potential costs."

Thus the conundrum on federal government involvement in catastrophe risk: why create federal (re)insurance programs if the result is: 1) discouraging private sector risk bearing; 2) reducing incentives for loss mitigation; and 3) increasing taxpayer exposure to future costs? The National Flood Insurance Program (NFIP) seems to be an apt case in point. The subsidized federal flood insurance program has crowded out private sector risk bearing, removed incentives to remove properties from flood prone areas, increased development in areas at risk and as a result increased the threat of injury and loss of life to many people.

In the United States, the US or state governments authorize multiple government (re)insurers. At the state level, Minnesota operates a mandatory workers compensation reinsurer; Michigan operates a mandatory auto liability reinsurer; and Florida operates a mandatory property catastrophe reinsurer. Also at the state level, nearly every state operates auto, property and workers compensation residual markets that may also operate as reinsurers. At the federal level, the US government authorizes a federal insurance or reinsurance program for crop insurance, terrorism risk and flood insurance. These existing state and federal (re)insurance programs can serve collectively to displace private capital and expose taxpayers to additional risk. ABIR believes such government authorized programs should be redesigned to maximize private sector risk bearing and to minimize government subsidies to insurance markets. Government resources should be focused on reducing risk of loss (hazard mitigation, building codes enforcement) and emergency response. If private (re)insurance capital is not available, only then should government-authorized insurers serve as markets of last resort.

There is ample evidence of state and federal insurance programs being manipulated to lower insurance prices to levels that otherwise would be inappropriate for either the risk insured or the expenses expected to the program. The General Accountability Office (GAO) has written numerous reports documenting this problem. It is a problem inherent in any government insurance program – whether it is Social Security, health insurance or property insurance.

The political pressures often result from concerns with “affordability”. Affordability is a relative term of course, not easy to define except in the eye of the beholder. In a research paper by the Brookings Institution,[xviii] the authors noted that if insurance subsidies are politically necessary then they should be “means tested” and transparent – there is no public policy rationale to deliver a taxpayer subsidized insurance product to a consumer with the means to pay for the risk based price of the product. Insurance subsidies as they are delivered today eliminate the important “price signals” about the cost of risk related with the peril insured. By eliminating the risk based price signals incentives for reduction of losses are removed from the consumer’s decision making; and as a result insurance claims will likely increase further increasing the insurance costs for taxpayers under the government program. It’s a self-fulfilling prophecy with a problematic compounding effect. The hole just keeps getting bigger, as witnessed with the $18 Billion dollar debt now owed by the National Flood Insurance Program. A debt which the FEMA administrator’s realize cannot be paid off by the current inflow of premiums to the program. ABIR is encouraged by the President’s recent signing into law of the NFIP reform package which moves to risk-based pricing, encourages mitigation and allows use of private reinsurance to reduce the federal government’s exposure to loss. To successfully implement this new law, though, the Executive and Congressional branches of government will have to affirmatively explain and defend the program by identifying the benefits to the public at large and taxpayers specifically, in order to overcome the complaints of individuals and specific localities which will argue that they’ve been asked to pay more than they can afford.

Bermuda's catastrophe reinsurers are global providers of coverage. Insured values and mega cat events are growing around the world, as evidenced by the 2010 and 2011 loss experience from brush fires, tsunamis, earthquakes, hurricanes and floods. Ironically US consumers benefit from the growth in non-US catastrophe risk. As property values grow in cat exposed areas in emerging markets, more insurance and reinsurance will be purchased and the global pool of premiums and capital will grow as a result. As noted elsewhere in this paper, because of the principles of diversification the more risk reinsurers write in those non-US markets the more risk we can assume from the US because our capital will be deployed more efficiently against uncorrelated loss exposures. Greater global diversification means greater US capacity at competitive prices.

