REINSURANCE
ASSOCIATION
OF AMERICA

STATEMENT

TESTIMONY

OF

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HEARING ON
"U.S. INSURANCE SECTOR: INTERNATIONAL COMPETITIVENESS AND JOBS"

BEFORE

THE HOUSE FINANCIAL SERVICES COMMITTEE SUBCOMMITTEE ON INSURANCE, BANKING AND COMMUNITY OPPORTUNITY

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My name is Michael C. Sapnar and I am President and CEO of Transatlantic Reinsurance Company. I am testifying today on behalf of my company and the Reinsurance Association of America (RAA). The RAA is a national trade association representing property and casualty companies that specialize in assuming reinsurance.

I am pleased to appear before you today to provide the industry's perspective on regulatory impediments for the reinsurance business. I commend Chairman Biggert for holding this important hearing and welcome the opportunity to address the Subcommittee on Insurance, Housing, and Community Opportunity.

Transatlantic Reinsurance Company (TRC) is a New York domiciled professional reinsurer. TRC is a wholly-owned subsidiary of Transatlantic Holdings, Inc., a Delaware corporation, which is in turn a wholly-owned subsidiary of Alleghany Corporation (NYSE: Y), a Delaware corporation. TRC has over 650 employees worldwide, the majority of which are located in the United States. TRC is fully regulated in the United States with New York as its domiciliary regulator. TRC is licensed or qualified in every state, the District of Columbia, Guam and Puerto Rico and operates globally through a network of 17 branches and offices and 3 subsidiaries.[1] The worldwide branch structure is intended to be a more efficient use of capital by consolidating assets in one entity to enhance TRC's standing as a potential counterparty for reinsurance transactions.

[1] The branches and/or offices are located in: London, Paris, Bermuda, Munich, Warsaw, Panama City, Buenos Aires, Rio de Janeiro, Shanghai, Tokyo, Sydney, Chicago, San Francisco, Kansas City, Miami and Stamford. There are also three subsidiaries; Calpe Insurance in Gibraltar, Trans Re Zurich Reinsurance Company, headquartered in Zurich, Switzerland and Fair American Insurance and Reinsurance Company, a New York domiciled insurance company.

I. BACKGROUND ON REINSURANCE

a. US Reinsurance Regulation – Direct and Indirect

US reinsurers are currently regulated on a multi-state basis. While the current state-based insurance regulatory system is focused on solvency regulation with significant emphasis on regulating market conduct, contract terms, rates and consumer protection, reinsurance regulation focuses almost exclusively on ensuring the reinsurer's financial solvency so that it can meet its obligations to ceding insurers.

Reinsurance is regulated by the states utilizing two different methods: direct regulation of US-licensed reinsurers and indirect regulation of reinsurance transactions. States directly regulate reinsurers that are domiciled in their state, as well as those US reinsurers that are simply licensed in their state, even if domiciled in another state. These reinsurers are subject to the full spectrum of solvency laws and regulations to which an insurer is subject, including: minimum capital and surplus requirements, risk-based capital requirements, investment restrictions, required disclosure of material transactions, licensing, asset valuation requirements, examinations, mandated disclosures, unfair trade practices laws, Annual Statement requirements and actuarial-certified loss reserve opinion requirements.

There is also indirect regulation of reinsurance transactions through the credit for reinsurance mechanism, which is the financial statement accounting effect given to an insurer if the reinsurance it has purchased meets certain prescribed criteria. If these criteria are met, the insurer may record a reduction in its insurance liabilities for the effect of its reinsurance transactions. One of the most widely discussed criteria is the "collateral" requirement that a non-licensed reinsurer must establish in the US, such as a clean, irrevocable and unconditional letter of credit issued by an acceptable institution or a US trust fund, to cover its potential liabilities to the insurer. This provision is based on the historic premise that state regulators do not have the regulatory capability or resources to assess the financial strength or claims paying ability of reinsurers that are not authorized or licensed in that state. As part of its recent Solvency Modernization Initiative, however, the NAIC revised its Model Credit for Reinsurance Law and Regulation. This change is intended to transition from a domicile-based system to one based upon a company's actual ability to pay, as assessed by a recognized rating organization, as well as the degree and effectiveness of financial supervision in its home country.

