

Casualty Actuarial Society 2009 Seminar on Reinsurance

Federal Reinsurance Issues: Where Do We Go From Here

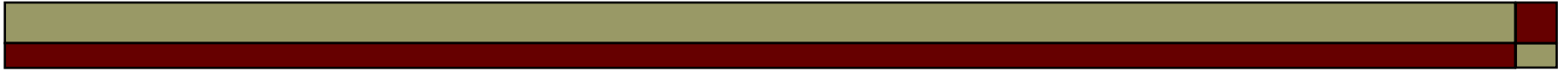
May 18, 2009

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AGENDA

- U.S. Market
- Bermuda Market
- U.S. Financial Services Regulatory Reform
 - Federal
 - State
- U.S. Catastrophe Issues
- U.S. Tax Issues



U.S. Market

Top 25 P&C Reinsurance Groups in 2007

1.	Munich Re	Germany
2.	Swiss Re	Switzerland
3.	Hannover Re	Germany
4.	Berkshire Hathaway	U.S.
5.	Lloyd's	U.K.
6.	SCOR	France
7.	Reinsurance Group of America	U.S.
8.	XL Re	Bermuda
9.	Allianz Re	Germany
10.	Transatlantic Re	U.S.
11.	Everest Re	Bermuda
12.	Partner Re	Bermuda
13.	Tokio Marine	Japan
14.	Mapfre Re	Spain
15.	Korean Re	Korea
16.	CCR	France
17.	ACE Tempest Re	Bermuda
18.	Axis Capital	Bermuda
19.	Odyssey Re	U.S.
20.	Toa Re Co. Ltd.	Japan
21.	QBE Re	Australia
22.	GIC Re	India
23.	Arch Re	Bermuda
24.	Platinum Underwriters Holdings	Bermuda
25.	Paris Re	France



U.S. Market

- The U.S. is the largest property/casualty market. The U.S. has the largest amount of long-tail casualty business in the world.
- In 2007, U.S. reinsurance premium was ceded to over 4700 reinsurers in 108 jurisdictions.
- Companies in **10** countries received approximately **97%** of the unaffiliated premium.

Bermuda – 47%

United Kingdom – 20%

Germany – 11%

Cayman Islands – 7%

Switzerland – 3%

Barbados – 2%

Turks & Caicos – 2%

France – 2%

Ireland – 2%

Canada – 1%



U.S. Market (cont'd)

- U.S. reinsurers assumed **43.7%** of the reinsurance risk in the U.S.
- Non-U.S. reinsurers assumed **56.3%** of this reinsurance risk in the U.S.
 - Total U.S. reinsurance premium ceded to non-U.S. companies was **\$58.4 billion**.
 - - **\$26.4 billion** to unaffiliated reinsurers
 - **\$32.0 billion** to affiliated reinsurers

U.S. Reinsurers' Underwriting Results 2004-2008

<u>Period</u>	<u>Policyholder Surplus</u>	<u>Net Premiums Written</u>	<u>Combined Ratio</u>
2008	\$ 64.4 B	\$ 23.9 B	101.8 %
2007	\$ 75.9 B	\$ 21.7 B	94.7 %
2006	\$ 74.5 B	\$25.8 B	94.9 %
2005	\$ 66.6 B	\$ 25.3 B	129.4%
2004	\$ 60.8 B	\$24.8 B	104.8%

Source: RAA



Rating Agency Views

- Fitch: Stable outlook for global reinsurance sector
- A.M. Best: Stable outlook for global reinsurance sector.
- Standard & Poor's: Stable outlook for global reinsurance sector.



2008/2008 Market Characteristics

- Capital is king
- Reduced retro market
- 2008: Active catastrophe year
 - Hurricane Ike - \$10.65 BN
 - Hurricane Gustav - \$2.1BN



Catastrophe Bond Market

Year	Issuance	# of Transactions
2008	\$ 2.7 BN	13
2007	\$ 7.0 BN	27
2006	\$ 4.7 BN	20
2005	\$ 2.0 BN	10



Bermuda Market



Bermuda's American Partnership

- ❑ 400 years and counting
- ❑ Rescue of the Jamestown Colony
- ❑ Gunpowder to save George Washington's army
- ❑ Aiding the North AND the South in the Civil War
- ❑ Easter Lilies and vegetables for the U.S.
- ❑ Anti-Nazi submarine warfare
- ❑ Cold War mid-Atlantic spying
- ❑ Insurance market support



