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TREASURY'S REPORT TO CONGRESS ON THE TERRORISM RISK INSURANCE ACT (TRIA)

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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TREASURY'S REPORT TO CONGRESS ON THE TERRORISM RISK INSURANCE ACT (TRIA)

Wednesday, July 13, 2005

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 2:11 p.m., in Room 2128, Rayburn House Office Building, Hon. Michael G. Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Baker, Pryce, King, Royce, Kelly, Gillmor, Ryun, Shays, Fossella, Kennedy, Hensarling, Garrett, Barrett, Price, Davis of Kentucky, McHenry, Frank, Kanjorski, Waters, Maloney, Velzquez, Ackerman, Sherman, Meeks, Lee, Capuano, Crowley, Israel, Baca, Matheson, Miller of North Carolina, Scott, Davis of Alabama, Cleaver, and Bean.

The CHAIRMAN. The committee will come to order. Pursuant to Rule 3(f)(2) of the Rules of the Committee on Financial Services for the 109th Congress, the Chair announces he will limit recognition for opening statements to the Chair and ranking minority member of the full committee, and the Chair and ranking minority member of the Subcommittee on Capital Markets, Insurance, and Government-sponsored Enterprises or the respective designees to a period not to exceed 16 minutes evenly divided between the majority and minority. The prepared statements of all members will, of course, be included in the record.

The Chair is also advised that our witness today, the distinguished Secretary of the Treasury, needs to leave by 4:30. The Chair now recognizes himself for an opening statement.

Good afternoon, Mr. Secretary, and welcome back to the committee. We look forward to hearing your testimony today on the Treasury Department's recent report on the Terrorism Risk Insurance Act, or TRIA.

This Nation suffered a series of brutal terrorist attacks on the morning of September 11, 2001. The massive destruction wrought by the enemies of America, including the total incineration of the World Trade Center, caused tens of billions of dollars in damages, and of course, killed over 3,000 people. No one knew how our economy would react in the immediate aftermath of these attacks. The uncertainty that was felt in the wake of that tragic day greatly impacted consumers in the insurance marketplace. Insurers paid out record claims in excess of $35 billion, but industry surpluses were drained, reinsurers withdrew, consumers couldn't get new policies with terrorism coverage, and construction projects with real jobs were being put on hold.

President Bush immediately called on the Congress to pass terrorism insurance legislation to protect consumers and our economy. This committee rose to the challenge, and within 3 months of 9/11, we developed and passed in the House the initial version of TRIA that eventually became law.

TRIA established a public-private partnership with a temporary backstop to protect against future catastrophic terrorist attacks through December 31, 2005.

Reviewing the Treasury's report on TRIA, it is clear that the U.S. economy has recovered quite well from the attacks of 2001. However, TRIA has not encouraged private insurance to return to the U.S. market. In fact, TRIA may be hindering the development of innovative private sector approaches to providing terrorism insurance. TRIA was constructed as a temporary program, and a simple extension to the current program could actually be detrimental to the Nation's long-term economic health. I agree with the Treasury's assessment that we need a new revamped terrorism program. We need a terrorism program that will encourage the growth of private sector capacity, provide for greater taxpayer protection, and reduce the role of the Federal subsidy over time.

This committee has spent the last 3 years studying terrorism insurance and the need for an effective long-term solution. We have held hearings and roundtables, ordered numerous GAO reports, reviewed countless studies, and met with key marketplace regulators, consumer groups, and industry representatives. We know what needs to be done and have a good idea how to do it. My hope is that we can overcome partisan rhetoric to do this in a manner that is pro-consumer, pro-taxpayer, and pro-national security.

I look forward to hearing the Secretary's analysis of the Treasury report and on working together on a revamped terrorism insurance program that will meet the goals in the Administration's letter. I retain the balance of my time, and now yield to the gentleman from Massachusetts, the ranking member.