For several reasons, including the cumbersome nature of a multi-state licensing system, capital providers to the reinsurance market have in recent years opted for establishing new reinsurance platforms outside the US and conducting business in the US either through a US subsidiary or by providing financial security through a trust or with collateral. Following the events of September 11, 2001, 12 new reinsurers with $10.6 billion capital were formed. After Hurricane Katrina, at least 38 new reinsurance entities with $17 billion of new capital were formed. Nearly all of this new capital came from US capital markets, yet no new reinsurer was formed in the United States. Transatlantic Re in its current form was established in 1978; other than the US insurance subsidiaries of new start-up companies, not one US-domiciled reinsurer has been formed since 1989. For these startups, the ease of establishment, capital formation, and regulatory approvals in non-US jurisdictions contrasts with the protracted nature of obtaining licenses in multiple US jurisdictions. We believe that a streamlined national US regulatory system will make it more attractive for reinsurers to conduct business through US operations and US-based personnel. Congress has already demonstrated a commitment towards this streamlining goal when it passed the Nonadmitted and Reinsurance Reform Act (NRRA) as part of the Dodd-Frank legislation. The NRRA takes the first step towards streamlining state regulation of reinsurance by providing that (1) the reinsurance company's domiciliary regulator is the sole regulator of the company's financial solvency; (2) the ceding insurer's domiciliary regulator is the sole decision maker of that company's credit for reinsurance; and (3) states cannot apply their insurance laws on an extraterritorial basis.

b. The US Reinsurance Market

Reinsurance is critical to the insurance marketplace. It is a risk management tool for insurance companies to reduce the volatility in their underwriting results and stabilize their financial performance. It is widely recognized that one of the primary functions of reinsurance is to spread natural and man-made catastrophe risk throughout the globe. Reinsurers have assisted in the recovery from every major US catastrophe over the past century. By way of example in the United States, 60% of the losses related to the events of September 11th were absorbed by the global reinsurance industry, and in 2005, 61% of Hurricanes Katrina, Rita and Wilma losses were ultimately borne by reinsurers.

Reinsurance is a global business. Encouraging the participation of reinsurers worldwide is essential to providing the critical risk transfer capacity in the US for both property and casualty business. This can be best illustrated by the number of reinsurers assuming risk from US ceding insurers. In 2010, more than 2,700 reinsurers in 106 jurisdictions outside the US assumed business from US ceding insurers.[2] Although the majority of US premiums ceded offshore is assumed by reinsurers domiciled in ten countries, the entire global market is required to support the enormous risk exposure in the US. Foreign reinsurers now account for 46% of the US premium ceded directly to unaffiliated reinsurers; a figure that has grown steadily from 29% in 1997.

[2] Reinsurance Association of America (RAA), Offshore Reinsurance in the US Market 2010 Data (2011)

II. Trade Barriers in General

Notwithstanding the openness of the US market to foreign-based reinsurers, and following the recent actions by the Congress and the state insurance regulatory process, many countries impose barriers on the transaction of (re)insurance business, whether by established branches or subsidiaries of non-domestic (re)insurers or by cross-border (re)insurers. These barriers can take different forms and can include:

- limitations on foreign direct investment in domestic entities;
- restrictions on establishment in a foreign country, for example, by way of legal form and the number of licenses or branches allowed to establish;
- government policies which create an unlevel playing field to the advantage of local (re)insurers, creating barriers to globalization of risk;
- nationality requirements for directors and employees;
- restrictions on international cross-border market access;
- mandatory cessions imposed on insurance suppliers to cede all or a portion of their risks to specified reinsurance suppliers;
- greater restrictions on cessions to foreign reinsurance suppliers than to domestic reinsurance suppliers;
- right of first refusal privileges for domestic reinsurance suppliers;
- unjustified prudential capital measures;
- reinsurance monopolies or unfair preferences for State-controlled companies;
- restrictions on international cross-border data flows.[3]