ABIR members have an ongoing interest in writing cat risk for hurricanes, earthquakes and floods, including reinsurance of the NFIP. Evidence is available of capital being available to take on US earthquake risk in the event that secondary mortgage market rules are amended to phase in an earthquake risk purchase requirement tied to the issuance of new mortgages. Today due to the absence of any mortgage market requirement for earthquake insurance, the largest holders of residential earthquake risk are mortgage lenders. In spite of the growth in the state property insurance facilities, there is ample evidence of private sector risk appetite to assume this risk. Both the Florida and California entities (with the largest US natural disaster exposures) have successfully placed growing amounts of their risk into private capital markets including reinsurance markets. In Florida, the Florida Citizen's Property Insurance Corporation this year was able to secure $750 Million in catastrophe protection via a catastrophe bond backed by investors (Everglades Re) and purchased an additional $750 million in private reinsurance protection. Both deals were well received in the markets and additional capacity would have been available to Citizens.[xix] The California Earthquake Authority has more than $3 Billion of reinsurance coverage in place. For the current year it has in place $300 Million in a catastrophe bond and recently sought an additional $300 million in a cat bond.[xx] This growing investor interest in earthquake risk and the success of the CEA in making these catastrophe bond placements, means that there is no need for federal legislation (as some have suggested) creating a catastrophe loan guarantee program that would be subsidized by the US government. Further we note that the risk appetite of investors for property catastrophe risk is growing. Recently Credit Suisse estimated that the US benefits from $15 Billion in alternative reinsurance market support in capacity provided by cat bonds, collateralized special purpose reinsurers, and industry loss warranty covers (ILW's).[xxi] The interest of investors to assume catastrophe risk has attracted a great deal of attention this summer. Several commentators argue that the dramatic uptick in such risk assumption that will lead to a decline in pricing for traditional reinsurance markets. If not good for reinsurance companies, it certainly is welcome news for US consumers.

By contrast state catastrophe facilities have grown disproportionately due to politically motivated rate suppression; and opaque cross subsidies that blur geographical and line of business risk factors. The enormous potential unfunded liabilities of funds such as the Florida Hurricane Catastrophe Fund and Florida's Citizens Property Insurance Corporation attest to the need to avoid over reliance on post-event funding for bond dependent state facilities. Hastily conceived federal legislation could incent the creation of additional state cat funds which would further move cat risk from the private sector's balance sheet to the public sector with the ensuing negative consequences to taxpayers.

The Florida home insurance market remains troubled primarily because, the state: 1) imposes stringent price regulation; 2) subsidizes rates in its residual market (Citizens) which makes it difficult for willing private insurers to win over insurance customers; 3) squeezes out private reinsurance capital with an oversized mandatory reinsurance fund; and 4) is characterized by a great deal of political risk due to dramatic swings in state laws governing these markets in the 20 years since Hurricane Andrew. Laws that have frozen rates and limited non-renewals have chilled the market. The current municipal bond insurance market problems have created a new kind of risk for Florida, which is dependent on a thriving bond market to buy up post-event debt that will be issued by at least three different state authorized insurance entities.

The Florida Hurricane Catastrophe Fund, according to its own management, has found itself in a position where it will be unable to honor all the claims that will come due from a major hurricane. According to the Cat Fund's Executive Director, in three of the last four years if a major hurricane had struck Florida, the Cat Fund would not have likely been able to keep its commitments due to the inability of the bond market to provide the financing necessary for the Cat Fund to pay its claims. In spite of this, insurers were mandated by state law to buy the dubious Cat Fund protection. Furthermore the Cat Fund's executive director has noted that in the 2011 hurricane season that if the Cat Fund had been unable to pay 20% of its claims stemming from a large land-falling Florida hurricane, the result would have been that six of the top 15 insurers in the state would have gone insolvent. Further to this point, Florida Insurance Commissioner Kevin McCarty responded to a legislative question on this same point in January. Commissioner McCarty estimated that in a "worst case scenario" that if 25% of the Cat Fund's maximum obligations could not be paid that 24 of the top 50 Florida home insurers would have less than the mandated minimum statutory capital and thus would be in need of regulatory action.[xxii] Florida's legislature again in 2013 will debate the Cat Fund management team's legislation to "right size" the fund and make it more reliant on retained assets and less reliant on post event bond financing.

Capital flows into the reinsurance markets as evidenced in the US by the waves of capital that flowed into new Bermuda start-up insurers following the commercial liability insurance crisis in 1985, Hurricane Andrew in 1992, the World Trade Center 9/11 terrorist tragedy in 2001, and the Katrina, Rita and Wilma hurricanes of 2005.[xxiii] But poor decisions from policy makers can interfere with this free flow of reinsurance capital. The Florida government's unwise 2007 decision to expand the Florida Hurricane Catastrophe Fund by $12 billion meant that of the $34 billion in capital raised in 2006 following Hurricane Katrina, more than $17 billion was returned to shareholders in 2007. The capital was determined to be excess, unneeded to support insurance risk, and thus funds were returned in the form of share buy backs and dividends. The lesson is that international reinsurance markets will willingly meet the needs of the US, but US policymakers can undercut that capital support by creating or expanding state or federal funds that displace private capital; or by enacting discriminatory tax laws. US policy makers can either act to maximize private sector risk bearing, or to maximize the use of government debt. The current problems in US state and municipal finance and the European sovereign debt crisis make the correct choice obvious.