Mr. FRANK. Thank you, Mr. Chairman. I appreciate your calling this hearing and I appreciate the Secretary's diligence here. To me, the key point comes from the Secretary's testimony; and he says in that testimony—and I know the Administration has a somewhat mixed view on this, but this is a flat statement: "While the immediate effect of the removal of the TRIA subsidy is likely to be less terrorism insurance and higher prices, we expect that, over time, the private market will develop additional terrorism insurance capacity."

I do not think it is reasonable for us to allow a situation in which we will see, quote, from the Secretary, "less terrorism insurance and higher prices". There are specific proposals for change that we are prepared to consider, obviously. You, Mr. Chairman, when the original proposal came forward, made some changes. The level of the co-payments, the deductible, all of those are legitimate to talk about. But I think it is clear from what the Secretary has said that a failure to go forward with this program now would be a grave error.

It is also important that we move quickly. I think it is important to note that in the minds of many of us, the main beneficiaries of this are not the insurance companies but the insureds. The prob-

lem here, I think, frankly, is that a lot of insurance companies will find other things to do. But particularly in some of our bigger cities, particularly where we are talking about the construction of large buildings, the existence of terrorism insurance is important. I will be putting into the record, and I would ask unanimous consent to do that now, a letter from the Commercial Mortgage Securities Association.

The CHAIRMAN. Without objection.

Mr. FRANK. In the letter they talk about the devastating effect the absence of terrorism insurance would have on them. And they note that a number of pension funds have bought these securities and would be negatively affected.

It is also the case of what we are talking about here is the end users, the builders, and that is the reason why we have to move quickly. You cannot, if you are planning to build a large building, wait until the expiration date. We need people to be given the assurance that this program will continue. And it is entirely legitimate to consider whether or not there should be changes. But as I said, I take the Secretary's statement as an indication that at least for the next few years—we can talk about what goes on after that—we need to continue this program. And we need to make that decision very promptly so that the people who are contemplating building can go forward.

And just two other policy points. The Secretary says, and I agree with this, that the macro economic effects are not great, but micro economic effects are very important. This does not affect the whole country equally. There are some parts of the country, as we recognize with our formulas, that are more vulnerable to terrorism than others. There are some parts of the country that will be asked to pay a greater price if there were to be no Federal terrorism insurance. And I do not want to see a burden put on those parts of the country which are more vulnerable to terrorism attacks as we anticipate than others to see that insurance there goes much higher for things that are not their fault.

When we are talking about many of the risks against which we ask them to insure, we are talking about risks that we can ask them to control. But nobody building an office building can do anything about terrorism. This is legitimately a Federal responsibility. And since the deterrence of terrorism is a Federal responsibility, it makes sense to have the insurance be a part of it.

Finally, I just would note that along with the other members on our side who have been very active in this, we have urged that group life be included. And to have terrorism risk insurance that covers buildings and not life would I think be the kind of committee equivalent of the old neutron bomb which killed people and left buildings standing. We don't want to do the reverse of that and compensate for buildings and ignore human lives. As a matter of fact, this Congress recognized the problem there when we passed the program which was well administered by Mr. Feinberg to provide some compensation to people. And there were ways in which we could change it. But it was very important, and it is particularly important for the economic development and health of many of our larger cities that we go forward with this program and that we go forward with it properly.

I would reserve the balance of my time for Mr. Kanjorski.

The CHAIRMAN. The gentleman yields back. The gentleman from Louisiana, Mr. Baker.

Mr. BAKER. I thank the Chairman. We are indeed in difficult days. As we consider the aftermath of the attacks in London, it is clear that the President's leadership in Iraq and pursuing terrorists of every stripe is indeed the right action to take because we know for certainty that at some point they will return.

What is not clear is how we protect taxpayer interest while balancing the necessity to ensure our economic system functions without disruptive interference as a result of a physical assault on our property and lives. This is the difficult balancing act: preserving taxpayer money while not giving it away to businesses whose profit is based on the taking of risk and, at the same time, ensuring that when the surpluses are exhausted and the system can no longer function that the Federal Government steps in at that point to act as a bridge, not as a guarantor of profit, but to ensure the economic function continues without interruption.

