



SUBMITTED STATEMENT OF
JERRY THEODOROU
DIRECTOR, FINANCE, INSURANCE & TRADE
R STREET INSTITUTE

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SUBCOMMITTEE ON HOUSING AND INSURANCE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

HEARING ON
“DIVERSIFYING RISK: THE BENEFITS OF REINSURANCE AND CREDIT RISK TRANSFERS”

APRIL 22, 2026

**JERRY THEODOROU TESTIMONY,
HEARING ON “DIVERSIFYING RISK: THE BENEFITS OF REINSURANCE AND CREDIT RISK TRANSFERS”**

Chairman Flood, Ranking Member Cleaver and members of the subcommittee,

Thank you for holding this hearing and for the invitation to testify. My name is Jerry Theodorou. I am the Director of the R Street Institute’s Finance, Insurance & Trade Program. I have been an analyst of the primary property & casualty insurance and reinsurance industry for close to 20 years. I have researched and written numerous studies and reports on the global reinsurance industry. Prior to this hearing I have served as an expert witness on insurance at hearings held by this subcommittee, by the Senate Banking Committee and by the Senate Budget Committee. In addition, a few months ago I was invited to brief members of the Council of Economic Advisors on reinsurance. My goal in this testimony is to present an overview of the large and complex global reinsurance industry.

We live in an increasingly risky world, with rising frequency and severity of natural catastrophes and volatility extremes in our capital markets and the economy remind us every day that we must manage risks to the best of our ability. Today’s hearing, “Diversifying Risk: The Benefits of Reinsurance and Credit Risk Transfers” sheds light on reinsurance and credit risk transfer as tools that can help manage physical as well as financial risks.

Reinsurance is insurance for insurance companies. Insurers practice sound risk management by retaining risk up to a certain level (retention) and paying reinsurance companies to assume the risk they choose to offload. The act of transferring risk to a reinsurer is known as ceding; the primary insurance company that cedes premium to reinsurers is referred to as a cedant.

The reinsurance industry is global, with hubs of reinsurance companies domiciled in five main clusters:

1. Continental Europe
2. Bermuda
3. United States
4. East Asia
5. Numerous syndicates of the Lloyd’s market

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Close to half of the global reinsurance market is domiciled in continental Europe. The “big four” continental reinsurers – Munich Re, Swiss Re, Hannover Re and SCOR, account for approximately half of the world’s reinsurance market. If the primary insurance industry is effectively the economy’s financial first responder, the reinsurance industry is the market’s shock absorber. Several features of the reinsurance market enable it to maintain stability and support healthy capital positions in insurance markets. These include:

Diversification and Spread of Risk. Primary insurance companies purchase reinsurance from multiple reinsurers. Diversification occurs at two levels. Cedants benefit by reducing their concentration in a particular product or geography, and reinsurers achieve diversification by taking small positions in the risks they assume. Insurers have counterparty relationships with numerous reinsurers. A medium-sized insurance company may have reinsurance relationships with dozens of reinsurers. This achieves spread of risk and mitigates the down side that can ensue when disaster strikes and insurers have all their eggs in one basket.

An illustrative example of reinsurers enabling global spread of risk was seen in the 2004 – 2005 period when there were numerous¹ U.S. landfalling hurricanes. Hurricanes Charley, Frances, Ivan, and Jeanne struck Florida in 2004. And in 2005 the Gulf and Florida were battered by hurricanes Katrina, Rita and Wilma.² The reinsurance industry lost much of its capital paying losses from the disastrous storms. The global reinsurance industry paid³ approximately 61 percent of the losses from the 2005 hurricane season. What is more, 60 percent of the losses from 9/11⁴ were assumed by the global reinsurance industry; and in 2008⁵, close to one-third of insured losses from Hurricanes

¹ “Four Hurricanes in Six Weeks? It Happened to one state in 2004.” National Oceanic and Atmospheric Administration. August 26, 2019. <https://www.noaa.gov/stories/4-hurricanes-in-6-weeks-it-happened-to-one-state-in-2004>

² “20 Years Later: How Hurricanes Katrina, Rita and Wilma Changed Everything.” International Association of Firefighters. August 29, 2025. <https://www.iaff.org/news/20-years-later-how-katrina-rita-and-wilma-changed-everything/>

