



September 21, 2007

The Honorable John Oxendine
Chair, NAIC Reinsurance Task Force
Commissioner State of Georgia

The Honorable Steven Goldman
Vice Chair, NAIC Reinsurance Task Force
Commissioner State of New Jersey

Subject: ABIR Statement NAIC Reinsurance Supervision Review Department and Port of Entry
Criteria for Non-US Reinsurers

Dear Chair Oxendine and Vice Chair Goldman:

On behalf of the 23 members of the Association of Bermuda Insurers and Reinsurers (ABIR) we offer these comments on the September 7 NAIC Reinsurance Supervision Review Department (RSRD) and Port of Entry State Criteria proposals. The ABIR membership includes the global insurers and reinsurers domiciled in Bermuda; all have their headquarters and underwriting operations there. Our members collectively wrote at year end 2006 \$56 billion in premium with a surplus base of \$67 billion. Our members are all licensed as Class 4 insurers under the regulation of the Bermuda Monetary Authority, which provides robust oversight in respect of the products and services offered by our market.

With regard to the US market, our members provide:

1. 25% of the US reinsurance market
2. 40% of the US property catastrophe reinsurance market
3. 50% of the Florida property catastrophe reinsurance market
4. 27% of the reinsurance placement of the California Earthquake Authority
5. 61% of the placement for the Texas Windstorm Reinsurance Association
6. 25% of the US medical professional liability insurance and reinsurance market
7. 57% of the US crop insurance and reinsurance market
8. 17% of the US directors and officers' liability market.

ABIR members make a significant contribution to the US economy and 14 of our members have created US subsidiary corporations to conduct additional insurance or reinsurance operations. These US companies are fully subject to a state's applicable insurance solvency regulation.

As we noted in our June oral remarks to the Reinsurance Task Force, the NAIC's December 2006 action to advance collateral reduction proposals represented a significant change in course in the NAIC's approach to reinsurance regulation. That NAIC action was reaffirmed with the charges approved at Executive and Plenary in March 2007. We noted in June that since the

NAIC had decided to take this action that ABIR will support the NAIC in its efforts to advance these proposals. This letter expresses our key points with regard to the current proposal. We also recognize and associate ourselves with the Interested Party comments on numerous clarifying, correcting and technical comments with regard to these two proposals. Critical among those Interested Party comments are those that focus on the need for uniformity in the state approach in adoption and implementation of these proposals. One of the central points in evaluating the effectiveness of this NAIC effort is whether a new reinsurance regulatory framework can be deployed at the state level in a uniform manner that provides an efficient and reliable framework for cedents to access the international reinsurance market. One of the fundamental points of that new framework will be that a reinsurers approval in a Port of Entry state accomplishes two objectives: 1) the reinsurer is free to do a reinsurance business across the country without additional licensure; and 2) the ceding insurers doing business with that reinsurer will be granted credit in their state of domicile and other states in which they do business according to the regulatory decision made by the Port of Entry state. We note, however, that for non-US reinsurers that the regulators in the ceding insurer's state of domicile can override collateral requirements in the nominated Port of Entry which seems contrary to the spirit and intent of the proposed framework.

As with past reiterations of a collateral reduction framework (the Approved List, the Reinsurance Evaluation Office), the proposals impose on non-US reinsurers significant new regulatory requirements. The current proposals create a two part test that measures both the domiciliary jurisdiction and the reinsurer. It is disappointing that the reinsurers that undertake this time consuming and expensive regulatory compliance effort (including the quarterly and annual filing requirements) will only qualify for a 20 to 40% collateral reduction even when their financial standing will be the same or better than their US counterparts. Effectively most of the non-US reinsurance market will be operating with a 70% to 80% collateral requirement. We believe that these inappropriate barriers would deter non-US carriers from participating in the process, thereby depriving consumers of the potential market benefits that might be realized under a more efficient and appropriately tailored regime. Accordingly, we encourage the Task Force to reconsider the collateral reduction scale and grant a greater reduction for the Class 1 through 3 rated reinsurers.

In addition, we would urge the NAIC to grant collateral reduction to two additional classes of business. We restate here the rationale for a greater collateral reduction for "short tail" business and for affiliated reinsurance between a US subsidiary corporation and its non-US affiliates in jurisdictions approved by the RSRD.

Reinsurance of "short tail" business can readily be defined by a review of the NAIC annual statement line of business definitions. Our focus is primarily on the property insurance business subject to natural disaster perils in the United States. The property catastrophe reinsurance market is one where our members have a great deal of expertise. The property catastrophe reinsurers have been tested by the worst of man and Mother Nature in the last six years with record-setting catastrophes in 2001, 2004 and 2005. These carriers have withstood those unprecedented tests and have met their financial obligations to their US clients, rapidly and in full. These companies have proved to be resilient and have further proven their commitment to

the US property catastrophe markets by expanding the capacity that they made available even after the record setting losses of Katrina, Rita and Wilma in 2005.