In summary, since government (re)insurance programs distort private markets, we'd recommend that the FIO develop a list of principles that could be applied to current government (re)insurance programs. These operating principles would serve as either the regulatory operational impetus for change in programs; or as the recommended legislative vehicle to incorporate necessary principles. Among those principles would be:

- Government (state or federal) (re)insurance programs should not compete with private (re)insurance markets, or with other capital providers willing to assume risk;
  - Private capital should be encouraged to assume insurance risk, incentives for placement with government authorized programs should be removed;
  - Government insurance programs should have risk based prices that are set intentionally above those charged in the private market so as not to displace private sector risk bearing;
- To test whether private risk capital is available, governments should operate first consumer assistance programs or temporary residual market programs to test the degree to which private markets are restricted and to better understand the causes of the private market constraints;
- If private markets are unwilling to provide private insurance protection then governments should first focus on what corrective loss mitigation actions could be undertaken to win the return of private capital; (examples of loss mitigation measures are numerous but could include varied activities such as: flood plain mapping; dram shop liability laws, medical malpractice reform, general liability reform; safety inspection programs for boilers, nuclear facilities, nursing homes, health care facilities; building code mandates and enforcement);
- If private markets continue to be unwilling to provide capacity even after the government's risk mitigation/loss liability measures are implemented, then temporary or short term government insurance programs could be authorized for critically necessary risks as long as:
  - Insurers which manage the programs have an incentive to properly protect against loss by compelling them to share a portion of the risk in return for a share of premium;
  - Prices were based on risk so as not to deter the return of future private capital to the market;
  - Product coverages would be clearly distinguishable from private sector coverage so that consumers would always have an incentive to purchase a broader coverage package from the private sector;
  - Data collected from such programs could be organized, collected and provided in such a way as to allow private markets to analyze the data and determine which risks would be available for return to the private sector;
  - Subsidized insurance products are to be avoided, if "politics" dictates less than a risk based price then the program should be organized so that only consumers unable to afford the risk based price would be allowed the subsidy and the subsidy

to both the beneficiary and the taxpayer would be transparent so as to encourage assumption of the risk where possible in the private sector;

- State based programs which receive any federal assistance would be subject to the same tests as described above for federal insurance programs and states not able to certify compliance with the above standards would become ineligible for federal assistance.

6. <u>The coordination of reinsurance supervision nationally and internationally.</u>

ABIR addressed these issues in our earlier filing with the FIO. Rather than repeating ourselves we provide here a summary of a recent submission we made to the NAIC on how to make group supervision work. Group supervision seems to us to be one of the most critical issues to resolve quickly and correctly. ABIR believes there is merit in creating well-crafted group supervision regimes that are focused on identifying the gaps in supervision and then effectively coordinate the work of interested supervisors of the various legal entities. On August 14 we provided written and oral remarks to the NAIC with regard to supervision of international insurance groups. We incorporate here an edited set of those remarks.

ABIR supports the creation of group supervision statutes and supervisory regimes. We believe proper implementation of such regimes can lead to more effective and more efficient regulation. We are quite concerned, however, that such regimes will not be implemented in such a way as to achieve effective and efficient group supervision. We look at implementation of group supervisory regimes as being a multiple step process that will evolve as time goes on:

- Step 1: Crafting statutes that promote the creation of a single group supervisor, the group supervisor would be selected in a process that includes consultation with the insurance group and relevant interested supervisors;
- Step 2: Operation of effective supervisory colleges that serve to promote better understanding of intra-group transactions; focus on the group's risk management practices; allow for calculation of group regulatory capital needs; respect the roles of legal entity supervisors and avoid creation of duplicative or contradictory financial reporting or capital requirements; ensure that jurisdictional requirements are consistent with IAIS principles, standards and guidance;
- Step 3: Operationalize the group supervision structure and learn from the experience; encourage the development of trust and cooperation amongst the supervisors; the lessons learned will help shape future amendments to the statute;
- Step 4: Retool based on the lessons learned from supervisory crises that will inevitably occur.

Here are the ABIR principles that guide our comments to jurisdictional supervisors about group requirements.

<u>Effective and Efficient Group Supervision</u>**:**

1. <u>Foundation Principal One</u>: Group supervision of internationally active insurance groups (IAIGs) is important because without it there are potential regulatory gaps in supervision of

various businesses of an internationally active insurance group; and because it can create deterrents to regulatory arbitrage that would afford unfair advantages to groups that choose to exploit those gaps to the ultimate detriment of insurance consumers. Group supervisors can uniquely focus on the impacts of intra-group transactions and provide a clearer understanding of the overall financial picture of the group.