Association of Bermuda Insurers and Reinsurers

- 23 Class 4 Companies
- Highly capitalized, distinct regulation
- \$61 B GWP, \$65 B Surplus (YE 2008)
- Mostly headquarters in Bermuda with principal operations in Bermuda, the U.S. and Europe
- Worldwide business enterprises
- 1,800 employees in Bermuda; 10,000 U.S.; 23,000 worldwide



ABIR Members

- ACE
- Allied World
- Argot Group
- Ariel Re
- Arch
- Aspen
- Assured
Guaranty
- Axis
- Catlin
- Endurance
- Flagstone Re
- Harbor Point
- Hardy
- Hiscox
- IPC Re
- Lancashire
- Max Capital Group
- Montpelier Re
- Partner Re
- Platinum Re
- Renaissance Re
- Torus
- Validus Re
- XL Capital



Class 4 Market Impact

- Largest property cat reinsurance market
 - Supplies 40% of the U.S. and EU market
- Growing casualty market:
 - 3 of the U.S. top 10 professional liability
- Supply 25% of U.S. medical malpractice
- Wrote 30% of Lloyds 2008 premium
- Supply 25% of U.S. reinsurance market
- Supply 27% of EU reinsurance market (broker)



World Wide Rankings

- AM Best top 35 reinsurers:*

 - Bermuda 16 of top 35
 - Europe 9 of top 35; U.S. 6 of top 35
 - Europe 58%; U.S. 19%; Bermuda 15%

- Standard and Poor's reinsurer rankings:*

 - Bermuda 12 of the top 40
 - Europe 12 of the top 40; U.S. 7 of the top 40
 - Europe 57%; U.S. 20%; Bermuda 13%

- Benfield top 20 P/C Reinsurers*

 - Bermuda 7 of the top 20
 - Tied with Europe for 7 of the top 20

*2008 reports; 2007 data



Market Diversification Reinsurance*

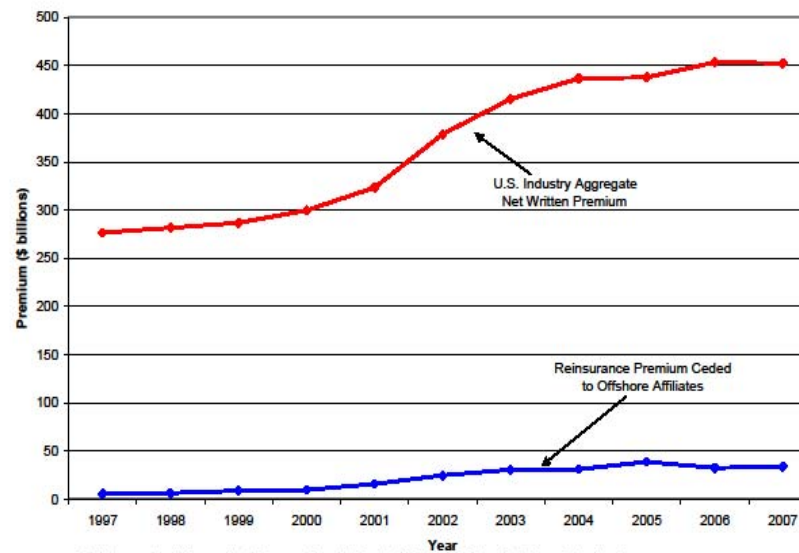
- ❑ AM Best, top 10 groups 76% of market
- ❑ Europe's largest reinsurer is 7 times as big as Bermuda's
- ❑ Growth of Bermuda leads to market diversification
- ❑ Good for the cedents
- ❑ Bermuda carrier growth leads to market choice, less concentration

*AM Best Reinsurance 2008 Report, 07 Data

Put us in perspective . . .

1/6/09

Growth in U.S. P&C Industry Aggregate Net Written Premium and Offshore Affiliate Reinsurance Premium, 1997-2007



Data Sources: Best's Aggregates & Averages, Property/Casualty United States & Canada (various editions) and Reinsurance Association of America, Offshore Reinsurance in the U.S. Market (various editions).



