



May 8, 2006

The Honorable Kevin McCarty
Chair, NAIC Property and Casualty Insurance Committee
Commissioner of Insurance
Office of Insurance Regulation
Larson Building, Room 101A
200 East Gaines St.
Tallahassee, FL 32399-0301

Subject: Private Sector Risk Bearing Capacity

Dear Commissioner McCarty:

During a recent conference call of the NAIC Catastrophe Issues Working Group several state regulators asked if reinsurers could provide data on private sector risk bearing capacity. Although trade groups do not collect market data, recently the *Reinsurance Association of America (RAA)* and the *Association of Bermuda Insurers and Reinsurers (ABIR)* encouraged our members to cooperate in a survey conducted by the *World Insurance Forum*. In conjunction with a February Bermuda conference, the *World Insurance Forum* organizers surveyed the members of ABIR and the broker members of the *RAA's Council of Reinsurers and Brokers*. The survey was conducted from late January through the end of February and was an attempt to document catastrophe capacity following the close of the important January 1 renewal season. An estimated 50% of US property catastrophe business is renewed around January 1. The World Insurance Forum collected the responses and published the raw results with a post conference paper in early March. It was distributed to those who attended the conference.

Those who are reading this analysis should keep in mind the following: European markets were not surveyed; the response rate was 32%; results from the January 1 renewal period may or may not be representative of responses that would have been received if the survey were conducted at another time during the current calendar year; those surveyed were reluctant to share what they considered proprietary information; and only reinsurers and brokers were surveyed.

In addition, we point out that property catastrophe risk bearing capacity comes from a multitude of sources and this survey attempted to only measure one such source—private reinsurers and the brokers who work with private reinsurers. Private sector property catastrophe capacity is composed of the following elements: primary insurer retentions,

reinsurance, alternative risk transfer instruments including derivatives and securitization, and special dedicated capacity provided by hedge funds. The survey only attempted to measure reinsurance capacity, so if conclusions are drawn from this survey for public policy purposes, then that limitation should be understood. It would be incorrect to assume that the private sector risk bearing capacity is limited to the capacity identified in this letter.

Survey Results

For the nine respondents we have calculated mean and median information. We have provided the raw results as well.

World Insurance Forum, 2006 US Property Catastrophe Reinsurance Survey

Following the completion of the important January 1 renewal date, and in conjunction with a reinsurance conference being held in Bermuda in late February, the *World Insurance Forum* surveyed 28 leading reinsurance markets to seek answers to key public policy reinsurance capacity questions. Those surveyed included the leading property reinsurers domiciled in Bermuda and the United States and the leading reinsurance brokers.ⁱ Of the total 28 companies surveyed, nine responses were received. This is a 32% response rate. The major reason given for not responding was that the survey questions would require reinsurers and brokers to disclose potentially proprietary information.ⁱⁱ Although the number of responses was disappointing, the respondents themselves represented major reinsurers, major property reinsurance specialists and leading reinsurance brokers. As a result, the *World Insurance Forum* released the survey results in a March 1 report which summarized the Forum's presentations. Attached you will find the original survey questions and a summary of the responses received.

Analysis of US Property Catastrophe Reinsurance Survey

Question 1: Approaching the January 1 renewal date, an estimated \$ _____ billion in aggregate limits for property catastrophe excess of loss reinsurance coverage was sought by US based ceding insurers.ⁱⁱⁱ

The answers ranged from \$15 billion to \$62.5 billion.^{iv} This question produced the widest divergence in responses.

Median: \$38.5 billion

Mean: \$36 billion

Question 2: Following the completion of the January 1 renewal cycle, an estimated \$ _____ billion in property catastrophe excess of loss reinsurance coverage limits was purchased.

The answers ranged from \$12.5 billion to \$47.5 billion.

Median: \$35 billion

Mean: \$31.5 billion

Question 3: Was the available supply of property catastrophe excess of loss reinsurance exhausted with these purchases? Choose one: Yes or No.

8 of 9 responses were “no”; 89%. One was “yes”.

Question 4: What percentage of the global property catastrophe excess of loss reinsurance market do reinsurers owned or controlled by Bermuda companies provide? Choose one: 25% 35% 45% 55% Other: _____.