Trade barriers restrict the ability of foreign (re)insurers to compete on a fair basis in various national markets, constrain capital fungibility, restrict competition, generate needless additional costs which ultimately have to be reflected in (re)insurance pricing, and create

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[3] *Worldwide Barriers to Trade in (Re)insurance* paper to the OECD Insurance and Private Pensions Committee by some private sector representatives.

prudential risk by encouraging concentration of risk in local counterparties, to policyholders' ultimate detriment.

III. 2011 Global Catastrophe Losses/Importance of Industry

The 2011 global insured catastrophe losses were the highest ever recorded. Of the $105 billion in total insured losses, the bulk of these occurred in Asia and Oceania. The 2011 losses were dominated by "mega cat" events that occurred, in several cases, in relatively small jurisdictions as measured by market size or GDP. These extraordinary losses also occurred in places where catastrophe losses are unexpected (Thailand) or were larger than expected (New Zealand).

Despite these extraordinary losses, insurance capital remains ample and for many reinsurers active in these international markets, the losses recorded were an earnings and not a capital event. According to one public report[4], global reinsurance capital was $470 billion in 2010; after the 2011 loss events, it declined by only 5% to $445 billion. Of the $105 billion in global cat losses in 2011, it is estimated that 45% ($47.5 billion) of this loss amount was ceded to reinsurers. With regard to the largest events, the "mega events", the share that was reinsured rose to 54%. 2011 illustrates that the larger the loss generally, the greater share of the loss that flows into reinsurance markets.[5]

[4] Aon Benfield Reinsurance Market Outlook September 2011.
[5] The share of the 2011 mega event cat losses that were reinsured ranged from 40% to 73%. The Chilean earthquake, which occurred in 2010, had a reinsured share of 95%.

The table below summarizes the jurisdiction, the type of loss and the insured and reinsured amounts. The data is taken from publicly available sources and is based on liabilities assumed and not necessarily claims that have been paid to date.

Jurisdiction	**Insured Losses (Mega Cats)**	**Reinsured Losses (Mega Cats)**	**Estimated Reinsured Share**	**Non-Domestic Reinsured Share**
Australia	**$ 8 BN**	**$ 3.5 B**	**44%**	**90%**
New Zealand	**$17 BN**	**$12.5 B**	**73%**	**100%**
Japan	**$35-40 BN**	**$12 to $14 B**	**40%**	**98%**
Thailand	**$15-20 BN**	**$12 B**	**60%**	**95%**
Chile	**$ 8.5 BN**	**$ 8 B**	**95%**	**100%**
2011 Summary:	**$75-85 BN**	**$40 to 42 B**	**54% average**	**96% average**
Summary (with Chile 2010):	**$83.5-93.5 BN**	**$48 to 50 B**	**62% average**	**97% average**

Reinsurance markets functioned well because the 2011 flooding, typhoon (cyclone, hurricane), earthquake, tsunami, brush fire, and tornado events were pooled effectively by the reinsurance business. Reinsurers of large events rely on the principles of diversification in underwriting the risk in which they assume. Pooling risk from this spectrum of cat losses, from varying jurisdictions and from perils which are not interconnected, enables reinsurance to be provided on a capital base that allows reinsurance to be priced on a basis lower than it otherwise would be priced if capital had to be held to support only a specific risk, or a specific jurisdiction's risk exposures. This is why "ring fencing" of capital through locally mandated jurisdictional reinsurers or through government funds leads to higher reinsurance costs and less capacity when viewed over the long time horizon.