We cannot let the terrorists win twice. We know for certain they will come again unless we are successful in the near term in eradicating these evil-minded individuals; they are committed to destroy any free enterprise system they can attack and escape into the dark night.

I think the report is an essential and critical overview of the status of the industry as it is now structured, and I have found much of its content to be very helpful in reaching a better understanding. What is required now is a creative solution, one which calls for balancing protection of taxpayers with the backstop being very far afield where industry resources are deployed and made the most effective utilization, and where I can go to my rotary club in my hometown and say to my taxpayers your money was not put at risk without good reason. And, when the industry returns to profitability, we will get your money back. It will require creative thinking and a new solution. I do not believe we now have that creative solution within our grasp. I am pleased that the Secretary would come here today and give us an explanation as to their findings, and I hope that today marks the beginning of a new effort to determine what that creative solution should look like, and that we can, within a timely and responsible manner, develop legislation for this committee to consider.

Mr. Chairman, I look forward to continuing to work at your direction and with those who are interested in this important matter, because we cannot turn our back on the consequences of another unbridled assault on the American economic system and have the Congress stand by with its hands in its pockets. We have got to find a way to get this fixed. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman yields back. The gentleman from Pennsylvania, Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman. I am pleased that we are finally meeting this year to examine the need to extend the Terrorism Risk Insurance Act. This law is critical to protecting our economic security.

In the wake of the 2001 terrorist attacks, reinsurers, unfortunately, curtailed the supply of terrorism reinsurance, and insurers began to exclude such coverage from policies. Eventually we belatedly approved the Terrorism Risk Insurance Act to address these pressing problems.

Our efforts to address this predicament appeared to have worked. After all, the Treasury Department's recent study on the law found that the program has helped to stabilize our insurance markets. Several other studies have also determined that TRIA has worked to increase the availability of terrorism risk insurance and advance economic development projects.

Last year, we were also able to reach an agreement in the Financial Services Committee to extend TRIA for 2 years and to modestly expand its coverage with group life insurance. Unfortunately, our bipartisan efforts fell short of their goal and that bill did not become law. Nevertheless, I continue to believe that we need to move aggressively now to extend this economic stabilization. Our failure to reach quick agreement on this important issue, according to Treasury's TRIA report, would likely result in less terrorism insurance, higher prices, and lower policyholder takeout.

A recent report by the RAND Corporation also found that TRIA is needed, but because of its gaps it is not robust enough to protect against evolving threats. Another report by the Organization of Economic Cooperation and Development found that private markets are still unable to comprehensively cover the large losses that could result from terrorist attacks.

Despite the Administration's preference against extending TRIA in its current form, last week's terrorist attacks in London highlight the genuine need for us to do so. Terrorism is unpredictable. Many others, including regulators, trade associations, insurance risk experts, and commercial mortgage investors have also called upon the Congress to act expeditiously in these matters in order to prevent short-term market disruptions. We need to heed their wise advice.

In debating any plan to extend TRIA, we ought to work to incorporate group life insurance. These products, after all, have characteristics similar to commercial property and casualty insurance in that there is often an excessive concentration of risk within a small geographic area.

Today, I also hope that Secretary Snow will expand upon the need for the reasonable legal reforms the Administration is requesting in any TRIA extension. I am very concerned that such a posture could once again stall legislative efforts as it delayed consideration of the original law.

I should also point out that, to the best of my account, we have six legislative weeks left in this term. And since we have had this law in effect for almost 2-1/2 years without a comprehensive program better styled to meet the needs and suggestions of the Administration, I am leery of the fact that, within the next 6 weeks, such a comprehensive change could adequately be made.