2. Foundation Principal Two: Regulatory requirements are those applicable in the jurisdictional law of the supervised entity. A home or host country jurisdiction cannot impose additional regulation on a party it doesn't have legal authority to supervise. Regulators must recognize and respect the legal authority in place and not seek to contradict or duplicate regulation lawfully in place. Regulation of legal entities of insurance groups cannot be used as a protectionist tool.
3. Foundation Principal Three: Group supervision should be designed to eliminate overlapping or redundant regulation, streamline financial reporting, and establish modes of regulatory cooperation.
4. Foundation Principal Four: Group supervision in and of itself does not create an additional layer of regulation; rather it organizes regulation, improves information sharing, ensures regulatory cooperation, establishes leadership in coordinating regulatory action, and encourages deference to the appropriate roles identified for the group supervisor and legal entity supervisors.
5. Establishes clear goals for what is expected of group supervision – such as:
    a. Understanding interconnectedness and the impact of intra-group transactions
    b. Deterring regulatory arbitrage
    c. Promoting confidential regulatory information sharing with peer regulators
    d. Avoiding additional , redundant or duplicative financial reporting
    e. Creating group enterprise risk management reporting for regulators
    f. Identifying of regulatory gaps; Establishing clear lines of authority for regulatory action consistent with the laws in jurisdictions
    g. Reporting a group capital calculation that provides a single capital number reflecting regulatory requirements applicable to the legal entities that comprise the group
    h. Utilizing legal entity on site financial examinations and acceptance of them by the group supervisor.
6. Designates a single group supervisor based on characteristics in local law based on principles developed by the IAIS. Multiple group supervisors are to be avoided.
7. Establishes regulatory colleges as the foremost tool for supervision of internationally active insurance groups; and creates a priority action list for initial and subsequent college meetings;
    a. Regulatory colleges are the fundamental tool of group supervision which is by definition a cooperative process whereby individual regulators empowered and constrained by local law share information and coordinate regulatory actions.
    b. Regulatory colleges are intended to: a. improve information flow; b. establish cooperation among legal entity supervisors; c. mediate disputes amongst regulators; d. identify regulatory gaps; and e. establish trust amongst the regulators which furthers the goals of regulatory cooperation.

8. <u>Encourages legal entity supervisors to accept</u> decisions made by the group supervisor, to the degree permissible by jurisdictional law and consistent with effective legal entity supervision.
9. Group supervision does NOT require uniform financial reporting, accounting standards, and capital measurement across jurisdictional boundaries<u>. Uniformity in these prudential requirements is a matter for separate consideration and may or may not emerge as a beneficial component of group supervision.</u>

We attach as an appendix a summary of Bermuda's group supervisory law, regulation and guiding principles.

The BMA's group supervisory regime is comprehensive. The financial reporting on a group basis is central to the need for the group supervisor and the supervisory college to be able to make a qualitative assessment of the risks in the group. The BMA has developed a groups' regime that focuses on key areas related specifically to groups, i.e. intra-group transactions, group corporate governance, group ORSA and a group Bermuda Capital and Solvency Return (BSCR). In addition, the BMA requires groups to apply prescribed stress tests to assess the capital adequacy of the groups under adverse economic and underwriting conditions. The tests assess the impact of the events on a group's statutory balance sheet (statutory admitted assets, admitted liabilities, and capital and surplus) as determined by the groups' internal model and/or vendor model(s). These tests help determine the capacity of groups to absorb key financial risks, such as shocks to investment performance and the loss profile associated with specific underwriting risks.

To complete this work ABIR members will take their group audited consolidated financial statements and run it through the BMA's standard risk based capital formula; or run the group financials through the internal capital model if that has been approved by the BMA. The output for the group will include: an audited group financial statement; a group ORSA; a group BSCR; and a statutory income statement, balance sheet and capital and surplus filing. Our members view is that this is a considerable undertaking on the first go around, including the key task for making the group data fit into the existing BSCR framework which includes allocation of certain lines of business. Once completed, though, for future years it involves replication of an existing framework. Doing this group analysis for the BMA based on Bermuda law is acceptable; having to conduct the same group analysis on an additional US or EU basis would be contrary to the goals of group supervision and would be expensive and inefficient. We urge regulators to avoid such redundant, duplicative and contradictory group reporting action.

