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Mr. Mike Moriarty, Chair, and Members
Catastrophe Reserve Working Group
National Association of Insurance Commissioners
2301 McGee Street, Suite 800
Kansas City, Missouri 64108
Attn.: Mr. Eric Nordman
By E-Mail

Dear Mr. Moriarty and Members:

The NAMIC membership comprises approximately 1,400 mutual, property and casualty insurers of which about 1,300 are domiciled in the United States. NAMIC is a regular participant in NAIC and government deliberations affecting the interests of its membership, which range from the smallest to the largest mutual insurers underwriting property and casualty risks.

We respond by this letter to the Working Group's May 14, 2008, request for comments on whether the NAIC should re-activate deliberation on a model law or regulation enabling insurers to institute and maintain what is identified in the request as a "tax-deferred, pre-event catastrophe reserve." We understand such potential re-activation as a measure accompanying other NAIC efforts to equip insurers to cope with the potentially massive capital demands of claims made in consequence of catastrophic events.

Yet we must observe that the circumstances of federal taxation with respect to any pre-event accumulation of capital within an insurer have not changed: The IRS Code does not provide deferral of taxation for revenues received by an insurer that are allocated to a pre-event catastrophe reserve. It was the problematic nature of such accumulation under the burden of taxation that led, in our understanding, to placing the original project in abeyance.

Given the unavailability of such deferral of taxation applicable to pre-event accumulation—and, in our understanding, the very limited possibility of such pre-event deferral becoming available—the more relevant question now would appear to be the viability or efficiency of an insurer's pre-event catastrophe reserving without the deferral of federal taxation until amounts reserved could be matched with losses paid in settlement of catastrophe claims.

Several considerations become relevant and important when weighing the usefulness of pre-event reserving in the absence of deferral of taxation on those amounts allocated to an insurer's catastrophe reserve:

- Amounts committed on an after-tax basis to an insurer's catastrophe reserve are, therefore, very expensive capital. Rates of the insurer almost certainly will reflect a) the taxes collected and remitted to the Treasury and b) the after-tax amounts held in a reserve. Such amounts exacted as taxation provide no direct benefit to the insurer or policyholder in any multi-year scenario. Interpretations of SSAP 10 could possibly, via actuarial or other analysis, posit on an insurer's books a deferred tax asset for downstream benefit; yet this is uncertain and of minor concern.

- Under existing federal taxation, the insurer would additionally be liable for investment earnings of capital committed to such a reserve. That additional dimension of taxation would significantly aggravate the expense of capital held by an insurer in such a reserve and simultaneously constrain its accumulation.

- In any probable scenario, very large numbers of insurers would not simultaneously experience catastrophe-related claims. Huge amounts of capital held by those unaffected insurers would, presumably, not be available for catastrophe-related claims made on insurers that are subject to catastrophe-related claims. In other words, capital is, in effect, trapped with those insurers that are not affected. Perhaps some more efficient allocation of such capital could be achieved, but the industry's existing strategies of reinsuring and pooling appear to be significantly more efficient.

More broadly and in summary, we observe that financing catastrophe risk via a "pre-event catastrophe reserve" would be extraordinarily expensive and very probably entail the negative result of trapping capital within unaffected insurers. Were deferral of taxation available for such "pre-event catastrophe reserving," and were there a better way to use the aggregate capital accumulated within the industry, such efforts might be useful. That would not appear to be the case now.

Therefore, we recommend to the Catastrophe Reserve Working Group that it not reactivate the project known as "tax-deferred pre-event catastrophe reserve" endure until the Congress accommodates the need for deferral of taxation on such reserves held by property-casualty insurers.

Respectfully yours,

/s/ William D. Boyd

William D. Boyd
Financial Regulation Manager