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Via E-Mail

The Honorable Kevin McCarty
Commissioner of Insurance
State of Florida
Chair, NAIC Catastrophe Issues Working Group
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ABIR Statement – NAIC Proposed Paper: *Natural Catastrophe Risk: Creating a Comprehensive National Plan*

Dear Commissioner McCarty:

On behalf of the 18 members of the Association of Bermuda Insurers and Reinsurers (ABIR) we file these comments on the proposed draft NAIC paper entitled “*Natural Catastrophe Risk: Creating a Comprehensive National Plan.*” ABIR represents the major, international insurers and reinsurers domiciled in Bermuda. Our membership includes the market leaders in the reinsurance of property catastrophe risk. The ABIR membership includes carriers which are expected to pay more than \$13 billion in losses stemming from the record-setting 2005 US storm season including hurricanes Dennis, Katrina, Rita and Wilma. As losses develop, this number will rise.

We applaud the Chair and the NAIC for its leadership in this important US public policy debate. State and federal policy makers will look to the NAIC for its recommendations on insurance for natural disaster risk. We know from past experience that US federal government policy makers are reluctant to create new insurance programs so it’s important that any program presented to the policymakers be one that has a broad base of support. We hope that this statement helps the NAIC identify a program that would have a broad base of US insurer support.

First, let us underscore these important points:

1. Bermuda’s Class 4 insurers and reinsurers willingly assume US natural disaster risk. Class 4 carriers are the major international insurers and reinsurers domiciled in Bermuda.
2. In spite of substantial 2004 and 2005 losses, reinsurers continue to willingly bargain to accept such risk. As a whole, Bermuda’s reinsurers have expanded their capital bases so that they can meet the new requirements of the rating agencies and so that they can write additional business.
3. A large segment of reinsurance business renewed on January 1. Policymakers should look to gain insight into market capacity from public information on

- renewals from company financial statements, investment analysts, brokers' reports and trade press articles. Information should be available by the end of January.
4. Policy makers should analyze the effect of new capital requirements being imposed by rating agencies to assess the impact of these new requirements on insurers' willingness to assume risk.
 5. Policy makers should also analyze the revisions to the catastrophe models being proposed by the major modeling firms to assess the impact of these new loss projection techniques on insurers' willingness to assume risk.

Second, ABIR would commend to you these policy recommendations:

1. US policy makers should maximize private sector risk bearing and the obvious ways to do this are to: repeal statutory price controls on the primary insurance market; avoid counterproductive regulatory mandates on products and underwriting; and eliminate certain, counterproductive residual market assessments.
 - a. Reinsurance markets are an example of what happens if price controls are removed -- capital quickly flows into the business following a shock loss responding to the perceived increase in product demand. Investment analysts report that the Bermuda market will have raised an additional \$18 billion for 2006 operations.
 - b. In Bermuda, five new stand-alone reinsurers were created last fall and were in operation for the January 1 renewal date. In addition, three new London-market companies were established; and six so-called "side car" facilities were created. It's accurate to think of these latter entities as dedicated retrocessional capacity.
2. As a matter of principle, US policy makers should not endorse programs that displace willing private sector risk bearers. Government risk bearing should be an option of last resort. The private sector's risk appetite is healthy, but we won't know the true scope of that appetite until policy makers remove price controls. Once price controls are eliminated, policymakers will be able to make a fair assessment of how much risk insurers willingly assume. Then, policy makers can design a government program, if one is necessary, that would fill any gap left by the private sector.
3. Equally important as the elimination of price controls is the enactment and enforcement of effective loss reduction measures. Policy makers should direct their attention toward effective building codes, enforcement of those codes, land use planning and retrofitting of existing structures to save lives, reduce injuries and prevent future losses.
4. We have no recommendation with regard to the so-called "all perils" policy approach. From a reinsurer's perspective we note that an all perils policy redistributes the existing available risk transfer capacity. We defer to the primary carriers on this recommendation.
5. The "comprehensive national plan schematic" illustrates how intrusive the proposed governmental state and federal reinsurance funds would be. We note that the Florida Hurricane Catastrophe Fund attaches at a hypothetical aggregate

- loss associated with a 1/10 year event. Under the proposed plan, states would be free to set the attachment point either higher or lower. The Florida fund exhausts at nearly a 1/50 year event. In essence every residential loss event in Florida today with a loss potential of greater than \$5.5 billion is ceded to the state fund; losses excess of roughly \$20 billion would be assumed by the federal fund. (Each fund would operate with a small, pro-rata retention.) The federal fund in turn would be capped at losses associated with a 1/500 year event. This is a substantial transfer of risk to state funds (and the consumers that would finance them) and to the federal government (and the consumers that finance it) as the reinsurer of the multiple number of state funds.
6. Under this proposal, private sector reinsurers would have been largely displaced from providing residential coverage for much of the losses associated with the hurricanes we saw in 2004 and 2005 with the exception of Hurricane Katrina. Private reinsurers would be left with a relatively small share of the residential property reinsurance market. In addition, the state funds, if based on the Florida model, would operate with a substantial degree of cross subsidization (primarily from the potential bond debt financing). Notably, losses would be distributed statewide to all property and casualty policyholders, not just policyholders subject to the catastrophe peril; and losses would be distributed to multiple lines of business, including auto, general and professional liability, and the large commercial insurance market generally. Under the Florida model, surplus lines business also pays subsidies to the residential market. The federal fund could also operate with subsidization from bond debt, general appropriations, or other financing options. As with the National Flood Insurance Program, taxpayers nationwide would be on the hook for the true costs of the program. It is self-evident that adoption of this model would result in a tremendous transfer of risk to taxpayers in other states (and within certain states like New York and Texas) who do not have significant exposure to hurricane or earthquake losses.
 7. The plan's cross subsidization schemes are antithetical to private sector risk bearing principles. If a consumer does not bear the true cost of risk, then the private sector is not able to make a market. In addition, risk based pricing allows a consumer to weigh the risk and judge whether the venture is justifiable. As a result risk based pricing can deter building and development in areas particularly sensitive to natural hazards. Legislation intended to camouflage this risk will lead to greater future losses, greater injury to people and greater damage to the economy – all of which would seem to be at odds with sound public policy.
 8. State and federal government funds come with substantial political risk and over time, experience has shown, such mechanisms may be used to suppress prices. Prices would be expected to be less than what would be set in the private sector which needs to adhere to actuarial principles and recognize the cost of capital when determining at what price insurance risk could be accepted. The end result of any such price suppression would be to further displace private capital inevitably leading to a substantial government subsidization of cat risk by non-cat affected policyholders in the US. The end result being that the government would become the chief risk taker of natural disaster risk.

9. We await data on the close of calendar year 2005 so that we can learn what effect the 2005 storms had on the US property and casualty insurance industry's surplus. Some have argued that many insurers will be able to finance their 2005 losses from their annual earnings with no reduction to their surplus. If this proves to be the case then this itself is a testament to the ability of insurers to absorb the record-setting 2005 hurricane season's losses and argues against the creation of a government program that substantially removes insurers from risk bearing for catastrophic events.
10. Finally, we submit that there likely are certain sized natural disaster losses, based on projections of the potential for natural disaster losses excess of \$100 billion that would put a strain on insurance industry resources and may well threaten the solvency of many carriers. If a federal program were to be created it should be focused on providing aid for loss events greater than those that have occurred and be focused only on events of such a large size (or a series of such events) that the survival of the US insurance industry would be in doubt.

Thank you for the opportunity to present these views. We look forward to working with the Working Group and the parent committee as it continues to search for an NAIC consensus on these recommendations.

Sincerely,

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