What's distinguishable about property catastrophe reinsurance is that claims are settled quickly and that ultimate expected losses can be estimated via commercially available catastrophe models. Hurricane reinsurance claims are paid quickly with a very large portion of hurricane reinsurance claims being paid within the first and second quarters following the event. According to the RAA's Catastrophe Loss Development Study (2006 Edition), 90% of hurricane reinsurance claims are paid within nine quarters of the occurrence of an event (Hurricane Andrew, 80% of reinsurance claims paid within five quarters). For earthquakes, 90% of reinsurance claims have been paid within five years of the occurrence of an event (Northridge Earthquake, 80% of reinsurance claims paid within 14 quarters). Since these reinsurance claims are reported and settled quickly, ceding insurers can rely on the financial due diligence analysis of the reinsurer that was done prior to the business being placed. By contrast, since casualty reinsurance claims can run on with a tail exceeding 30 years, it is difficult for a ceding insurer to have confidence that the financial security analysis done the day the casualty treaty was placed will have merit decades later when the claim must be paid. This long tail payment pattern is one of the primary arguments made by cedents as to why they think a 100% collateral requirement is justified. That argument simply is not applicable to property reinsurance and therefore we believe that it is appropriate to draw a distinction between the collateral requirements of short and long tail business.

Furthermore, with the uncertainties associated with North Atlantic hurricane cycles and climate change and with the continued annual growth in US property insured values in exposed areas, we expect that the property catastrophe reinsurance markets in peak zones will occasionally run up against capacity constraints. Since the current 100% collateral requirement for property catastrophe business does marginally limit capacity, a reduction or elimination of collateral for qualifying reinsurers in this market would benefit the capacity constrained market. In essence it would provide a benefit to consumers, without creating any new financial insecurity. The limitation on capacity comes from the double funding required of the reinsurer. The reinsurer has to both fund its collateral obligations to the ceding insurer (trust funds or letters of credit) while at the same time it is paying the claims from the insured event to the cedent. An element of double funding is mandated by the current system because of the time lag and banking expense issues associated with reporting losses and drawing down on letters of credit or trust funds associated with the quarterly reporting obligations of the ceding insurer. Collateral reduction for this class of business would basically provide an elimination of collateral for "claims in the pipeline". It would have a marginal affect on capacity, but with respect to peak regions at times of capacity needs, that additional capacity could be meaningful.

We also support collateral reduction/exemption for affiliated transactions between US reinsurers and their non-US affiliates located in qualifying RSRD jurisdictions. These transactions reflect no "moral hazard" because the nature of the business is "truly known" to both parties to the transactions. There is no incentive for it to be otherwise. In addition, the affiliated reinsurance transactions are subject to multiple points of regulatory review today: ceding insurer credit for reinsurance analysis, material transactions statutes, holding company legal standards, third party rating agency review, and the financial disciplines required by the US federal tax transfer pricing

rules. In addition under the NAIC's current proposals, the assuming reinsurer is subject to both a regulatory equivalency finding of its domicile and then additional financial strength testing and regulatory review of the reinsurer itself. In short, it seems self evident that affiliated reinsurance transactions themselves can be defined as a class of business subject to a separate and lower collateral reduction regime than what might otherwise be in place. Collateral reduction for affiliated transactions does not create an additional threat of financial insecurity to the original, unaffiliated US domiciled ceding insurer. The financial strength of the group itself provides a greater financial protection to the US ceding insurer that ultimately outweighs the risk that may be created by a reduction of affiliated reinsurance collateral. Finally, we underscore that US holding company and US tax rules require that affiliated transactions meet an arms length test with regard to key elements of the reinsurance transaction. Transfer pricing regulatory compliance is the subject of volumes, but at its heart it provides a rationale that assures regulators of the legitimacy of the pricing and terms associated with affiliated transactions.

In conclusion, we applaud the significant work that has been done since the December 2006 NAIC decision to work on a revised reinsurance collateral regulatory framework. We must also conclude, that following the review of the current drafts and stakeholders' comments that much additional work likely remains to be done by the NAIC in order for it to achieve its own goals. After that, years of work remain as states consider amendments to their laws and regulations to bring them into compliance with a new NAIC model framework. In short, we are likely still years away from any broad-based, countrywide collateral reduction. In light of that, we suggest that the NAIC consider a two track process whereby work on the RSRD and the Port of Entry proposal proceed, but that also the NAIC provide simple amendments to its current credit for reinsurance model law and regulation that would allow for significant collateral reduction for short tail reinsurance business and for affiliated reinsurance transactions.

As always, we thank you for the opportunity to present our views and we look forward to continuing to work with regulators as they advance these meaningful revisions in the reinsurance regulatory framework.

Sincerely,



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

Copy: Bryan Fuller, NAIC