CICA
CAPTIVE INSURANCE COMPANIES ASSOCIATION
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August 27, 2012

Michael T. McRaith
Director
Federal Insurance Office
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington D.C. 20220

Re: Public Input on the Report to Congress on the U.S. and Global Reinsurance Market

Dear Director McRaith:

Please accept these comments of the Captive Insurance Companies Association ("CICA") and the various related captive insurance trade associations detailed below in response to the Federal Insurance Office ("FIO") notice and request for comment on the U.S. and global reinsurance market.

CICA is the leading domicile neutral trade association representing the global captive insurance industry. CICA represents hundreds of members, both onshore in North America and offshore in markets like Bermuda and Europe. CICA's members are individual captives, companies that own and utilize captives and service providers to captives, such as actuaries, accountants, attorneys and insurance consultants. These members represent a wide range of industries and include both Fortune 100 companies and small, family-owned businesses.

CICA is joined in this submission by the National Risk Retention Association (NRRA), a national trade association representing risk retention groups and risk purchasing groups.

In addition CICA is being joined by a number of U.S. captive domicile trade associations representing the captive insurance companies licensed in their states, along with the service providers supporting the captive industry in that state, to-wit:

- Missouri Captive Insurance Association (MOCIA) – David Dimit, Executive Director; 9648 Olive Blvd #329, St. Louis, MO 63132
- Montana Captive Insurance Association (MCIA) – Brenda M. Olson, Chair; 1302 24th St. West #303, Billings, MT 59102
- Nevada Captive Insurance Association (NCIA) – James L. Wadham, Chair; 300 S. Fourth Street, Suite 1400, Las Vegas, NV 89101

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- South Carolina Captive Insurance Association (SCCIA) – Tom Brumgardt, President; 1320 Main Street, 17th Floor, Columbia, SC 29201
- Tennessee Captive Insurance Association (TCIA) – Kevin M. Doherty, Chair/President; 3102 West End Avenue, Suite 700, Nashville, TN 37203
- Vermont Captive Insurance Association (VCIA) – Richard Smith, President; One Lawson Lane, Suite 320, Burlington, VT 05401

Captives are insurance arrangements that enable businesses to manage their risks, lower and stabilize their insurance costs and access the commercial reinsurance market. The importance of captives to the business community is evidenced by their steady growth over the last two decades. In 1990, there were some 2,500 captive insurers worldwide. Today, there are more than 5,300 captives, and over 60 percent of Fortune 500 companies own a captive.[1] It is estimated the captive insurance market represents $55 - $60 billion in annual premium globally.[2]

Reinsurance is extremely important to captive insurers. In fact, obtaining direct access to the domestic and international reinsurance markets is a primary reason many businesses form a captive. Having such access allows captive owners to reduce and manage their insurance costs, gain access to underwriters of specialized risks and mitigate their overall risk exposure by reinsuring the captive portfolio. In addition, captives often act as reinsurers of primary insurers for their risks and provide additional insurance capacity. Often, coverage is retroceded to other reinsurance companies.

The global reinsurance market has shown remarkable stability and resilience, as evidenced by it ability to weather the recent financial crisis and historically unprecedented catastrophic losses in 2011 while maintaining robust capital levels. Indeed, insurance regulators have concluded that the reinsurance market has a stabilizing effect on financial markets and the global economy has a whole.

Based on this evidence and the experience of our members, we believe existing regulatory structures, both domestic and international, have been successful in ensuring the viability, stability and solvency of the reinsurance market. We see no evidence that the current regulatory system is in need of change.

Our comments below are organized according to the topics identified in the FIO notice and request for comments. Our comments focus on topics 1, 3, 4 and 6.

Topic 1. The purpose of reinsurance

The purpose of reinsurance is, of course, to transfer risk from one insurer to another. More generally, reinsurance contributes to the global diversification of risks, efficient allocation of capital and improved risk management on the part of captives and their owners and other insurers.

[1] According to SNL Financial LC.
[2] According to Beecher Carlson.

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Reinsurance operates in the captive insurance market in essentially the same way it does in the traditional market. Captive insurers reinsure risks they cannot or do not wish to retain, such as risks for which the captive does not wish to maintain surplus capacity, including excess or catastrophic risks, or risks that are difficult to underwrite. A recent survey of CICA's members indicates that over 50 percent of captives purchase reinsurance.

In addition, a captive may act as a reinsurer where an insurance program is "fronted" by a traditional insurer. In this case, some or all of the insured risk is ceded by the fronting carrier to the captive. Fronting is employed where a traditional insurer is required to meet requirements of law in a state or other local jurisdiction or where the insured desires coverage from a traditional insurer for credentialing or other reasons. In a recent survey of CICA's members, 43 percent of captive respondents said they reinsure risk under such an arrangement.