IV. SPECIFIC TRADE BARRIERS FOR U.S. REINSURERS

TRC seeks to provide reinsurance in numerous foreign jurisdictions, some of which impose onerous barriers through laws and regulations. Several of these jurisdictions are set forth in the attachment. I would like to focus my testimony on issues TRC is currently having in the European Union. Transatlantic Re has maintained a branch in the UK for over 30 years which is subject to regulation by the FSA. Examples of this include: the branch is subject to "fit and proper" requirements for key personnel; the company has biennial ARROW visits (which last time included an FSA delegation interviewing the company's board of directors in NY, senior management and its regulators at the NY DFS); the recent imposition of a requirement that the branch retain a "skilled" person (consultant) and take several steps to become more compliant with FSA governance guidelines, including hiring a local risk manager, adding additional controls and hiring a local internal auditor, all functions previously provided for by the NY head office).

The UK regulator maintains that a finding of Third Country equivalence for U.S. reinsurers under Solvency II applies only to "cross-border" transactions and that maintaining a physical branch in the U.K., however closely supervised by the FSA, requires that the third country reinsurer be Solvency II-compliant back to the home country. So, Transatlantic is confronted with a difficult choice – either close our EU branch and write reinsurance from outside the EU (such as from NY), in which case we will not have to comply with Solvency II, or maintain a UK presence, and risk being required to be compliant with Solvency II on an organizational level even if the US is found to be "equivalent" under Solvency II.

By its actions, the FSA has indicated that the current EU rules forces TRC to form an EU insurance subsidiary, and possibly an EU holding company, to ensure that the US holding company does not need to be Solvency II compliant. Besides the enormous resources necessary to accomplish this, forcing US companies to form subsidiaries in the EU effectively ejects the few remaining US owned and controlled reinsurers from the local market and replaces them with an EU domestic. US reinsurers will cease to be a diverse source of risk management in the European market to the detriment of our reinsureds. It is worth noting that 85% of the reinsurance purchased in the US comes from outside the US; this diversity should be viewed as a strength and not as a trade imbalance. If Transatlantic maintains its current branch structure, EU policyholders will have the benefit of being reinsured by a global reinsurer with over $4 billion in surplus.

This situation also raises a competitive issue -- if TRC is forced to form an overseas company and allocate capital to it, Transatlantic will incur significant new operating costs for such structure.

Last but not least, it is worth noting that, through changes in the Model Act for Credit for Reinsurance in 2010, the NAIC and several states have made it easier for non-US reinsurers to reinsure US business. In return, US companies with branches are apparently being ejected from the EU.

V. **<u>POTENTIAL REFORM OF U.S. LAW TO INCREASE U.S. REINSURER COMPETITIVENESS IN OTHER COUNTRIES</u>**

Transatlantic encourages the Committee and its members to consider the following areas of U.S. law, which impact Transatlantic's (and other U.S. based reinsurers') competitiveness, both in the U.S. and doing business in other countries:

1. The U.S. should adopt a structure that would allow for each reinsurer to be regulated by a single regulator with the power to preempt conflicting or inconsistent state laws and regulations. The single regulator's authority should provide for the recognition of substantially equivalent regulatory jurisdictions, including equal treatment of regulated entities.

2. The Federal Insurance Office (FIO) should assert its role in international regulatory bodies and use its authority to enter into covered agreements with other countries.

3. On April 1, 2012, Japan lowered its top corporate tax rate, leaving the U.S. with the highest total corporate tax rate for federal and state (39.2%) in the developed world. Simply stated, this puts U.S. business and workers, particularly those that compete globally such as in the financial services industry, at a significant competitive disadvantage. These high corporate tax rates, and the "worldwide" tax system that taxes profits generated abroad both domestically and in the country they were earned, discourages corporations from investing in operations in the United States. Two of President Obama's bipartisan "blue ribbon" panels, the Economic Recovery Advisory Board, chaired by Paul Volcker, and the National Commission on Fiscal Responsibility and Reform, chaired by Erskine Bowles and Alan Simpson, both made strong cases for cutting the corporate tax rate and reforming the entire corporate tax system.