³ “RAA Affirms Industry can Handle Japan Catastrophe.” *Insurance News*. March 18, 2011. <https://www.insurancejournal.com/news/national/2011/03/18/190528.htm#:~:text=The%20bulletin%20also%20pointed%20out,third%20of%20insured%20losses%20from>

⁴ *ibid*

⁵ *ibid*

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Ike and Gustav were borne by the global reinsurance market. If it were not for the actions of overseas reinsurers, 2005 would have been a financial as well as a physical disaster. The response to the weakened condition of reinsurers from the two back-to-back years of elevated catastrophe activity was entrepreneurial insurance executives creating eight new Bermuda reinsurance companies⁶ to focus on property catastrophe risk. This spawn of the 2004-2005 catastrophes is known as the “Class of 2005.”

Volatility Management. By ceding excess risk to reinsurers, insurers can reduce volatility in their results. Smoothing earnings is especially desirable for publicly-traded insurers, whose investors are made more comfortable in the absence of excess volatility. Reinsurance behaves like a cushion to absorb insurance risk.

Source of Capital. Reinsurance is a source capital for primary insurers. Prudent use of reinsurance liberates capital from being tied up in legacy business with strong capital requirements. It can be a more efficient and reliable capital source than equity or debt raised in the capital markets.

Retrocession. Reinsurers protect their own capital position by purchasing retrocessional reinsurance, which is reinsurance for reinsurance companies. Providers of retrocessional reinsurance include hedge funds and other investors who recognize that insurance risk is uncorrelated to capital market risk.

Incubation. When primary insurers are interested in entering a new territory or introducing a new product, but don’t have voluminous loss experience to guide ratemaking, they typically buy lots of reinsurance protection in order to prevent unexpected adverse financial surprises emerging in the new venture.

Flexible Capital. Buying reinsurance is a more readily available capital source for liberating capital than engaging in equity or debt offerings. Traditional and alternative

⁶ Rupal Parekh. “Bermuda Class of 2005 Awarded Secure Rating.” *Business Insurance*. January 1, 2006. <https://www.businessinsurance.com/bermuda-class-of-2005-awarded-secure-ratings/>

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reinsurance offer a variety of different reinsurance solutions suited to the needs of the cedant.

There are several different types of reinsurance products. The contractual agreements that specify the type of cession and the terms and conditions of the arrangements are known as “treaties.” Large insurance companies typically purchase excess of loss (XOL)⁷ reinsurance, which kicks in when losses exceed a limit stipulated in the treaty. Most reinsurance treaties have a one-year duration, and are renewed annually on January 1⁸. Other key dates beyond the important January 1 date in the global reinsurance calendar when most treaties are renewed, are April 1 for Japanese, Chinese⁹ and Korea risk¹⁰, June 1 for Florida¹¹ hurricane risk and July 1 for North America catastrophe risk.

Smaller primary insurance companies typically purchase quota share (Q/S) reinsurance, where the reinsurer participates on a proportional¹² basis with the cedant. Typically, the smaller the insurer, the more reinsurance it buys to protect its more vulnerable balance sheet.

The balance sheet of the traditional reinsurance market is strong, with sufficient capital reserves to pay for current and modeled future losses.

Credit Risk Transfer

In addition to their role in assuming insurance risk from primary insurers ceded to reinsurers, reinsurance companies also have products for managing credit risk. Among such products

⁷ “What is XoL in Reinsurance?” Allianz Trade.” July 2023. https://www.allianz-trade.com/en_US/insights/what-is-excess-of-loss-insurance.html

⁸ Nataly Kramer. “Japan April 1 Renewals Extend Softer Reinsurance Pricing Trend.” Beinsure. April 7, 2026. <https://beinsure.com/news/japan-april-1-renewals-extend-softer-reinsurance-pricing-trend/>

⁹ L.S. Howard. “Reinsurance Rates Continued Softening During April Renewals, Despite Iran War.” *Business Insurance*. <https://www.insurancejournal.com/news/international/2026/04/02/864470.htm>

¹⁰ Ibid.

¹¹ Taylor Mixides. “Florida’s Property re/insurance market rebounds following tort reform: Gallagher Re.” September 26, 2025. <https://www.reinsurancene.ws/floridas-property-reinsurance-market-rebounds-following-tort-reform-gallagher-re/>

¹² “Proportional and nonproportional Reinsurance.” Swiss Re. August 1, 1997. https://www.allianz-trade.com/en_US/insights/what-is-excess-of-loss-insurance.html

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enabling reinsurers to assume financial risk are credit risk transfer¹³ transactions. Such transactions typically involve government entities (mainly agencies) that have borrower default credit risk on their books.

