Press Release

13 September 2010

Global Reinsurance Forum remains actively engaged in the ongoing regulatory debate to secure the value proposition of reinsurance

The Global Reinsurance Forum (GRF) was formed in September 2009 as the representative body for the world's largest reinsurers to respond to international policy and regulatory issues affecting the reinsurance industry. The GRF aims to promote a stable, innovative and competitive reinsurance market environment on a worldwide basis. The formation of the new Forum proved timely as it took place against a background of heightened regulatory changes, increased scrutiny on global financial services firms and a severe financial crisis. This crisis has led to intense debate on the supervisory architecture and regulatory requirements. The reinsurance sector is faced with the potential for overly conservative regulatory reactions as well as protectionism and fragmentation of regimes. The GRF has been focusing its efforts on three major regulatory developments and the role of reinsurance in Chile:

1. Liberalisation of reinsurance markets
   The GRF strongly believes that open reinsurance markets are in cedants' and economies' best interests. They help to provide cedants with choice of provider, product and price and protect economies by enabling financial risk to be diversified into the global marketplace. As a general rule, reinsurance can be and is transacted freely, both on an establishment and cross-border basis, and from many countries worldwide. Yet barriers to trade in reinsurance still remain, including in developed economies. The GRF will continue to make the case for open markets and for the removal of such barriers. *(See appendix 1)*

2. Supervisory Recognition
   The IAIS has set a framework aiming at harmonising solvency regimes and establishing supervisory recognition. The IAIS Common Assessment Framework is expected to facilitate the international regulatory dialogue for cross-border groups. In Europe the CEIOPS published advices to the European Commission on third country equivalence assessment under Solvency II. The GRF supports the European Commission's efforts to establish an adequate framework for recognition of equivalence. The recognition of solvency regimes is a key process to support capital efficiency and ensure adequate economic decisions. *(See appendix 2)*

3. Systemic risk and reinsurance
   The reinsurance sector weathered the financial crisis well and acted as a source of stability in the global financial system by continuously providing needed capacity to insurers during the crisis. The financial crisis exposed flaws in the supervisory system and the GRF supports the introduction of comprehensive group supervision as well as macro-prudential surveillance. *(See appendix 3)*

4. Reinsurance role in the Chile earthquake
   The GRF believes reinsurance plays a major role in emerging markets with catastrophe exposures, as generally local insurers do not have the capital to mitigate their exposures which can be very high. Chile is the most seismic country in the world with the highest severity and frequency of earthquakes and therefore take up rates for quake insurance in the country are high. The recent major earthquake in Chile has demonstrated the key role of reinsurance in such a catastrophe which insured loss could be as high as USD 10 billion, which is estimated reinsured at over 95%: *(See appendix 4)*.

GRF members believe that the value of reinsurance to clients and the global economy became even more apparent during the present crisis. Because of reinsurers' shock absorbing capability, reinsurers are a major factor of stability to the financial system. The ongoing, prolonged, governments' support to the banking industry results in a low interest rates environment which puts significant pressure on (re)insurers' investment income. This is detrimental to the (re)insurance industry, and the GRF believes policy makers should aim at normalizing macro-economic policies as soon as possible.
The GRF will continue to monitor closely regulatory, financial and economic developments and contribute to relevant debates.

Denis Kessler, Chairman of the GRF, comments: "*We are very happy with the efforts conducted by the GRF during its first year since formation. It is an active forum, which enables global reinsurers to monitor global issues closely and share views on key trends impacting the reinsurance industry. In a world where international policy and regulatory issues are profoundly changing the supervisory landscape, it is vital to have a unified voice to respond to debates in a timely manner*".

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Appendix 1 – Liberalisation of reinsurance markets

The GRF supports open and fair reinsurance markets.
Cedants and economies benefit from the choice and competition which results from liberalised insurance markets. Closed markets and restrictive rules have the opposite effect, limiting cedants' choices of provider and product and inhibiting economic activity. In general, reinsurance can be and is transacted freely, both on an establishment and cross-border basis, in and from many countries worldwide without major trade barriers.
That said, many countries, both in the developed and developing world, impose barriers on the transaction of reinsurance business, whether by established or cross-border reinsurers.

