

The Honorable Michael McRaith
Director, Federal Insurance Office
US Department of Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Subject: Modernizing and Improving US Insurance Regulation

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 Oct. 17 consultation notice. ABIR represents 22 insurance groups which have principal underwriting operations in Bermuda. ABIR members at year end 2010 wrote global group gross written premiums of \$62 billion on a capital base of \$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 the membership globally has 31,000 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. The ABIR members illustrate perfectly the global nature of the (re)insurance business and epitomize internationally active insurance groups. The membership is quite knowledgeable about global regulatory challenges and committed to Bermuda's goal of meeting international insurance regulatory standards.

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 have attached to this letter an ABIR fact sheet which contains additional statistical data. We provide group underwriting results for our members twice a year and they are posted on our web site at www.ABIR.bm.

ABIR members have chosen to provide comments to five of the 12 questions posed in the October notice; and provide some additional comments on natural disaster risk management. This letter provides comments in numerical order as posted.

1. Question 1: Systemic risk regulation.

The core underwriting operations of property and casualty (re)insurers do not pose systemic risk. As has been noted in statements filed by academics and market participants with the International Association of Insurance Supervisors (IAIS), the G 20 nations and the Financial Stability Oversight Council (FSOC), the nature of the property and casualty insurance business is fundamentally different from that of banking. We will highlight here some brief comments on key issues including: liquidity, substitutability, insolvency, and interconnectedness.

With regard to liquidity and solvency concerns, for example, insurers' policyholder claims are essentially pre-funded with premiums which are placed in reserve until claims' payments are due. The long tail pay out pattern of insurance claims allows insurers time to adjust for any shortfalls in the reserve accounts and prevents a "run on the bank" which might cause immediate liquidity problems. In addition, troubled property and casualty insurers can be put into runoff and through this process claims are paid as they come due over time. Furthermore insurers are not highly leveraged and tend to operate with excess capital over regulatory capital due to the need to demonstrate financial strength to their customers.

With regard to substitutability, if an insurer becomes insolvent, since the market is characterized by low barriers of entry one insurer can be easily substituted with another. Insurance markets are not characterized by a high degree of interconnectedness and it would be a mistake to think of reinsurance utilization as an example of bank intra-market trading. When purchasing reinsurance, ceding insurers look for strong independent insurers; and actively investigate and manage against risk concentrations with counterparties. Market share is not concentrated in specific lines of business and the market is characterized by a high degree of competition. We believe the work of the FSOC and the IAIS (for the Financial Stability Board (FSB)) provides the basis for determining that property and casualty insurers do not pose systemic risk. We provide this Nov. 15 quote from the IAIS Chair Peter Braumüller:

“Based on information analyzed to date, for most lines of business there is little evidence that traditional insurance generates or amplifies systemic risk within the financial system or the real economy. However, supervisors need to monitor very closely those insurance activities that deviate from the traditional insurance business model.” He added: “The differences in the impact of failures of insurers and banks should be reflected in the measures applied.”

In ABIR comments made to the IAIS we have noted that if systemic risk potential was to be found in some insurance companies based on non-core business activities, that the appropriate regulatory measures would include: implementation of group supervision (where it does not exist) and creation of enterprise risk management requirements (where they do not exist). Group supervision can identify gaps in regulation, or can help identify accumulations of risk that have gone unnoticed amongst the various operations of an insurance group. As such it is a useful regulatory tool if applied in an efficient, coordinated and non-duplicative manner. Enterprise risk management, as measured in Own Solvency Risk Assessment systems (ORSA) provides a regulator with insight into an insurance group's assessment of its own risk. The BMA has statutory authority for group supervision and is implementing it to be effective for the 2012

calendar year; and ERM measures (Commercial Insurer's Solvency Self Assessment –CISSA) have been in effect since 2010. Further testing, evaluation and implementing measures for the internationally active insurance group sector are underway in Bermuda.

