

US Reinsurance Regulation Reform: The Future is Now

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In a firm call for the modernisation of the US Reinsurance Regulatory System, , Member of the Executive Board, Chairman and CEO, Swiss Re America Corp, stresses that both regulatory oversight and market discipline benefit substantially from a framework that not only encourages but requires insurers and reinsurers to fully understand the risks that they write.

Reinsurers assuming business from US cedents must be licensed, or otherwise approved, in each state or they must collateralise their obligations to cedents under US law and regulation. During the latter half of the 20th Century, such a system might have represented a reasonable balance between the need for international reinsurance capacity and the need to ensure the collectability of reinsurance recoverable from non-US reinsurers.

However, the world has changed. Within the group of top 10 reinsurers, companies representing more than 60% of reinsurance premiums written are internationally based. Accounting conventions are more transparent and regulation of reinsurers has been strengthened in many countries, partly due to the efforts of the International Association of Insurance Supervisors, the European Union (EU) and certain non-EU jurisdictions, such as Switzerland, which have restructured and strengthened their regulation of reinsurance in the past few years.

Reform of reinsurance regulation in the US has been opposed by some participating in the debate, primarily because there is a need for future changes and improvements in international accounting standards and regulation. However, these changes and improvements are in hand and the future is now.

US Collateral Debate

For years, non-US reinsurers have advocated that the US system of reinsurance regulation should recognise their financial strength and relieve them of at least a portion of their collateral obligations. This effort has been opposed by US ceding insurers that do not want to give up the security of collateral and do not have confidence in their competitors to make wise reinsurance purchasing decisions. Historically, the US collateral requirements have served as a proxy for the credit worthiness of unauthorised reinsurance companies. Credit worthiness in the current sophisticated financial services environment, however, is no longer elusive but subject to reasonable and sound determination. The current system does not differentiate among reinsurers with varying degrees of

financial strength, though we believe it should, and the means exist to do so.

Any effort that focuses on the narrow issue of collateral rather than comprehensive reform is, in Swiss Re's view, misplaced. Doing so creates a perception of winners and losers - non-US reinsurers which are perceived as 'winning' reduced collateral obligations, ceding insurers which are perceived as 'losing' the security currently afforded them, and US reinsurers that continue to be burdened by a system of regulation with 51 jurisdictions (50 states and Washington, DC). In the end, a comprehensive effort to modernise US reinsurance regulation is the only way that can benefit all stakeholders.

Comprehensive Reinsurance Regulation Modernisation

While there may be other areas of the insurance business that are appropriate for comprehensive reform, the most compelling argument can be made for reinsurance. The global nature of the reinsurance market requires that capital and trade flow across borders consistent with an increasingly global economy. The regulatory framework of the future must take into account that risk transfer through reinsurance is a global business. A global approach to reinsurance regulation requires a consolidated view of the reinsurer, consistent with the firm's own view of its operations, including its financial strength, specific and aggregate risk profile, and risk management approach. It also demands consistent standards and supervision across jurisdictions and co-ordination and communication among international regulators.

Both regulatory oversight and market discipline benefit substantially from a framework that not only encourages but requires insurers and reinsurers to fully understand the risks that they write; a modernised approach to reinsurance regulation should be based upon this fundamental concept. Following the examples of Basel II, the Financial Services Authority (FSA), Swiss Solvency Test and the direction of Solvency II, the US formulaic approach to minimum solvency requirements should be replaced with forward-looking risk assessment measures. Such measures would bring regulatory capital in line with economic capital, providing higher-quality risk management and ensuring that regulatory capital is integrated within the firm's wider capital management processes.

In a global marketplace, reinsurance capital will flow where it is least restricted and less expensive to transact business. It is difficult for a regulatory system with 51 sets of different and sometimes redundant and conflicting rules to compete with other jurisdictions that have updated their method of regulation. Jurisdictions like the EU are able to obtain a competitive advantage through more efficient regulatory systems, which results in an acceleration of capital inflow. A comprehensive approach to regulation, consistent with the global realities of the business, must be premised on a single regulator. Swiss Re favours an optional federal charter (OFC) modified to provide a meaningful choice between a federal regulator and a single state regulator.

Ultimately, an OFC will make the US more competitive, more responsive

and result in lower costs to the insuring and reinsuring public.

The regulatory challenge facing the US is the need to provide the proper balance between the US cedents' security needs and the reinsurers' need for effective and efficient capital management. US regulators cannot continue to sustain their role as global leaders without playing a central role in ensuring a strong, resilient and global reinsurance industry. Modernising the US reinsurance regulatory system is long overdue, not a matter for the future. The future is now.

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