

EXTREME EVENTS BULLETIN #09-50

FROM: Marsha Cohen
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DATE: April 21, 2009

SUBJ: New York– Proposed Mandatory Catastrophe Reserves Regulation

Action Requested: RAA Members are asked to review the attached proposed regulation on mandatory catastrophe reserves and provide any comments to RAA staff by close of business Friday, May 8, 2009.

THE PROPOSED REGULATION

On April 8, the New York Insurance Department introduced proposed Regulation 189, which would require authorized property/casualty insurers (including reinsurers) to establish reserve funds for payment of losses that occur in New York arising out of natural catastrophes. Regulation 189 would apply to every authorized property/casualty insurer that receives New York subject premiums under a policy of insurance or contract of reinsurance covering losses resulting from a natural catastrophe to property located in New York.

The reserve will only be used to pay claims arising out of “qualifying losses,” which are defined as losses and loss adjustment expenses incurred, net of reinsurance, resulting from loss to property located in New York that are directly attributable to a catastrophe in the state.

Catastrophe is defined as a “natural event designated as a catastrophe by the Property Claims Service” and “(1) which causes \$250 million or more in industry-wide direct insured losses in the United States and results in qualifying loss to property located in [New York]; or (2) which causes \$25 million or more in direct insured losses in a qualifying loss to property located in [New York] and results in a 10% reduction in the insurer's surplus to policyholders in any calendar year.”

Each property/casualty insurer must annually fund its mandatory catastrophe reserve in an amount equal to its “aggregate catastrophe load,” included in its New York subject premiums, for the calendar year. The term “aggregate catastrophe load” is defined as the total dollar amount of all catastrophe loads, net of non-hurricane catastrophe provisions and excess of loss reinsurance ceded, charged to all rating territories.

The mandatory catastrophe reserve will have a thirty year rolling term. At the end of the reserve's thirtieth year, the first year's annual contribution, including

investment income, to the extent it was not used to fund qualifying losses, will be taken into income while the thirtieth year's contribution will be added to the reserve. From the thirty-first year onward, this process will repeat.

When a property/casualty insurer incurs a qualifying loss on property located in New York, it may convert its New York mandatory catastrophe reserve, or a portion thereof, to an event specific catastrophe loss reserve. The insurer is required to provide written notice to the Department within 30 days of any such conversion.

DIFFERENCES FROM PRIOR PROPOSALS

The proposed regulation is substantially similar to a draft written by the Department in October 2007. The significant differences from that proposal are detailed below.

1. In the Statement of Purpose (**Section 111.0**), the new draft clarifies that the underwriting gains from years without a catastrophe that should be retained are “the portion of these underwriting gains generated from premiums being charged to insureds for catastrophe coverage” The new regulation also requires not only that the gains be retained, but that “not be distributed to shareholders or otherwise re-collected from policy holders through the premium on an annual basis.”
2. In the Definitions Section (**111.2**), the new draft adds dollar amounts to the definition of Catastrophe, rather than just relying on PCS designation.
3. New definitions are added to Section **111.2** for “Aggregate catastrophe load,” “Event-specific catastrophe loss reserve,” and “Natural event.”
4. Section **111.3** (Annual contribution to the New York mandatory catastrophe reserve) states that the funding is “net of any federal, state and local income tax incurred on the reserve.” While the prior draft provision in this section specifically stated that the reserve liability was “net of any reinsurance ceded,” out understanding is that the new proposed regulation still operates in this manner as the definition of “qualifying losses” is “net of reinsurance.”
5. Section **111.4** (Accumulation of the New York mandatory catastrophe reserve) states that the reserve shall have a 30-year rolling term. The prior draft had a 20-year rolling term.
6. Section **111.5** (Conversion of the New York mandatory catastrophe reserve) now uses the term “conversion” instead of “transfer” to describe how funds are released and used as a specific loss reserve.
7. Section **111.7** (Agreements with other states) is a new section stating that the superintendent may enter into reciprocal agreements with other states that have similar reserve requirements so that a single reserve may be used to pay losses in multiple states under certain conditions.

RAA ACTION

In October 2007, the RAA filed the attached comment letter on the draft regulation. The RAA comments argued that the proposed catastrophe reserve would have significant unintended consequences and would likely interfere with the way companies underwrite risk and allocate capital. The RAA comments further stated that the proposed reserve was likely to increase market instability and was unlikely to result in a more stable, abundant supply of affordable insurance.

Pursuant to the Notice of Proposed Rulemaking, the comment period closes May 26, 2009. The RAA plans to file a similar letter in response to the current draft proposal. Please provide any comments on the changes to the regulation or the RAA's previous comments to Matt Wulf, wulf@reinsurance.org, by close of business Friday, May 8th.