It would be most unfortunate, in my opinion, that we lolly dolly around over the next 6 weeks and then realize that we are not going to have an extension of TRIA and we are just going to allow it to lapse, to the like of some elements of our society, but I think

detrimentally to most elements of our society. So I look forward, Mr. Chairman, recognizing that time is of the essence, to move quickly. This is not a Democratic or Republican issue, if I may say to the Secretary, Mr. Secretary, I am a Democrat and I represent a working district. My telephone has not been ringing off the hook on this issue. The people I am talking to are commercial developers, investors, insurance companies, and people that generally are associated with your side of the aisle, if I may, sir. But, I assure you that in my position, and I think I speak rather broadly for the Democratic Caucus, that we see the need to get this done.

This, again, is not a Democratic issue and it is not a Republican issue. It is an American issue, it is a business issue, it is an economic security issue. Therefore, I look forward to working with you and the Administration and my colleagues on the other side of the aisle to get something done in the next six legislative weeks. Thank you.

The CHAIRMAN. The gentleman's time has expired. The Chair yields the 2 minutes I had left to the gentlelady from New York, Ms. Kelly.

Ms. KELLY. Thank you, Mr. Chairman.

The recent Treasury Department report confirmed that TRIA lowered premiums and increased uptake rates in cities at risk of terror attack. However, the transmittal letter for the Treasury report indicated that TRIA should only be extended for 2 years. It is an unfortunate reality that al Qaeda operatives and others will likely be plotting against us for many years to come. The recent London attacks also show that insured losses might not be the best indicator of changed conditions in an insurance market. Any change to the TRIA trigger should include casualty trigger so that mass casualty low property loss attacks cannot dry up the provision of insurance for a region or an industry.

I am troubled by the Treasury Department report's assertion that commercial real estate is not a sector of the economy worthy of stimulus. According to the Department of Labor, construction industries will create more than 1 million new jobs in the next decade. According to the President, 15 billion in construction, which stopped after 9/11, was ultimately restored by TRIA. Failing to make a terrorism reinsurance permanently available leaves our economy, our jobs, and our well-being more vulnerable to the designs of the terrorists who hope to destroy our economic strength. I yield back.

The CHAIRMAN. The gentlelady yields back. We now return to our distinguished witness and only witness today, the Secretary of the Treasury, John Snow. Mr. Secretary, again, welcome back to the committee. And please feel free to give your statement at any time you are comfortable.

STATEMENT OF JOHN SNOW, SECRETARY, UNITED STATES DEPARTMENT OF THE TREASURY

Secretary SNOW. Thank you very much, Mr. Chairman, Ranking Member Frank, Mr. Kanjorski, Congresswoman Kelly, Chairman Baker, I appreciated your opening comments.

The issue we face here, it seems to me, is getting the balance right, as risks are shared in a public-private partnership that was

put in place by TRIA in the first place, and now we have an opportunity to see how it can be revamped to better serve its original purposes, which the Treasury Department report, of course, says were well achieved; that this was legislation well designed to advance an important public interest, stabilizing the insurance industry, helping the economy, and providing for coverage that otherwise wouldn't have been there. I think we probably would all agree there.

The question now is, has the market advanced, as we think it has, to a further state of development and maturation where the private insurance industry can play a larger role? Where that sharing of the risks between the private sector and the taxpayers can be shifted a little bit more, somewhat more to, I think, as you were suggesting, Chairman Baker, more to the private sector.

We have seen the private sector expand and play a much more robust role here over the last 3 years. That is the basic conclusion of our report; I think it is the conclusion of the CBO report as well. By giving the marketplace a larger role here, we are confident that coverage will continue to expand, that we will encourage innovation, and we will encourage creativity. We probably all would agree that the private sector should do what it can do, and where it can operate well, the Federal Government and the taxpayer responsibility can recede. That is basically what we are saying here. And we have laid out some areas in which we think the program can be revamped, and can be improved. Raising the trigger point is one. Another is raising the deductibles, raising the co-pays some, and putting in place a stronger litigation environment. Those are the essence of the reforms that we are proposing.