The BMA has identified the insurance groups for which it wishes to act as group supervisor and has consulted with other regulatory authorities about its group supervisory role. Although these decisions have not been made public, based on consultation with ABIR members we believe about 20 insurance groups have been identified and for the most part the appropriate non-Bermuda supervisors have agreed to the BMA's leadership role. We believe conversations with other supervisors are ongoing with regard to a few Bermuda groups. If a group is restructured, then that can lead to a different determination on selecting a group supervisor. The full Bermuda group supervision framework takes effect on January 1, 2013; however, group financial reporting on a best efforts basis began with the year ending December, 2011, and some group on-site examinations have already been conducted.

Central to a successful operation of a group's supervisory regime are regulatory cooperation agreements. Such regulatory cooperation agreements are not new to the BMA or to individual state regulators. The BMA had as of this summer had completed the following Memorandums of Understanding with international, North American, US and European regulatory bodies:

- International Association of Insurance Supervisors (IAIS) - signed June 25, 2009;
- US Commodity Futures Trading Commission - signed March 3rd 1997
- Jersey Financial Services Department - signed April 10, 1997
- Isle of Man Financial Supervision Commission - signed October 28, 2002
- UK Financial Services Authority - signed April 21, 2004
- Luxembourg (Commission de Surveillance du Secteur Financier) - signed May 31, 2005
- Cayman Islands Monetary Authority - signed June 30, 2005
- Financial Services Board of the Republic of South Africa - signed August 15, 2005
- International Organization of Securities Commissions - signed June 6, 2007
- Malta Financial Services Authority - signed June 3, 2008
- The Office of the Superintendent of Financial Institutions of Canada - signed August 19, 2008
- New York State Insurance Department - signed September 25, 2008
- Luxembourg (Commissariat Aux Assurances) - signed February 2, 2009
- Florida Office of Insurance Regulation - signed September 24, 2009
- Nebraska Department of Insurance - signed October 28, 2009
- Pennsylvania Insurance Department - signed December 10, 2009
- Swiss Financial Market Supervisory Authority - signed March 11, 2010.
- Regional Regulatory Authorities (Caribbean) - signed May 27th 2011
- Financial Supervisory Authority of Norway - signed May 2nd 2012

We understand that additional MOU's are underway with jurisdictions in the US and Europe.

International Standards, EU Solvency II and IAIS ComFrame

Bermuda's group structure has to be put in context with the IAIS standards on group supervision, the development of the IAIS Com Frame and Europe's Solvency II equivalence project. The BMA has completed two IMF Financial Sector Assessments (FSAPs) based on the IAIS standards. A third one has been scheduled.

As already noted, Bermuda is one of three candidates for equivalence under the EU's Solvency II regime. As such, the BMA has been audited for its group supervision framework and its group capital calculation regime. EIOPA concluded in 2011 that the group supervisory regime of Bermuda is likely to be equivalent given that the Bermudian regulatory framework for group supervision was still under development at the time. Although the European Commission won't make its equivalence decision until mid-Year 2013, Bermuda's regime has been well received with EIOPA expected to make a final review at the end of this year. The EU Parliament has delayed the adoption of the Omnibus 2 Directive. The equivalence timeline may be affected by the eventual EU Parliamentary action.

The key issues for international groups which ABIR members would ask the FIO and the NAIC and its members to focus on include:

1. Ensuring that only one group supervisor is appointed; the role is coordinating and leading, not supplanting; not undermining the legal entity supervisory role.
2. In the case of state regulators, a key issue will be the legal authority of the state regulator to serve as a group supervisor of an international insurance group; can non-US supervisors rely upon a US state based group supervisor for coordination, enforcement and cooperation with other interested supervisors?
3. Ensuring that legal entity financial reports and exam reports are accepted by the group supervisor and that groups are not asked to develop and implement new financial reporting that overlays on top of individual legal entity financial reporting.
4. Focusing on intra-group transactions and understanding those; understanding how the group itself manages risk; identifying regulatory gaps; these are two critical areas where group supervisors can play a key role in helping to uncover voids in regulation or identifying areas of enhanced risk in intra-group transactions or in non-regulated entities which may have previously gone unnoticed.
5. Avoiding ring-fencing of group capital; protectionist legislation that has the effect of mandating creation of subsidiaries or additional sub-holding companies is inefficient and counterproductive to the spirit of group supervision; the impact of such measures on consumers is to subdivide capital and as a result reduce capacity in critical insurance markets which in turn has an effect on consumer product price and availability.
6. Creating supervisory colleges with the enhanced supervision under the leadership of the group supervisor. This will provide a wealth of additional insight into the group which in and of itself should focus regulators on essential group functions. Furthermore, it should deter regulators from duplicative or contradictory action.
7. Identifying in the US a lead state supervisor to assist in coordination of state supervisors with the supervisory colleges that will be established by the BMA.