Financial Services Regulatory Reform Efforts



2009 Congress

House of Representatives

- ◆ 256 Democrats/178 Republicans
- ◆ Relevant leadership Positions
 - Barney Frank (D-MA) – Chairman of Financial Services Committee
 - Paul Kanjorski (D-PA) – Chairman of Capital Market, Insurance Subcommittee

Senate

- ◆ 57 Democrats/40 Republicans/2 Independents
- ◆ Relevant Leadership Position
 - Chris Dodd (D-CT) – Chairman of the Senate Banking Committee



Financial Services Regulatory Reform Efforts

- Timing
- Players
- Structure
- Possible Elements
 - Systemic Risk Regulator
 - Resolution Authority
 - Office of Insurance Information
 - [Optional] Federal Charter
 - Surplus Lines/Reinsurance Bill



Financial Services Regulatory Reform Efforts (cont'd)

Systemic Risk Regulator

Administration's proposal to create a "single, independent regulator with responsibility over systemically important institutions and payment and settlement systems".

- ❑ What companies will be subject to this?
- ❑ Who will be the SRR?
- ❑ What is the extent of the SRR's authority?
- ❑ How can/will this interact with the current 50 state insurance regulatory system?

Resolution Authority

Treasury's Proposal: Establishes broader receivership/conservatorship authority to "financial companies" that Treasury determines create a "systemic risk".

- ❑ Lots of issues
- ❑ Status



Financial Services Regulatory Reform Efforts (cont'd)

Office of Insurance Information

- Passed House last Congress
- Authorized Treasury
 - Collect & analyze data
 - Advise Sec'y of Treasury on domestic and international policy issues
 - Coordinate federal efforts and establish policy on international insurance issues.

[Optional] Federal Charter

- Royce/Bean Bill
- Senate Bill?
- Who's in/out?

Surplus Lines/Reinsurance Bill

- Single financial regulator
- Attempts to get rid of extraterritoriality



State Regulatory Reform Efforts

NAIC Reinsurance Regulatory Modernization Proposal

Elements

- ❑ Designed to modernize state-based regulation of reinsurance
- ❑ Creates two new classes of reinsurers
 - Single State Reinsurers
 - Port of Entry Reinsurers
- ❑ Create RSRB, a non-profit corporation affiliated with NAIC with the authority to evaluate state/non-U.S. jurisdictions supervisory systems
- ❑ Requires other states to grant credit for reinsurance to ceding companies for reinsurance assumed by National/POE Reinsurers
- ❑ Modifies collateral requirements

Constitutional and non-constitutional Issues

Status



Catastrophe Issues



Property catastrophe

- The issue: will the U.S. federal government create risk financing programs that displace the private sector?
 - Federal backstop combined with state cat funds will substantially displace private reinsurance
 - Affects all ABIR members—
 - Bermuda is the world's center for property catastrophe underwriting