In the aggregate, what they do is build on the model that Congress put in place back in November of 2002, a good model, a model that was then intended to be temporary, a model that was intended to let the marketplace expand and play a larger role. And I think that process should be very much continued with the action that I hope you will take here in reforming the program, revamping it so that we can encourage the most creative and cost effective means of covering terrorism insurance. We recognize the need for terrorism insurance; we want to see it provided in a way that is most creative and most cost effective. And with that, Mr. Chairman, I thank you very much for the opportunity to appear before you.

The CHAIRMAN. Thank you, Mr. Secretary. And we will make your full statement part of the record, without objection.

[The prepared statement of Secretary Snow can be found on page 49 of the appendix.]

The CHAIRMAN. Let me ask you, I notice particularly in the report and your testimony the desire for creating a system that would encourage innovation in the private sector. And I suspect all of us, to some degree or another, share that. What did the Department have in mind as to what type of innovations could conceivably take place in the marketplace? And the reason I ask that is because it was my assumption all along when we were working on the existing legislation, TRIA, that once the market was stabilized and you had this backup from the Federal Government, that the reinsurance industry would become much more active and get back

into the game. Your report indicates quite the opposite, and I have to say that I was in error on that assumption. Is it not the key to this entire exercise to somehow figure out a way that the reinsurers, who, after all, insure the insurers, to somehow come back into this game? Do you have some thoughts on that?

Secretary SNOW. Yes, I do, Mr. Chairman. And I think you have put your finger really on the essence of what the report is dealing with.

The Government occupies the reinsurance role here, primarily. That is the role that Congress gave to the Treasury. And while there has been some expansion of reinsurance particularly among smaller and medium-size insurers to cover their co-pays and deductibles, I don't think the market has developed as robustly and completely and as fully as we would have anticipated or hoped for. And one reason I think there is crowding out occurring is because of the large role, the subsidized role really that the Federal Government plays in the reinsurance world. So as we raise deductibles and co-pays and trigger points, I think that is naturally going to lead to the reemergence of a larger role for the reinsurance industry.

The CHAIRMAN. Would it be, one of the things that we are wrestling with is that very issue, and obviously the committee will want to hear from the reinsurance industry as well as the primary insurance industry just to see what would bring that about. I can understand what you are talking about in terms of raising the co-payment, raising the deductibles and retention levels to the point where you have got a band in which the reinsurance folks can get into. And I guess that is what we are going to wrestle with over the next few weeks to try to do this.

I am committed to delivering a bill to the House Floor this year. I think it would be the height of irresponsibility on our part as legislators to allow the TRIA to expire. I think the potential for damage to the economy is large. I think the President deserves a great deal of credit for his leadership on this issue. And if not for the President raising this to the highest level at the time that we passed legislation, we would not have passed that legislation.

This was historic in that respect. And now that we are in the waning months of this Act, at least from my position as Chairman, I just feel enormous responsibility to move the bill forward. And I am not going to prejudge what it looks like; we will have an enormous amount of input on the part of the committee and a great deal of interest on the part of the committee. But at the end of the day, at least this Chairman is going to deliver a bill. And we want to work with Treasury, we want to work with anybody in the private sector who has some good ideas, but at the end of the day, we are going to mark a bill up, and I think that to do otherwise would be a big mistake from a substantive standpoint clearly.

Let me ask you about one other issue. The approach that Chairman Baker insisted on, which was controversial at the time, which was essentially to provide that the taxpayer essentially be reimbursed for any losses, I think, given the history of this Act, was a very positive step in the right direction. It disarmed a lot of critics that were supportive of the taxpayer and the like, and I think Chairman Baker deserves a lot of credit for being one who really

stuck to his guns on this and ultimately was in the legislation. And I suspect that to get a bill again this time we are going to have to revisit—not revisit, but to essentially go along the same lines that we did before. Has the Department taken any particular position on that aspect of the current legislation going forward?