Credit Risk Transfer (CRT) is a financial mechanism which enables government entities that hold credit risk and have exposure to borrower default to shift default risk to reinsurers. In CRT transactions, a bank (the originator) or a government-sponsored enterprise¹⁴ (GSE), such as Fannie Mae and Freddie Mac, moves the risk of borrower defaults to reinsurers. In addition to the GSEs, other government entities that engage in CRT transactions because they have credit risk include the Small Business Administration, the U.S. Department of Agriculture, the Ex-Im Bank and the Department of Energy, with its energy project loans. There are numerous reinsurance companies that serve as CRT counterparties. These include the big four European reinsurers, Bermuda-based reinsurers, and specialized private mortgage insurers such as Essent, MGIC and Arch.¹⁵ Counterparties that assume sponsors’ risk include hedge funds¹⁶ such as AQR, Citadel, D.E. Shaw and Millennium. Moving the risk of borrower defaults to third-party investors reduces potential losses and capital requirements for the originator. CRT transactions may involve structured securities, credit derivatives, or insurance to transfer credit risk to the capital markets. The CRT market exemplifies how the financial strength of reinsurers allows them to deploy capital to reduce credit risk on government balance sheets.

CRTs were introduced to the market in the wake of the 2008 global financial crisis. At that time homeowner mortgage defaults rose to record levels. GSEs and taxpayers were left with significant risk of large losses. This led to the issuance of securities to transfer a portion of the credit default risk from GSEs to investors. The securities behaved as reinsurance for the GSEs. The transfer of credit risk provides some protection to Fannie Mae and Freddie Mac should there be another housing crisis, while also lowering systemic risk.

¹³ Don Layton. “Demystifying Credit Risk Transfer.” Harvard University Joint Center for Housing Studies. January 21, 2020. <https://www.jchs.harvard.edu/blog/demystifying-credit-risk-transfer>

¹⁴ Don Layton. “Demystifying Credit Risk Transfer: Part 1.” Harvard University Joint Center for Housing Studies. January 2020. https://www.jchs.harvard.edu/sites/default/files/harvard_jchs_gse_crt_part1_layton_2020_0.pdf

¹⁵ Ian Bell et al. “Insurance-Based Credit Risk Transfer: a Resilient Risk-Bearing Capacity Untapped in the EU.” The European Money and Finance Forum.

¹⁶ R.T.Cole et al. “Hedge Funds, Credit Risk Transfer and Financial Stability.” Ideas. Undated

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Reinsurers play an important role in managing insurance risk from natural and man-made catastrophes. They provide property disaster protection by absorbing risk that might otherwise erode significant amounts of insurers’ capital. Without reinsurance, insurance companies are fully exposed to financial losses in the wake of mega-catastrophe events. Reinsurers spread their risk with a variety of products suited for the needs of their primary insurer counterparties. Reinsurance products are complex, requiring deep understanding of risk and how to manage risk tolerance and risk management.

Financial reinsurance products where reinsurers assume credit risk are also sophisticated, complex products requiring substantial expertise. In recent years there have been proposals introduced in Congress to create federal reinsurance entities that would offer reinsurance products at lower than market rates. Such initiatives are ill-advised for three reasons. First, government-provided reinsurance would displace reinsurance provided by the private market. Second, underpriced government reinsurance would undermine economic incentives for risk mitigation by suppressing the transmission of risk-adjusted market price signals. Third, underpriced government reinsurance would force taxpayers with low risk to subsidize those with elevated risk, an unfair cross-subsidization.

Conclusion

The behavior of the reinsurance market following the large disaster toll of 2004 and 2005 is instructive. At that time, it was not the government that provided a way out for a capital-deprived industry. It was the private insurance market and investors who recognized that the primary insurance and reinsurance markets are key players for dealing with risk. Within just six months the Class of 2005 ushered in a new set of players backed by hedge funds and private equity. This demonstrates the agility of reinsurance markets. When disasters threatened to undermine the insurance industry's capital it was the market that saved the day.

Thank you to the subcommittee for holding the hearing. Thank you for your consideration of my views. I look forward to any questions you may have.