Are you ready for
**HURRICANE
SEASON?**





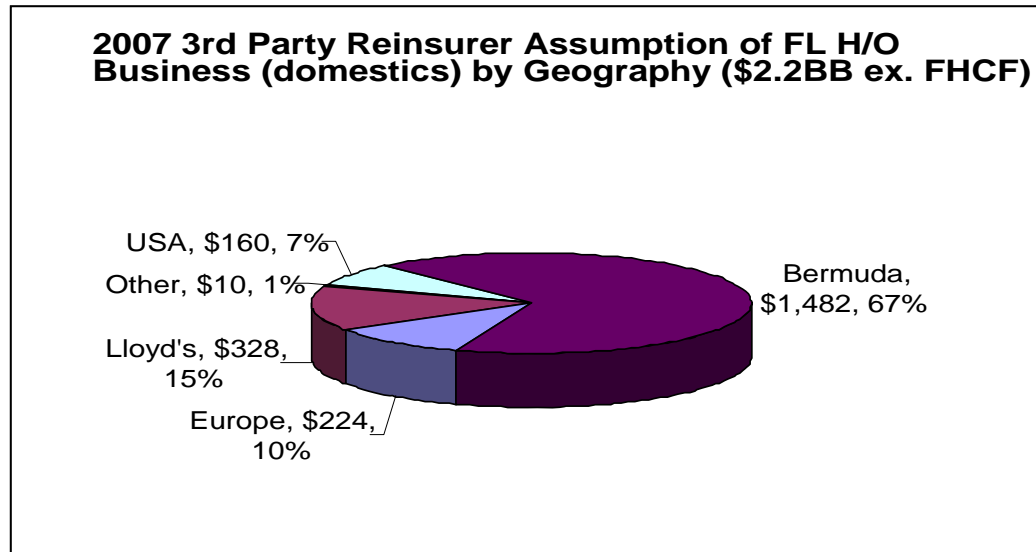
Key points

NFIP extension to September 2009

- Blue ribbon commission?
- Wind addition?
- Federal backstop
 - Loans
 - Reinsurance
 - Florida \$13 B bailout
 - Catastrophe Obligations Guaranty Act (COGA)
- Administration support
- The next event

Florida – 93% International

Florida Insurers: 93% Private Reinsurance is International





Environment at Risk

“Artificially reducing . . . insurance rates would encourage disregard for the public and private costs of unwise land use decision making and cannot be justified by considerations of fairness.”

“These subsidies would be unfair because they would force those who have chosen to live in relatively safe locations, like rural homeowners in Michigan, to pay for the risky decisions of those who have elected to live in or operate businesses in more hazard-prone areas, like beachfront property owners in Florida. ”

John Echeverria, Georgetown University (ELPI)



Americans for Smart Nat Cat Policy

- Coalition:
 - Environmentalists
 - Consumers
 - Free market groups
 - Tax activists
 - Reinsurers
 - Insurers
- Irony: opponents become allies



Our message

- Protect people and property; don't put people in harm's way.
 - Protect exposed land from development
 - Promote “storm proofing”
 - Provide mitigation incentives
 - Mitigation research – IBHS
 - Mitigation education – FLASH
 - Insurance costs come down when claims costs come down (50% reduction possible)
 - Means tested insurance subsidies
 - No federal reinsurance or loans



The Bermuda Example

- ❑ “Storm proofed” homes and buildings
- ❑ Disaster planning
- ❑ Protect people and property
- ❑ Help your neighbor
- ❑ Market based insurance
- ❑ Individual responsibility



Florida and Mitigation

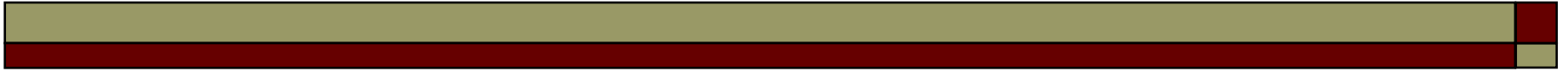
Florida has made a mess of insurance, but is a leader on mitigation:

- ❑ My Safe Florida Home, CFO Sink
- ❑ FLASH
- ❑ Institute for Business and Home Safety
- ❑ Wall of Wind at FIU
- ❑ Storm Struck at Disney World's EPCOT



TRIA Program

- ◆ Obama Budget Proposal Reductions
 - “Excessive federal subsidy” to private insurers
- ◆ Do not renew TRIA in 2014
- ◆ Eliminate domestic terrorism coverage
- ◆ Increase insurer deductible from 20% to 30%
- ◆ Increase insurer co-pay from 15% to 40%
- ◆ Increase trigger from \$10 billion
- ◆ Requires legislation



Tax Issues



1. **What is the proposal by Congressman Neal (HR6969) to disallow deduction for excess non-taxed reinsurance premiums paid to affiliates?**

Position of Coalition for Domestic Insurance Industry

Current tax code favors foreign-owned insurance companies over domestic insurers selling in the U.S. Foreign-controlled companies can avoid tax on most of underwriting and investment profits by reinsuring business with foreign related party in a low-tax or no-tax jurisdiction.

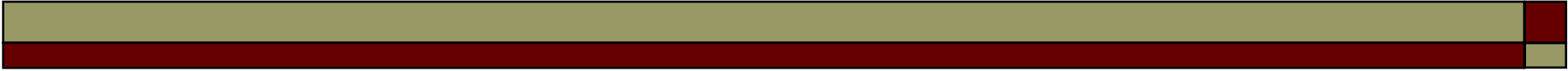
Proposal will address excess cession to affiliated reinsurers only.