We have attached to this letter the ABIR Feb. 25, 2010, comments filed with the IAIS on these issues. We have also attached the October 2010 letter commenting on systemic risk, regulation and protectionism that was sent to the G 20 Nations by 18 insurance associations from North America, South America, Europe, Asia and Australia.

2. Question 5: The regulation of insurance companies and affiliates on a consolidated basis;
and Question 6: International coordination of insurance regulation.

ABIR members support implementation of effective and efficient group supervision frameworks. Bermuda enacted a statute creating a group supervision framework in 2010; the BMA has now identified insurance groups that would be subject to this regulatory regime; and has published for consultation a set of group supervision rules. Implementation of group supervision rules in Bermuda is expected for 2012. The purpose of group supervision is threefold:

- a. Assess the overall capital held and risk managed by the insurance group; analyze inter connections within the group that affect these measures;
- b. Identify any gaps in regulation of the legal entities that are managed by a group; and
- c. Create a framework for regulatory cooperation and analysis of the various legal entities of the group to provide a platform for information sharing, regulatory cooperation and better decision making by interested insurance regulators of the various legal entities.

Equally important, though, is what group supervision is not. Group supervision does not:

- a. Impose guarantees of legal entities;
- b. Extend regulatory powers beyond what powers a jurisdiction can legally exercise with regard to regulated entities;
- c. Create redundant, contradictory or overlapping regulatory powers; or
- d. Authorize multiple group supervisors.

The development of group supervision of internationally active insurance groups is a work in progress. The primary focus of group supervision should be: data collection, assessment of intra-group connections; and creation of a platform for cooperation by various legal entity supervisors via regulatory colleges so that all are informed better about the group's risks and business activities. Over time these actions should build knowledge, trust and confidence. In turn this should result in more effective and efficient supervision.

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. There may also be opportunities to work on agreements that allow for efficiencies to be gained by exercise of common regulatory functions such as coordinated financial examinations and approval of internal capital models.

Such regulatory cooperation agreements are not new to the BMA or to individual states regulators. The BMA had as of March 2010 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;
- 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

We'd encourage the FIO and the BMA to have a memorandum of understanding to cover matters of regulatory interest with regard to these internationally active insurance groups. Under the Dodd Frank Act, the covered agreement provision provides a broad definition of prudential supervision matters that could be subject to such an agreement. We'd recommend consideration of a covered agreement between the BMA and the US Treasury as one way to deal with matters of regulatory cooperation for internationally active insurance groups. Such an agreement would be an effective way to deal with appropriate collateral requirements between US cedents and BMA supervised reinsurers; and to deal with matters essential to recognition of the BMA as the group supervisor of insurers which control various US legal entities.

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 is an efficient way to get to a national standard for such state collateral agreements.

3. Question 8: The feasibility of regulating only certain lines of insurance at the federal level.

ABIR members are engaged in “business to business” insurance markets. Our primary markets are sophisticated business entities looking for liability insurance, or ceding insurers looking for reinsurance protection. The client companies in turn are aided in their (re)insurance needs by regulated insurance brokers and reinsurance intermediaries. Due to the sophistication of our counter parties we believe that a different level of regulation is appropriate for these commercial insurance markets than would be needed to protect consumers with their personal insurance needs. For example, rate and form regulation, are typically not applied to these commercial insurance markets since the contracting parties want the freedom to set their own coverage terms and conditions. We believe that commercial lines insurance regulation can be separated from personal lines insurance regulation.

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. 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, the United States, Switzerland, Bermuda and the United Kingdom. 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.

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 over internationally active 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 internationally active 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. Such a regulatory model should aid in the development of regulatory cooperation agreements which will enhance prudential oversight of these internationally active insurance

groups thus meeting the major public policy need and the top G 20 concern about financial stability, while minimizing inefficiency and avoiding duplication and contradiction.

4. Question 10: The impact that developments in the regulation of insurance in foreign jurisdictions might have on the potential federal regulation of insurance.