The responses ranged from 35% to 60%.

Median: 40%

Mean: 42.8%

Question 5: Please give us your estimate of the maximum amount of property catastrophe excess of loss reinsurance coverage that is purchased and would attach to any one large US natural disaster event?^v Circle one of the following: \$35 billion \$40 billion \$45 billion \$50 billion Other: _____.

The answers ranged from \$27 billion to \$75 billion. Although these answers are divergent, seven of the nine responses were clustered between \$35 and \$45 billion.

Median: \$40 billion

Mean: \$42 billion

Question 6: In addition to property catastrophe excess of loss reinsurance coverage, insurers may purchase proportional, per risk excess and facultative coverage that also protects them from catastrophic loss. This combination of coverages is estimated to yield an additional amount of protection equal to ____% of the amount you selected in question 5.^{vi}

There were eight answers and the responses ranged from 15% to 50%

Median: 20%

Mean: 23%

Question 7: The US has experienced record natural disaster and manmade catastrophe losses in the last five years, have any claims gone unpaid due to the insolvency of the reinsurer? Choose one: Yes or No.

There were eight responses to this question. All eight chose “No”; 100%.

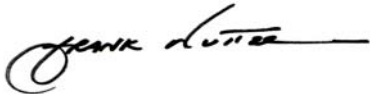
Conclusion

For the purposes of the NAIC Committee, the two questions that may provide the most important information are the answers to questions 5 and 6. The sum of the answers to these two questions provides an aggregate estimated US property reinsurance capacity for any one event of approximately \$48 to \$52 billion. Property catastrophe excess of loss coverage alone provides coverage of about \$40 to \$42 billion and then other reinsurance coverages including proportional, per risk excess and facultative, provide an estimated 20

to 23 % of that amount in additional capacity. Further, it is known that securitization instruments in the last 12 years have provided a growing amount of additional risk transfer capacity. With regard to insurance securitizations, reinsurance broker Guy Carpenter has reported that \$2 billion in “cat bonds” were issued in 2005. The firm also notes that about \$10.6 billion in policy limits have been covered with cat bonds since 1997. Many commentators expect that the use of securitization instruments is here to stay and that the market will continue to grow. Other derivative instruments have been experimented with from time to time and may continue to provide additional capacity. Finally, hedge funds are also active providers of risk transfer coverage through dedicated pools of capital that via collateralized reinsurance contracts sell protection to insurers and reinsurers. Some of these hedge funds sell their protection through Bermuda based reinsurance companies, while others simply provide a collateralized, contractual guarantee of protection.

The RAA and the ABIR recommend that regulators review publicly availability material on market capacity from investment analysts and reinsurance brokers. This material is available from websites and is often reported in the trade press. It is the best source of information we know of to address regulatory questions about ongoing market issues.

Sincerely,



Franklin W. Nutter
President
Reinsurance Association of America



Bradley L. Kading
President and Executive Director
Association of Bermuda Insurers and Reinsurers
Cc: Ray Spudek, Office of the Commissioner of Insurance, Florida
Eric Nordman, NAIC

Attachment

ⁱ Those surveyed all had an affiliation with either the *Association of Bermuda Insurers and Reinsurers* or the *Reinsurance Association of America*. Both associations encouraged their members to complete the survey.

ⁱⁱ The survey instructions asked respondents to draw from their own knowledge and experience and estimate market wide results in their answers.

ⁱⁱⁱ January 1 is an important reinsurance renewal date for US business; an estimated 50% of the market renews around this date.

^{iv} Note where respondents gave a range in any of their answers, for this analysis we have selected a midpoint in that range.

^v This is the amount of reinsurance payable; it would sit on top of insurer retentions from any event. This raises the key question: what is the aggregate amount of insurance industry retention from such an event?

^{vi} Thus post event, to calculate the total amount of reinsurance payable, the answer would be the sum of Questions 5 and 6. Taking the means, the sum is \$42 billion + \$9.7 billion = \$51.7 billion. Taking the medians, the sum is \$40 billion + \$8 billion = \$48 billion.