As we wrote in our earlier submission, for ABIR members with US operations, we look for the FIO to assist with opportunities to create regulatory cooperation with state insurance regulators and the BMA since the BMA serves as a designated group supervisor for most of our membership. We'd encourage the FIO to enter into agreements that allow for confidential information sharing and regulatory cooperation on a national basis with BMA supervised groups that have US legal entities.

Although we've addressed our concerns with the state based collateral system in response to an earlier question, we'd like to address some additional comments here in response to this question on "coordination". With regard to reinsurance collateral, the Florida Office of Insurance

Regulation and the New York Department of Financial Services have each approved 15 Bermuda reinsurers to operate with reduced collateral in transactions with their US ceding insurers. The covered agreement authority (conferred to the FIO via Dodd Frank) is an efficient way to get to a national standard for such state collateral agreements. Although the NAIC model credit for reinsurance measure is in improvement over requirements for 100% of collateral to be supplied to support ceded liabilities of US insurers, we would encourage the FIO to take the lead in development of a mutual recognition framework that would allow for qualified reinsurers from approved jurisdictions to operate to support US clients without posting collateral. We believe the Bermuda Monetary Authority together with the Bermuda government can demonstrate their cooperation with the US and can document the robust regulatory regime to the FIO so that Bermuda's reinsurers can operate without posting 100% collateral. We understand these discussions are likely ongoing with the European Union as part of the US/EU dialogue. It would be important in assuring a level playing field amongst reinsurers, that if the US/EU dialogue results in an agreement to relax collateral requirements further that Bermuda also be allowed to negotiated simultaneously a similar agreement with the US government.

IAIS ComFrame

ABIR has testified to the International Association of Insurance Supervisors (IAIS) about its concerns that ComFrame imposes an additional layer of supervision and regulation for internationally active groups. ABIR has noted since Bermuda already has a group's regime, that it doesn't see the need for an additional level of group supervision to be mandated by the IAIS. We've been advised that the IAIS ComFrame provisions will be implemented via the IAIS principles, standards and guidance and that legal enforcement of these standards will occur via jurisdictional law. We will observe to see if that is indeed the outcome. In the meantime, ABIR believes that ComFrame can be a productive means of achieving efficiency in supervision via the coordination of supervisory colleges and cooperative approaches to review of group information collected by group supervisors. We don't believe a common capital requirement or a common financial reporting requirement is a necessary component of ComFrame.

The IAIS is developing ComFrame to develop a more integrated multilateral framework for group-wide supervision for internationally active insurance groups (IAIGs). The IAIS suggests the target group would be the largest 40 or 50 global groups. ABIR has formulated a number of questions about ComFrame which help to illustrate the key issues surrounding its development. Since the FIO is a member of the IAIS Executive Committee we believe that the FIO is in an excellent position to help shape the proposed ComFrame measures. We offer these comments to assist you in your policy development.

Since IAIS Insurance Core Principles (ICPs) already exist for group supervision:

1. Is ComFrame another layer of regulation above group supervision?
    - --Will regulators permit IAIGs to file/submit the same documentation that is prepared at the group level already?
    - -- How will ComFrame be used to achieve efficiencies in regulation?

2. Further ABIR notes:

a) If the IAIS goal is to strengthen group supervision, then those changes should be made on the IAIS ICP's and related documents.

--ComFrame should not be developed as a second, overlapping regulatory regime.

--Existing group regulation frameworks cover regulatory cooperation, information sharing, gap analysis and focus on the interconnections and ERM within the group.

b) IAIS recommendations can only be implemented through enactment of jurisdictional laws; the IAIS cannot mandate regulatory standards on its own.

c) Implementing more effective group supervision via supervisory colleges should be the objective going forward.

--The goal should be to leverage supervisory colleges' information sharing, cooperation and coordination of regulatory responsibilities.

3. IAIS will not be making determination of IAIGs. This will be left for IAIS members to assess whether or not a particular group should be supervised according to ComFrame.

   --How will the IAIS ensure a consistent application of the criteria by its member regulatory jurisdictions?

   --Will ComFrame lead to a two–tiered system of regulation, a more expensive, additive layer of regulation for some groups that will put them at a disadvantage vis a vis competitors in certain markets?