2. **How is reinsurance treated under current and proposed tax law?**

Reinsurance premium is currently deductible from gross premiums written on insurance contracts during the taxable year (section 832 (b) (4) (A)).

Exceptions:

In 1984 a rule was enacted providing the Treasury Department authority to reallocate items and make adjustments in reinsurance transactions to prevent tax avoidance or evasion (section 845).



Exceptions (continued):

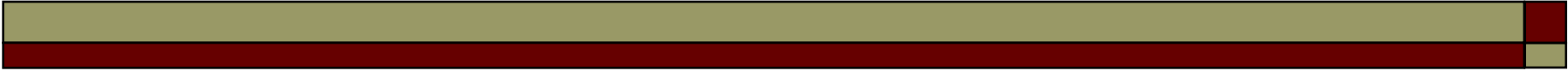
Provision amended in 2004 to allow re-characterize income (whether investment income, premium, etc.) deductions, assets, reserves, credits add to make any other adjustments in order to reflect proper source, character, or amount of that item. Authority expanded to include “amount” Congress expressed concern that “foreign related party reinsurance arrangements may be a technique to erode U.S. tax base”.

3. Earnings Strippings Rules

Present law limits ability of corporations to reduce U.S. tax on their U.S. source income through Earnings Strippings Transactions (example U.S. – Barbados income tax treaty amended in 2004 to make corporate inversions less amenable).

4. What is the new proposal trying to accomplish?

Amend provision to disallow any deduction to covered insurance companies for excess reinsurance premium with respect to U.S. risks paid to affiliated insurance companies that are not subject to U.S. income taxation.



Excess reinsurance premiums are affiliated non-taxed reinsurance premiums paid during the taxable year by a covered insurance company in excess of the sum

- (1) the premium limitation and
- (2) qualified ceding commissions with respect to such premiums.

5. **Premium Limitation**

Determined by comparing a covered insurance company's percentage reinsurance cession with an industry average cession amount of reinsurance based on industry fraction of reinsurance.

Industry Fraction – Determined each calendar year and published by Treasury Department based on published annual statements in arrears. Determination of industry fraction is made separately for each annual statement line of business.

Excess Amount – Subject to 35% corporate tax rate. Consult your auditors/tax accountants.

Calculation of Industry Fraction (2007, \$ in Millions)

	1	2	3	4	5	6	7	8
	Reinsurance Assumed			Reinsurance Ceded				
Line of Business	Direct business	From Affiliates	From Non-Affil.	To Affiliates	To Non-Affiliates	Net Premiums Written	Gross Premiums	Industry Fraction
Fire	11,943	446	2,148	1,542	3,197	9,798	14,091	22.7%

Source - 2009 Brattle Group Report p.14 from Highline Database

(6) = 1 + 2 + 3 - 4 - 5

(7) = 1 + 3

(8) = 5 / 7



Observations from Bill Berkley letter as representative of “The Coalition for a Domestic Insurance Industry”

Why is the draft bill appropriate?

- U.S. tax code should not favor foreign owned insurers over domestic insurers
- Not a new problem
- In 2003, Bush administration expressed concern
- Joint tax committee staff in 2007 affiliated reinsurance equivalent of earnings strippings

Why are some criticisms invalid?

- Only applies to reinsurance from U.S. affiliate to a non U.S. affiliate
- These transactions do not spread risk outside the holding company structures
- Tax advantage results in higher profits for shareholders not lower prices for consumers
- Pricing (hard or soft market) has not been impacted by tax advantage or where capital is raised



Why are some criticisms invalid? (continued)

- Significant migration of insurance capital and reinsurance capital outside U.S.

Final Comment

“Is it possible that Congress would ever pass a tax incentive only applicable to foreign based companies in order to reduce insurance prices or provide additional capacity? The answer is clearly no.”

Source: Bill Berkley letter February 27, 2009 to Max Barrcus Chairman at the Senate Finance Committee

Other Sources:

- Congressman Neal Bill HR.6969
- The Brattle Report
- Coalition for a Domestic Insurance Industry.



U.S. Tax

- Discriminatory reinsurance tax bill:
 - Targets all international insurers. Creates a punitive tax that renders utilization of affiliated reinsurance at any level uneconomic. Results in double taxation.
 - Purpose:
 - Revenue raiser?
 - Market barrier?
 - Address an inequity?