Topic 3. The role that the global reinsurance market plays in supporting insurance in the United States

Reinsurance is particularly important to captive insurers because many captives are formed specifically for the purpose of obtaining direct access to global reinsurance market. In a recent survey conducted by CICA, over 50 percent of respondents stated that access to the commercial reinsurance market was a major reason they formed a captive insurer.

Accessing the reinsurance market directly through a captive allows captive owners to reduce the cost of insurance by tapping a broader, more diverse market that may offer better rates and, in some cases, reducing transactional costs. In addition, direct access to the reinsurance market can allow captive owners to obtain coverage more easily for hard-to-place risks. Underwriters familiar with a niche risk often find coverage more available in the broader global reinsurance market than the domestic market for commercial insurance.

Topic 4. The effect of domestic and international regulation on reinsurance in the United States.

We believe the current structure and depth of domestic and international regulation is operating effectively to provide U.S. captives and other domestic insurers with access to financially stable and well regulated reinsurance market.

This conclusion is supported by the findings of major insurance and financial supervisory organizations. Insurance regulators have found that the reinsurance industry came through the recent financial crisis extremely well. In a report issued in the wake of the financial downturn, the IAIS stated, "We may safely conclude that the reinsurance sector overall has emerged from the depth of the financial crisis with robustness and has shown ability to substantially recover financial positions and capital levels impaired by the crisis in relatively short order."[3] Similarly, the Committee of European Insurance and Occupational Pension Supervisors ("CEIOPS") found that, "In 2009/2010 many reinsurers managed not only to restore their balance sheet, but to raise additional capital, leaving the industry well capitalised."[4]

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[3] IAIS Global Reinsurance Market Report at p. 4 (December 2010).
[4] CEIOPS Financial Stability Report at p. 3 (December 2010).

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In addition, insurance regulators have concluded that the reinsurance market has absorbed catastrophic risks well and will continue to have the capacity to do so. According to the IAIS,

> Over the years, reinsurers have demonstrated a remarkable resilience in absorbing peak risks aligned with their core business model. The global nature of reinsurance business allows for the pooling of broadly idiosyncratic and uncorrelated risks. At the end of 2011, despite an unprecedented series of large catastrophes in the Asia-Pacific region and the Western Hemisphere the top 10 global reinsurers monitored in our sample reported more equity capital than at the beginning of the year.[5]

Looking forward, the IAIS concluded that an extreme stress test it conducted for large reinsurers "suggests that large reinsurance groups are likely to absorb even a fat tail combining severe catastrophic and financial market stress."[6]

Insurance regulators also have found that traditional reinsurance does not present a systemic risk to the global financial system and, indeed, has played a stabilizing role in the financial services industry and the global economy, particularly during the recent financial crisis. According to the IAIS, "traditional reinsurance—including reinsurance of peak risks—is unlikely to contribute to, or amplify systemic risk. While reinsurance establishes intra-sector connectivity, the hierarchical structure of the insurance market dampens the propagation of shocks through the insurance market."[7]

The IAIS reached a similar conclusion with respect to the vast bulk of non-traditional reinsurance and particularly alternative risk transfer ("ART") activities, including cat bonds and other insurance linked securities. According to the IAIS, "While ART comprises characteristics of financial market products and derivatives, in most cases, ART does not intermediate credit. Consequently, the failure of a reinsurer engaged in ART will not undermine a larger credit pyramid, and it is unlikely to affect other financial market participants or the real economy.[8]

U.S. captives rely heavily on the international market for reinsurance. It is important that regulators, whether in the U.S. or abroad, not erect regulatory barriers that impede or unduly burden this access. It is equally important that neither the U.S. nor other countries establish barriers to trade that would limit the ability of captives or other insurers to obtain reinsurance.

Topic 6. The coordination of reinsurance supervision nationally and internationally.

As evidenced by the remarkable stability of the domestic and international reinsurance markets and our own members' experience, we believe the coordination of reinsurance supervision by the IAIS and similar organizations at the international level and by the National Association of Insurance Commissioners and state insurance regulators at the domestic level has

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[5] IAIS, "Reinsurance and Financial Stability" at ¶58 (July 19, 2012).
[6] *Id.* at ¶59.
[7] *Id.* at ¶91.
[8] *Id.* at ¶4.

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worked successfully and can continue to serve the market well in years to come. We encourage FIO to work closely with these organizations as it carries out its statutory responsibilities.

Reinsurance plays a vital role for captive insurers, and captives have benefited greatly from the stability and appropriately regulated domestic and global reinsurance markets. We believe current regulatory structures are well equipped to continue to ensure the solvency and stability of reinsurance markets. We look forward to working with FIO and appreciate the opportunity to provide these comments.

Sincerely,

Dennis P. Harwick
President

CC: Captive Insurance Companies Association Board of Directors
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Brenda M. Olson, Montana Captive Insurance Association
James L. Wadham, Nevada Captive Insurance Association
Tom Brumgardt, South Carolina Captive Insurance Association
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Richard Smith, Vermont Captive Insurance Association
Joe Deems, National Risk Retention Association

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