These barriers can take different forms but include:

- mandatory cessions imposed on insurance suppliers to cede all or a portion of their risks to specified insurance or reinsurance suppliers;
- greater restrictions on cessions to foreign reinsurance suppliers than to domestic reinsurance suppliers;
- right of first refusal privileges for domestic reinsurance suppliers;
- discriminatory requirements imposed on foreign reinsurance suppliers as they relate to collateralisation and localisation of assets and taxes;
- reinsurance monopolies or unfair preferences for State-controlled companies; and
- specific reinsurance regimes with State guarantees for risks such as natural catastrophes.

These barriers, apart from restricting the ability of reinsurers to compete on a fair basis in various national markets, constrain capital fungibility, restrict competition and choice for cedants and/or generate needless additional costs which ultimately have to be reflected in reinsurance pricing, to the detriment of cedants.

Reinsurers have been advocating over many years for liberalisation of reinsurance markets. The GRF proposes to play its part in this ongoing campaign, in the following ways:

- by collectively and individually continuing to make the economic case for open reinsurance markets, whether at conferences, through articles etc, and by encouraging relevant international organisations to reaffirm their support for open markets;

- by focusing the spotlight on individual countries, particularly those in the developed world, which maintain significant barriers to trade;

- by supporting the work of international organisations, such as the WTO, to promote open markets;

- by encouraging international trade negotiators, both in multilateral and bilateral trade talks, to press for removal of reinsurance barriers to trade;

- by supporting the work of the IAIS to promote unilateral, bilateral and multilateral supervisory recognition of equivalent reinsurance regulatory regimes and the removal of unnecessary and duplicative supervision;

- by taking part in IAIS work to promote regulatory convergence of reinsurance supervision at sensible and proportionate levels; and

- by supporting the EU's work on assessing the equivalence of third country regimes as a tool for promoting convergence of regulatory practices.

Appendix 2 - Supervisory Recognition

The IAIS has set a framework aimed at standardisation of solvency regimes and supervisory recognition. This is a global effort in which the European Union plays an active role. Recently CEIOPS published its advice to the European Commission on which third country jurisdictions should be subject to first wave equivalence assessment under Solvency II.

The GRF welcomes the European Commission's consultation process in respect of the general criteria to be used to assess third countries' equivalence under the Solvency II Directive. The standardisation of solvency regimes is a key process, ahead of individual country assessments.

The GRF believes there are two key issues to be highlighted in this context:
1. Reinsurance would be a prime beneficiary of standardisation of solvency regimes
2. GRF members promote a flexible, principle-based approach to supervisory recognition

Solvency II is still evolving, and many elements of the proposed regime are still under discussion, especially in relation to the level 2 implementing measures. As several elements of the Solvency II framework are not yet finally determined, compatibility of local rules with Solvency II cannot be fully addressed by third countries. For this reason, the GRF advocates a flexible, principle-based approach, as opposed to the necessity for third countries to comply with a detailed checklist of indicators.

It is positive that the CEIOPS states "when assessing a particular principle and objective, every indicator does not necessarily need to be fulfilled in order for principle and objective to be considered observed". More precise guidance and a hierarchy in indicators would nevertheless be useful in this connection.

With regards to third country recognition, the GRF believes the United States and the European Union are key markets. Conditions for a mutual recognition, with full reciprocity in terms of business conduct should be found as soon as possible.

Ultimately, the equivalence process should strengthen worldwide, open and fair reinsurance markets, which the GRF supports. The equivalence process plays an important role in the progress of group supervision. Regulatory oversight must take into account the specific nature of global groups, with well diversified operations around the world.

The GRF therefore supports the approach proposed by CEIOPS, which is similar to the one applied to assessing equivalence under the Reinsurance directive (2005/68/EC) and the Financial Conglomerates Directive (2002/87/EC).

Requiring equivalence with the core principles and objectives of the Solvency II Directive, rather than with each of the more detailed indicators, is considered to be an appropriate approach as this recognises that other methods may be used to be determined equivalence as long as a similar level of prudential supervision and policyholder protection is achieved.

Appendix 3 - Systemic risk and reinsurance

The reinsurance sector weathered the financial crisis well and acted as a source of stability to the global financial system by continuously providing capacity during the crisis. No diversified reinsurer failed during the crisis. Whilst reinsurers' investment portfolios were affected during the crisis, like the rest of the industry, the reinsurance sector continued to fulfil its role during a crisis of which it was not the cause.