U.S. Tax Public Policy: Affiliated reinsurance . . .

What's new:

- ❑ Democratic Congress, new leaders
- ❑ Focus on “Pay Go” and revenue raising
- ❑ Growth of Bermuda carriers

What's old:

- ❑ Third time this has been tried
- ❑ Business and consumer opposition
- ❑ International trade policy



Action to date

- September 07 Senate Finance information hearing
- HR 6969 introduced late in 2008
- Not in Obama budget
- HR 6969 likely to be reintroduced in May
- Senate staff draft for discussion – Feb. 28 comment deadline
- Both bills apply to ALL non-U.S. carriers with U.S. subsidiaries – Europe, Japan, Australia, Canada, Bermuda



Coalition for Competitive Insurance Rates

- Risk and Insurance Management Society
- National Risk Retention Association
- American Risk Retention Association
- Organization for International Investment
- Florida Consumer Action Network
- CEA – European Insurance Association
- Allianz, Zurich, Munich Re
- ABIR



Coalition letter . . .

“We urge you to be skeptical of amendments that offer additional revenue that in the end will be paid for by policyholders. Twice before, U.S. policyholder groups have urged opposition to such proposals because of their effect on the availability and affordability of insurance. We say it again now -- these proposals are protectionist measures aimed at benefiting some competitors in the market at the expense of others. Ultimately, the U.S. consumers will suffer if this proposal is approved.”

Coalition for Competitive Insurance Rates, October 2007



Coalition letter

Current Economic Conditions

“The property and casualty insurance industry has been largely insulated from the 2008 capital markets crisis. Ironically the impact of this legislation may well be to create a capital markets crisis for insurance where none exists today. Reinsurance functions as capital and the impact of this legislation is likely to create a capital shortfall!”

November 2008

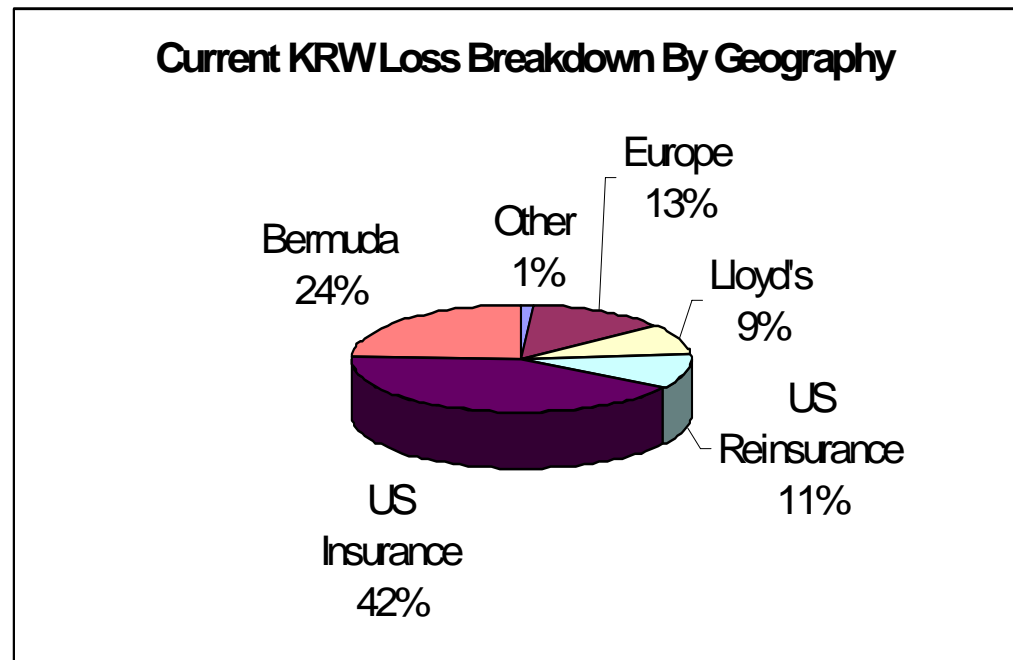


Debate's Three Dimensions

- International Trade:
 - European Commission and governments
 - OFII and USTR
- Consumer Impact
 - Insurance regulators
 - RIMS, FCAN and Consumer Federation SE
- Business Risk Management
 - Insurers and associations