4. Under the current proposal only the IFRS reporting framework will be allowed. Reporting should be consistent with the general purpose financial statements. With the recent announcement that the IASB and the FASB are not able to agree on insurance accounting, this measure needs to be reconsidered.

   a) ABIR notes:

   --We do not support requiring an IAIG to comply with an additional 'third' form of reporting and incur that burden. Goal should be to leverage the current form of financial reporting.

   b) Some in ComFrame have advocated for creation of a common financial reporting framework and common capital requirements; some have argued this is necessary to provide efficiency and comparability; while also allowing comparability and meeting Financial Stability Board demands for a common approach to supervision in the IAIG's. But no such standards exist on an international basis today.

   c) With regard to the quest for uniform capital and financial reporting requirements, the compromise position seems to be to assess jurisdictional capital measures: identify similarities, identify "quality of capital" measures, assess fungibility of capital, and then work on principles that would govern an acceptable capital framework without mandating a specific model.

ABIR will be filing its ComFrame comments with the IAIS by the end of August.

Conclusion

ABIR appreciates the opportunity to present these comments and looks forward to an opportunity to meet with the FIO team to answer questions and further engage in a dialogue about the FIO's interests in these matters. We appreciate very much the leadership role that the FIO has in these many issues of import to international insurance group in the ABIR membership.

Sincerely,

Bradley L. Kading

Bradley L. Kading

President and Executive Director

Appendix One

<u>BMA Legal Framework</u>

The Bermuda law allows the Bermuda Monetary Authority (BMA) to consider the following factors when identifying an insurance group for which it should be a group supervisor:

1. Is the insurance group led by a specified Bermuda legal entity insurer;
2. Is the insurance group led by a parent company (holding company) incorporated in Bermuda;
3. If the insurance group is not led by a Bermuda parent holding company, is the insurance group directed and managed in Bermuda? or
4. Is the legal entity with the largest balance sheet in the group located in Bermuda?

Further guidance is provided in the BMA Statement of Principles. The BMA will consider the "materiality of business lines, products and markets in relation to insurers in other jurisdictions in which the group operates and the location of the "group control" functions including actuarial, accounting and risk management." The BMA's determination involves both quantitative and qualitative factors and the weight to be assigned various factors necessarily depends on the "facts and circumstances of each case and the nature and composition of the group". There is not equal weighting given to the specified factors.

Finally, the BMA must evaluate the ability of the Designated Insurer of the group to facilitate and maintain compliance by the group and to serve in an "early warning" role which allows the BMA to administer its group supervision and oversight in an effective and timely manner. "This evaluation will take into consideration, *inter alia*, the manner in which members of the group are regulated and supervised in other jurisdictions and the structure of the group, including whether the structure of the group contributes to a lack of transparency that could hinder the BMA's ability to act as Group Supervisor."

In addition the BMA can exclude certain entities from the scope of group supervision if it determines that:

1. The company is in a country where there are legal impediments to cooperation and exchange of information;
2. The financial operations of the Bermuda company have a negligible impact on the insurance group operations;
3. The inclusion of the company would be inappropriate with regard to the objectives of group supervision.

Once the insurance group is identified by the BMA as a target for group supervision the BMA consults with the insurance group and other regulatory authorities. These conversations further inform whether or not the BMA will seek to be the group supervisor. As a group supervisor the BMA would designate a Bermuda legal entity as the so-called "designated insurer" through which it will seek compliance with the group supervision. The designated insurer will be compelled to cooperate with the BMA and provide pertinent information about the insurance group. When there is a competition of interests among potential regulators seeking to serve as group supervisor, the BMA's Statement of Principles states how the BMA will act in exercising its statutory authority recognizing that the BMA will seek the views of other potential group supervisors and take them into consideration in making its determination as to whether to serve as group supervisor. ABIR is unaware of a legal means to mediate amongst the diverse jurisdictions if a conflict exists over selection of a single group supervisor; thus the concern remains that more than one supervisor will determine it will act as group supervisor. If that is the case, such decisions will inevitably lead to conflict, expense, and in-efficiency and will create incentives for restructuring of operations to solidify key operations under a single jurisdictional supervisor.

The Bermuda law establishes the following functions of a group supervisor:

1. Gather, share and coordinate information flows with other regulators
2. Provide a financial review and assessment of the group
3. Assess the compliance of the group with solvency, risk concentration and intra-group transactions as prescribed generally in the law
4. Asses corporate governance and determine compliance with the provisions of the law
5. Plan and coordinate regulatory colleges (at least annually), or other meetings, with supervisors on regulatory matters of interest to the supervisors of legal entities of the group
6. Coordinate enforcement actions.