The reinsurance business model is completely different from banking. Compared to banks, reinsurers are much less exposed to liquidity risk and less interconnected with the financial services industry overall.

The GRF supports the approach of the Geneva Association in its March 2010 study on 'Systemic Risk in Insurance' and its recommendations to strengthen the role of reinsurers in financial stability. The study shows that the core insurance and reinsurance risk activities pose no systemic risk. The IAIS and countries' experts groups also recognise that there is little evidence that insurance can cause a systemic risk. However, supervisors remain concerned about the interconnectedness of reinsurers with the insurance sector. Many studies, such as the G30 study from 2006 and more recently the above mentioned Geneva Association study showed that the reinsurance sector poses no systemic risk. There are no examples of major cascading impact from a reinsurer failure on primary insurers. Furthermore, the failure of a large reinsurer would represent a modest loss in terms of global insurance premiums, total insurance market capitalisation, or total industry investments.

The financial crisis exposed flaws in the supervisory system. The GRF supports the introduction of comprehensive group supervision – such as contemplated under Solvency II – as well as macro-prudential surveillance. A lead group supervisor should be identified for each reinsurance group and recognised by other regulators as the competent supervisor having a comprehensive view on a reinsurer's worldwide activities. The focus of macro-prudential surveillance should be on monitoring risk activities and not adding new layers of supervision on financial institutions. The GRF supports the IAIS efforts in publishing an annual report on the global reinsurance market. The GRF also welcomes the IAIS latest position on financial stability, which underlines the specificities of the insurance business model as well as the experience of the sector prior and during the financial crisis. G20 leaders and the FSB should take into account the IAIS position when assessing systemic risk and introducing new regimes.

Under new macro supervisory regimes, it is important that systemic risk boards' composition be balanced (ie including (re)insurance experts). New macro-prudential bodies will need to closely coordinate and establish mechanisms of recognition or equivalence in order to avoid duplication of supervisory effort, market confusion, regulatory arbitrage, and extra-territoriality issues.

Diversified cross-border reinsurers bring many benefits to the global economy and to individual countries and companies. Imposing non-risk based capital requirements or artificial limits on size or activities on reinsurers would be harmful, counter-productive and unlikely to succeed in addressing systemic risk.

Appendix 4 – The Chilean quake and reinsurance

Chile is considered to be one of the most seismic country in the world and in fact the most powerful earthquake ever registered worldwide, the Great Chilean Earthquake, shocked Chile in 1960 (in Valdivia) with a magnitude of 9.5 (Richter scale), an ensuing tsunami, several thousands of deaths and an estimated economic loss in current dollars of between USD 4 and 6 billion.

On February 27th, 2010 a new major quake, again accompanied with a tsunami affected the central and southern part of the country. It was one of the biggest insured loss events ever registered out of Europe and the U.S.A. The quake was 8.8 on the Richter scale, one of the most powerful in recent history.

In the Chilean market, the level of retention of the companies compared to the risk is very low due to the size of the insurers, the high value of their exposures and their overall unbalanced portfolio. For an optional cover, the take up rate for earthquake coverage is high with an estimated average of 30% and up to 90% for the mortgages policies.

Losses from such a catastrophe are difficult to estimate due to their complexity (construction failures, infrastructure damage and business interruption) and it often takes months to establish a reliable range, as it happens in major earthquakes, such as the Northridge quake in the US (1994).

The total economic loss is estimated at around USD 30 Billion and the insurance loss might reach the USD 9-10 Billion. Of this amount, more than 95% is estimated to be reinsured through facultative and treaty business. This is around 7 times the P&C market premium and 1.5 times the overall market premium, showing the unbalanced nature of the catastrophe exposure in Chile. This does not represent the worst loss, since the damages were not in the most densely populated areas.

The Chilean disaster shows the utmost importance of reinsurance for catastrophe prone markets. It is a way to fund major losses that can be absorbed overtime and is a major help for the local insurance companies and government. It is very difficult for local insurers to fully pre-fund potential disasters of such magnitude in countries exposed to very high severity losses. Reinsurance is very useful under these circumstances to:

- Assess the risk
- Smooth the losses,
- Protect the local insurers' balance sheets
- Help improve protection for mitigating future losses