The benefits of reducing corporate tax rates and implementing broad corporate tax reform include:

- promoting higher long-term economic growth

- improving U.S. competitiveness

- promoting higher wages and living standards

- lowering overall dividend tax rates and taxes on capital

- attracting foreign investment

- promoting lower corporate debt and reducing the incentives for income shifting, and
- easing compliance costs.

TRC wishes to thank Chairman Biggert and members of the Subcommittee for this opportunity to comment and we look forward to working with all members of the Subcommittee on these important issues.

ATTACHMENT

The following summaries provide examples of recent regulatory actions taken by foreign jurisdictions that will likely have an anti-competitive impact on foreign reinsurers including US reinsurers:

1. Argentina and Brazil. Reinsurance markets are characterized as being free of rate and form regulation and thus reinsurance capital flows quickly into markets unrestrained by barriers on entry. However, in 2010 and 2011, two jurisdictions imposed stringent regulatory controls on the ability to conduct cross border reinsurance business and imposed provisions to compel localized capital to be held by locally licensed reinsurers. Brazil's reinsurance regulations were designed to support a "national champion" in the IRB which is being sold by the government to private investors. The Brazilian measures are in two parts, continuing a mandate that 40% of all risk be reinsured with local reinsurers, and a 20% limit on the amounts of affiliated reinsurance that can be ceded by a Brazilian local (re)insurer to a non-Brazilian affiliate.

Similarly, Argentina's new regulations impose an array of restrictions on foreign reinsurers and their branches in Argentina. The regulations provide that the first $50 million of insured risks must be reinsured with local companies. Foreign-registered reinsurers may only cover risks above that amount. In addition, local reinsurers (such as Argentine branches of US reinsurers) must retain in Argentina at least fifteen percent of all reinsurance premiums issued annually, and may only transfer to their foreign sister or parent companies up to forty percent of their yearly premiums. These local entities also cannot hold investments and funds outside of Argentina that exceed 50% of the company's capital. These restrictions appear to violate

Argentina's international obligations, including its obligations under the treaties of the World Trade Organization.

There are a number of other jurisdictions that also continue to impose a mandatory cession to local reinsurers (India, Thailand and China). Collectively these measures are protectionist in nature and have been the subject of protests by insurers and governments to the states that have imposed new market barriers.

Brazil's protectionist reinsurance regulations, adopted in 2011, restrict the degree to which non-Brazilian reinsurers can share Brazilian losses; thus losses are not distributed globally as they are under other mega-loss events. Under the Brazilian rules 40% of all risk must be placed with Brazilian reinsurers. If those Brazilian reinsurers are foreign controlled, they are prohibited from ceding more than 20% of their own losses to their foreign parents. Thus the impact of the Brazilian regulations is to compel mega event losses to be contained within the Brazilian economy, thus Brazil will not receive the economic boost from reinsurance recoveries that were received in 2011 in Australia, Japan and New Zealand; and in 2010 in Chile.

Brazil is not yet known to be exposed to earthquakes or hurricanes; however, it is exposed to catastrophic loss from crop failure, flooding and catastrophes that would occur to infrastructure, oil and industrial production facilities, from fire, explosion, terrorism or other man-made causes. Evidence from the US Gulf of Mexico oil spill and the Thai and Australian floods in 2011 make it clear that these loss potentials in Brazil could total billions of dollars.

The 2011 loss experience demonstrates the essential role of global risk spreading. If protectionist measures are enacted they will necessarily limit the ability to spread risk and to pool risk into legal entities where the capital is readily available to support the volatility that accompanies reinsurance of large scale catastrophe losses. Ring fencing measures such as those imposed recently in Brazil and Argentina, and other governmental measures that mandate local government reinsurance funds, can pose further risks. "Ring fenced" capital would compel risk to be financed locally without the broad support of affiliated reinsurance; or retrocessions generally. Because diversification is restricted on a global basis the amount of capacity available for catastrophe risk is limited by the locally available capital.