Via the designated insurer structure, the BMA can compel the designated insurer to provide information on group operations and can compel the designated insurer to take corrective action. Of course if supervisory action affects a company in another jurisdiction, the action would be expected to be discussed in the supervisory college and completed through an action by the appropriate regulatory authority.

A key function of the designated insurer is to ensure that Bermuda's group laws are in effect for the operations of the group. This would include key areas such as: corporate governance, risk management and assessment, financial reporting, internal audit, internal controls. The designated insurer is in charge of the group reporting function, collecting from the group the financial reporting needed by the group supervisor. In addition, the designated insurer must ensure that a group solvency self-assessment is completed that ensures that the group as a whole is capable of meeting the solvency standards as applicable to the Bermuda legal entities and as reported for the group as a whole. Further the designated insurer has an obligation to report to the BMA on any material change in business that may affect the group's operation and compliance with Bermuda's laws.

[i] July 2012, IBNR, Dowling and Partners

[ii] July 8, 2012, GC Capital Ideas, July 1 Reinsurance Renewals, www.guycarp.com.

[iii] Standard and Poor's Global Reinsurance Highlights (2011 Edition)

[iv] J. David Cummins, the Bermuda Insurance Market, an Economic Analysis, May 6, 2008

[v] J. David Cummins, the Bermuda Insurance Market, an Economic Analysis, May 6, 2008

[vi] An Analysis of US Economic Impact of Bermuda Based Insurers and Reinsurers, GSP Consulting, Nov. 2007

[vii] IAIS Insurance and Financial Stability, November 15, 2011; page 28; the paper goes on to explain why reinsurance does not present unique systemic risk noting that the "degree of interconnectedness within the (re)insurance sector is small…" The paper on page 29 further notes: "The record suggests that the evidence for global systemic risk to arise from reinsurance failures has been small or non-existent so far." The 2011 global cat losses further document this point: record losses, capital remains strong, markets remain robust.

[viii] Holborn, 2012 Reinsurance Market Outlook, January 2012; Australian flooding in Queensland and Victoria; Cyclone Yasi; other loss events included in aggregate global cat loss total but not in this table

[ix] Aon Benfield Reinsurance Market Outlook, Sept. 2011; Insurance Insider Analysis. Jan. 2012/1, Issue 468; AM Best Special Report, Nov. 7. 2011

[x] Aon Benfield Reinsurance Market Outlook, Sept. 2011; Various investor reports Barclays, Stifel Nicolaus, Moody's, Insurance Insider Report Jan. 2012/1, Issue 468; Research notes memo Aon, Jan. 2012

[xi] Insurance Insider Report, Jan. 2012/1, Issue 468, Insurance Insider Reports Nov. 8, 2011 and Nov. 24, 2011

[xii] Aon Benfield Reinsurance Market Outlook, Sept. 2011; Insurance Insider Chilean Loos Tracker Report.; ABIR Summary and Analysis, Jan. 25, 2012

[xiii] The US also imposes a Federal Excise Tax on cross border insurance activity, effectively a gross receipts tax on cross border sales; oddly under new IRS regulations this FET is applied in a "cascading" fashion, on any cession in which US risk is ceded, the tax will be "again" applied

[xiv] NAIC Winter Meeting, Dec. 7, 2009; Dr. David Cummins, Temple University/Wharton University, Reinsurance Tax Briefing

[xv] The Impact on the US Insurance Market of HR 3424 on Offshore Affiliate Reinsurance: An Updated Economic Analysis, July 8, 2010, Michael Cragg, the Brattle Group, J.David Cummins, Fox School of Business, Temple University; and the Wharton School, University of Pennsylvania; Bin Zhou, the Brattle Group

[xvi] Dowling and Partners, IBNR Report, April 5, 2012

[xvii] GAO, Larry Cluff to Rep. Spencer Bachus, Natural Catastrophe Insurance Coverage Remains a Challenge for State Programs, May 17, 2010

[xviii] Brookings Institution, American Insurance Association, Reinsurance Association of America, report on insurance vouchers, Oct. 18, 2007

[xix] Dowling and Partners, IBNR Report, May 10, 2012

[xx] Insurance Insider, California Earthquake Authority, June 2, 2012

[xxi] Credit Suisse, Michael Zaremski, Insurance Linked Securities Marked Poised to Continue to Expand, July 24, 2012

[xxii] Florida Commissioner Kevin McCarty, letter to Sen. J.D. Alexander, January 24, 2012

[xxiii] J. David Cummins, the Bermuda Insurance Market, an Economic Analysis, May 6, 2008