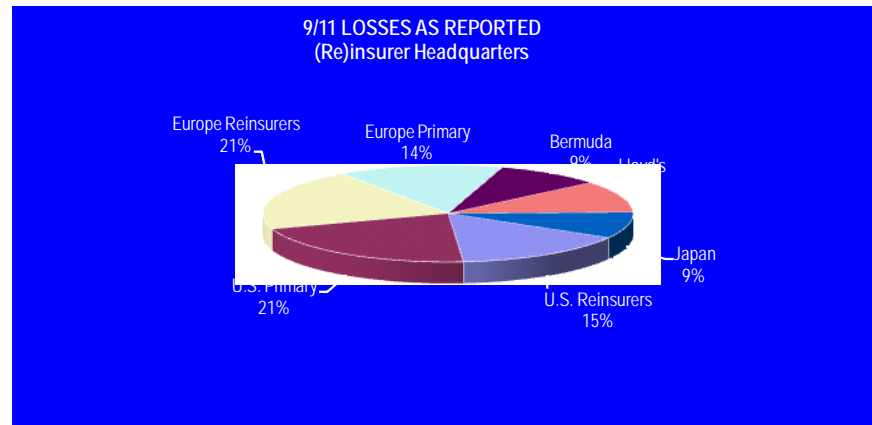
Katrina, Rita, and Wilma

47% of Hurricanes Katrina, Rita and Wilma Claims Were Paid by International Insurers



Source: DOWLING & PARTNERS IBNR #25, Page 16 KRW Hurricanes 2005

International Insurers and Reinsurers Paid 64% of US 9/11 Claims



DOWLING & PARTNERS WTC LOSSES

By Co Headquarters	<u>\$,MM</u>
U.S. Reinsurers	\$4,109
U.S. Primary	\$5,659
Europe Reinsurers	\$5,506
Europe Primary	\$3,865
Bermuda	\$2,479
Lloyd's	\$2,844
Japan	\$2,338
Total Announced	\$26,799



Brattle Group/Cummins' Conclusions

- Enactment of the discriminatory reinsurance tax bill will:
 - Lead to the elimination of affiliated reinsurance for non U.S. groups
 - Lead to a 20% reduction in overall U.S. reinsurance market supply
 - Lead to a 1 to 2 % drop in supply of primary insurance
 - Lead to \$10-\$12 billion annual increase in U.S. insurance costs



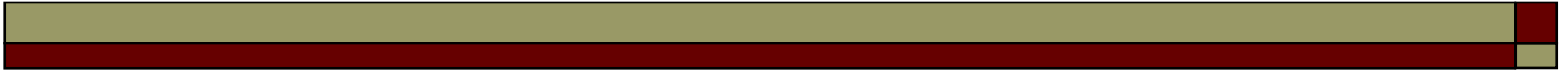
Brattle Group--Economics

- Vertical integration
- Flagship business model
- Efficiencies of affiliated reinsurance
- Adverse selection and moral hazard
- This – Not Tax -- drives U.S. and non-U.S. use of affiliated reinsurance



Brattle Group Analysis

- Neal bill trigger is:
 - “illogical and perverse”
 - \$24 B of \$27B in affiliated reinsurance would be classified as excess
 - Results in a 25% gross receipts tax on subject ceded premium
 - Compares with a U.S. industry pre-tax income of 11% of premiums
 - Does not level the playing field, punitive to foreign competitors – “confiscatory”





Brattle Group Analysis

- For each \$1 of affiliated reinsurance lost, substitute:
 - 29 cents of non-affiliated, (\$6.9 B)
 - 56 cents of capital, (\$13.4 B)
- This resulting short fall leads to a capacity reduction which leads to higher consumer prices
 - From less than 1% to more than 16% by line of business
 - Feedback affect of reinsurance cost not counted



“Smoot Hawley” Neal

- In the midst of the capital markets crisis, enactment of the discriminatory reinsurance tax bill is tantamount to enacting an isolationist market tariff for insurance in the U.S.
- It's the new version of the 1930's Smoot Hawley tariff.
- It's fundamentally contradictory to the U.S. cross border trade commitments.



Concluding Remarks