Government funds, such as those that exist for earthquake in several jurisdictions and for hurricanes in one jurisdiction, impose their own unique risks. If the government funds are pre-funded, then large loss events can eliminate available funds for risk going forward. If government funds are financed on a post event basis, then risk exists that bond debt will be insufficient.

2. **Panama.** On April 3, 2012, Panama passed a new insurance law (known as Law 12) that is intended to boost the local industry and changes the way local and foreign companies do business there. Under the new law, foreign reinsurers must now register with the Insurance Superintendent and make annual filings of their financial statements, rating certificates and other documents. Prior to enactment of the new law, foreign reinsurers did not need to be registered in order to write business in Panama and simply did business on a cross-border basis.

3. **India**. In early 2012, the Indian insurance regulator (IRDA) published new guidelines for companies writing cross border reinsurance in India. The IRDA guidelines include a template for the submission of information required of reinsurers writing reinsurance business emanating from India without having a physical presence there. This information is required to be submitted to IRDA by March 31 each year. On March 29, 2012, IRDA issued an update on its guidelines for companies writing cross border reinsurance in India. The update provides that reinsurance treaties will be permitted to be placed: (1) with all reinsurance companies registered with IRDA; (2) with reinsurance companies rated as BBB and above that are not registered with IRDA but which do so before March 31, 2013; (3) with reinsurance companies owned by government of countries recognized by the Indian government if they are registered with IRDA before March 2013.

4. **Canada.** In December 2010, Canada's Office of the Superintendent of Financial Institutions (OSFI) released final revised reinsurance regulations commonly referred to as Part XIII of the Canadian Insurance Laws. The Canadian Regulations are centered on solvency of Canadian domestic insurers and the rules concerning credit for ceded reinsurance. Unlike the US which is in the process of relaxing its credit for reinsurance rules to reduce or eliminate any collateral requirements, the Canadians have created new, domicile-based collateral requirements which determine the amount of credit that a Canadian domestic insurer can record for risks ceded to Non-Canadian reinsurers. This unfairly impacts the ability of US reinsurers reinsuring Canadian risks by requiring that a US reinsurer post collateral before the Canadian domestic insurer can take credit for reinsurance ceded to US reinsurers, regardless of the US reinsurers' financial strength.

Additionally, the Canadians have imposed other restrictions on credit for reinsurance that is ceded to foreign reinsurers that are licensed in Canada. TRC has been licensed as a reinsurer in Canada for over 20 years, with a fully staffed Toronto office and a designated Chief Agent. The current Canadian Regulations require that TRC, despite its licensed status, physically process any and all reinsurance of Canadian domestic insurers in Canada. This processing is a pre-condition for accounting credit for any reinsurance provided by TRC to a Canadian domestic insurer. For accounts produced in Canada this is generally not an issue, but where the account is produced elsewhere it becomes administratively burdensome on the reinsurance intermediary and the ceding company as well as for TRC. By way of example consider a situation where a reinsurance agreement covers risks located primarily in the USA and Europe and has some Canadian risks as well. To comply with Part XIII the broker must segregate the Canadian portion of the reinsurance program ceded to TRC and process this portion in an office physically located in Canada and TRC must, likewise, assign this portion of the program to its Toronto office where it must be documented as being underwritten and accounted for in the Toronto branch. Also the TRC Chief Agent in Canada must sign the agreement in addition to a company official where the account originated. This applies even when the Canadian portion of the agreement is minimal. These regulatory requirements have the effect of making regulatory compliance easier and more streamlined for the reinsured domestic company if it purchases reinsurance solely from Canadian domestic reinsurers.