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 internationally active insurance group sector the BMA does qualify for an equivalence finding subject to certain caveats. The equivalence assessment work is expected to be completed in the summer of 2012.

Due to the design of Solvency II certain regulatory penalties would accrue to internationally active 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 both 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 internationally active insurance groups. This is the logical extension of the IAIS principles for prudential supervision under which the IMF today evaluates jurisdictions. With regard to internationally active insurance groups, the IAIS has a new program in development – the Common Assessment Framework or ComFrame. We believe that international insurance regulatory standards will continue to evolve from IAIS standards to more explicit regulatory cooperation and coordination for internationally active 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 via the covered agreement authority of Dodd Frank.

Natural Disaster Risk Management

In addition to the specific questions posed in the consultation, we provide comments on one additional item:

1. Natural catastrophe risk; unfunded liabilities in the current US market; and the strong, growing and reliable international reinsurance market support for US catastrophe risk.

ABIR members are the largest providers of US natural disaster catastrophe reinsurance. Conservatively 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 have an excellent track record of timely claims payment and financial stability. We 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.

Bermuda's catastrophe reinsurers are global providers of coverage. These estimates of claims' liabilities we have assumed from 2010 and 2011 events attests to this point:

- 37% of the reported liabilities for Europe's 2010 Windstorm Xynthia;
- 38% of the reported liabilities for Chile's 2010 earthquake;
- 51% of the reported liabilities for New Zealand's 2010 earthquake;
- 29% of the reported liabilities for the internationally reinsured share of the 2011 Japanese earthquake.

With the October Thai flooding now estimated to have created \$10 to \$15 Billion in insured losses, we will have another example of the benefits of global sharing of catastrophe losses. 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. 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.

Despite record \$80 billion plus in global property catastrophe losses for 2011 the commitment of reinsurance markets to the US remains stronger than ever with ample capacity to meet the demands of US insurers. The record global property catastrophe losses from floods, earthquakes, hurricanes, tsunamis and tornadoes have not dented the private reinsurance supply that supports US property insurance markets. But neither did the worst ever US hurricane losses from 2005 which featured Hurricanes Katrina, Rita and Wilma. Reinsurance capacity has

grown since that worst ever US loss event; and despite these record 2011 catastrophe losses reinsurers continue to seek out US hurricane and earthquake risk. Here's an illustration: in 1992 the largest per event cover a US insurer could buy from reinsurers was \$400 million. That has now grown to \$3.5 billion for an insurer in 2011.

The US Treasury historically has had a position of encouraging private sector risk bearing and an aversion to creation of new federal insurance programs for natural disaster risk. We support that historical position of Treasury. The \$18 billion in debt of the US National Flood Insurance Program (NFIP) attests to the need to rethink federal natural disaster programs. ABIR members support the initiatives of Rep. Judy Biggert (HR 1309) and Sen. Tim Johnson to include an opportunity for the NFIP to purchase reinsurance as part of its own risk management and debt reduction program.

ABIR members have an ongoing interest in writing cat risk for hurricanes, earthquakes and floods. 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.

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 consequences to taxpayers.

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 that 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. This has led the Cat Fund management to petition the legislature (HB 833) for relief via revisions to its statute 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. 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.

We have attached presentation slides which elaborate on these points and which were presented at a December 1, 2011, housing and insurance conference hosted by the Atlanta Federal Reserve Bank.

Thank you for the opportunity to submit these comments in response to your consultation request.

Sincerely,



Bradley L. Kading
President and Executive Director
Association of Bermuda Insurers and Reinsurers

Attachments:

ABIR Fact Sheet;

Feb. 2010, ABIR statement, IAIS Technical Committee;

October 2010 INIA Submission to the G 20 Nations; and

Dec. 1, 2011, ABIR presentation on US catastrophe risk management, Atlanta Federal Reserve Bank

Cc: John Nolan, Senior Policy Advisor, Federal Insurance Office