

# Issue Brief

## Proposed California Reinsurance Regulations are Unnecessary: Proposed Regulation Could Impede Availability to Domestic Insurers

By Christian John Rataj and Milo Pearson

### Introduction

NAMIC and its state trade partner – the Pacific Association of Domestic Insurance Companies (PADIC) – opposes the implementation of proposed regulations regarding reinsurance in California.

The opposition by both groups focuses on four major areas:

1. The proposed regulations are not necessary and offer no appreciable benefit to insurance consumers.
2. The proposed regulations could limit availability of reinsurance to those that need it the most – small, domestic insurance companies.
3. The proposed regulations will most likely increase the cost of reinsurance products for insurance carriers, which would likely increase the cost to policyholders.
4. The proposed regulations could adversely impact insurance carriers' ability to secure reinsurance to handle natural disaster and/or terrorism-related claims.

### Additional Regulations Not Necessary in California

The NAIC has adopted model regulation for reinsurance regulation. A growing body of industry and non-industry experts questions whether additional regulation is necessary.

Regulations are created and adopted historically to resolve an identified problem or to address a potential problem within the insurance industry. There does not appear to be any evidence that insurance company insolvencies are increasing, or at least to the extent that would warrant the adoption of these regulations.

Occasionally, insurance company insolvencies occur. And while some may be related, in whole or in part, to reinsurance transactions, there is no evidence to support the conclusion that reinsurance carriers engage in business practices that would likely lead to insolvency problems and pose a meaningful risk to the primary insurance market. It appears that proposed regulations have been created to resolve problems that do not exist.

The California insurance marketplace is in fine shape with the ample availability of insurance products at competitive prices. Insurance companies pay claims and invest in the California economy. There are administrative mechanisms currently in place within the California Division of Insurance (CDI) to detect and prevent insolvencies that could adversely affect the insurance consumer.

The proposed regulations offer no discernable or appreciable benefit that would merit the imposition of new administrative burdens on insurance companies and reinsurance carriers. Overhead will increase to cover the new expenses created to comply with proposed regulations. The proposed regulations will force insurers to increase rates and/or decrease the level of customer services afforded to insurance consumers to fund these new administrative responsibilities.

### **Proposed Regulations Could Limit Reinsurance Capacity**

Increased regulation of the reinsurance industry in California could create reinsurance capacity limitations. Small, domestic companies would feel these limitations most strongly. Greater regulation, especially *unnecessary regulation*, will force reinsurers to consider whether it makes good business sense to participate in the California market.

If reinsurance carriers start leaving the California insurance market, this will adversely affect the competitive nature of the reinsurance market. The net effect of this will limit the capacity, variety, accessibility and cost of reinsurance. It is also likely to limit the number of policies available for certain insurance products. The irony is that the potential decrease in reinsurance capacity created by the proposed regulations may make it that much more difficult for the commissioner to move forward with his National Catastrophe Program in California. If the National Catastrophe Program is adopted, there will be an even stronger need for increased catastrophe capacity that may be eliminated because of these proposed regulations.

### **The Proposed Regulations May Increase Insurance Costs**

The California Department of Insurance indicated: “costs for reinsurance may increase” due to the implementation of the proposed regulations. Both the state and insurance companies will face increased costs to implement and administer the proposed regulations.

Neither PADIC nor NAMIC has yet quantified the costs, particularly the increased cost of reinsurance. The scope and extent of the economic effect of these proposed regulations, however, while real, is unknown.

The economic burden created by these unnecessary regulations and the increased administrative costs

associated with these proposed regulations will ultimately be paid by insurance consumers in the form of higher premiums.

### **Proposed Regulations Could Adversely Affect the Availability of Reinsurance**

Insurance carriers face increased financial responsibilities resulting from the Terrorism Risk Insurance Extension Act of 2005 (TRIA) along with the widespread natural disaster claims the industry has contended with during the past year. Imposing additional costs through unnecessary regulations could limit an insurance company’s reinsurance options.

As we have learned from recent terrorism events and natural disasters, the professional relationship between the insurance and reinsurance industries must be vibrant with competition to best serve consumers and offer the necessary protection to cover the list of ever-growing insurance realities. Regulation that offers no documented benefit to insurance consumers – like CDI’s current proposals - are unreasonable impediments to market competition in the reinsurance industry.

### **Conclusion**

- If implemented, the proposed regulations will harm California insurance consumers.
- There is a strong potential that the proposed regulations will limit reinsurance capacity in the marketplace, needlessly decreasing the variety and number of insurance products sold in the state.
- Insurance premiums for the consumer will increase due to the increased costs to reinsurance companies and intermediaries, along with the increased administrative costs to implement proposed regulations by primary insurance companies.

### **About the Authors**

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### **Endnote**

This NAMIC Issue Brief is adapted from comments filed jointly by the National Association of Mutual Insurance Companies (NAMIC) and the Pacific

Association of Domestic Insurance Companies (PADIC) to the California Department of Insurance on January 23, 2006.

PADIC members write approximately \$1 billion in property | casualty insurance premiums, almost exclusively in California.

NAMIC has 106-member insurance carriers that write approximately 23 percent of the property | casualty insurance business in the state.