Secretary SNOW. Mr. Chairman, we think that the recoupment provisions are an important part of the framework that exists, and we certainly encourage the retention of those recoupment provisions and would look forward—let me—back to your earlier comment about wanting to get something done. We certainly do, too, and want to work with you and the committee to see that something happens this year in a timely way, exactly.

The CHAIRMAN. Thank you. And I appreciate that. And I think the thing that the committee needs to understand is a lot of the criticism that went on before, and I think that the gentleman from Massachusetts mentioned specifically, that at the end of the day, this is not about the insurance companies or a boondoggle for the insurance companies, it is all about the economy and protecting against a catastrophic loss. And it just seems to me that, based on past experience, that obligation is pretty well evident.

The Chair has exceeded its time. The gentleman from Massachusetts.

Mr. FRANK. Thank you, Mr. Chairman. I am very pleased and not surprised to hear you say that you expect that we will be able to have a bill. I would say, based on the functioning of this committee, I am confident, given our history, that we will be able to produce a very good bill and maybe we will even get it to the Floor of the House. But I don't want to get too optimistic about what will happen. But I do think we will get this consensus. And, again, we are talking here about the end users more than the insurance companies. And as I said, I agree with the Secretary that it that is not a macro-economic issue, but it is an important micro-economic issue for some segments of our economy.

But, Mr. Secretary, I know there are some people, not yourself, who are just philosophically opposed to the whole notion of the Government being involved here except on an emergency basis. And they say, well, you know, after a while people should be able to get used to this.

Now, I am not a great biblical scholar and I don't want to provoke a controversy, but I do know that the first flood of note happened a long time ago to Noah, and certainly floods are nothing new in our economy. By the logic that says we shouldn't extend TRIA, should we not also abolish Federal flood insurance?

Secretary SNOW. Well, that is not a position we are advancing.

Mr. FRANK. I understand that. But it does seem to me that the notion that we should only do it transitionally and the private market should be able to do it I think is rebutted to me by the notion of flood insurance; that there are some costs that are hard for a human being to avoid. Although I think we on this committee can take credit for a rationalization of the flood insurance program the Chairman and I insisted on and we had a good bipartisan effort and did our best to make it less burdensome, but it does seem to me that it is not new to say that there are some risks beyond

human control, beyond our own control that should be dealt with and I appreciate that.

I do agree we should be dealing with the questions of the co-pays and the deductibility. I have to say to many of us the important thing to do is to get this in place so that the economy can go forward. If we have this kind of terrorism attack, if we do have that kind of disaster, frankly, the level of the co-payment I don't think, is going to be our major concern. In other words, I think the most important thing to do is to get this enacted in a reasonable way so it does not become a hindrance to economic development in the big cities and to the other kinds of things that we are doing.

But I do have one question, on your statement. You do state the Administration supports reasonable performance to make sure that injured plaintiffs can recover against negligent defendants. And I guess no Administration statement or policy on almost any issue would be complete without a denunciation of "unscrupulous trial lawyers". I think unscrupulous trial lawyers is one word in this.

Now, I hope that is not being made a condition precedent to passing the legislation. For one thing, we don't have jurisdiction over it. And I know there are broader issues. I don't think we want to let the tail wag the dog. I mean, whatever debates people have about the tort system, I don't think you say that this is the way that you deal with the whole thing.

So if this committee were to come forward in the bipartisan way we have often operated with an appropriately revised version of TRIA, does that mean, unless there is a considerable rewriting of the tort system in other committees, that this doesn't go forward?

Secretary SNOW. Mr. Frank, Congressman Frank, we hope that the committee, and the Judiciary Committee as well, could do as much as possible to revamp it in ways that strengthen the program. So we want to work with you to do as much as possible.

Mr. FRANK. And this is the obvious, but I think we ought to make it clear. To date, the cost to the taxpayer of this program has been what?

Secretary SNOW. We have not had any incidents under the terms of TRIA.

Mr. FRANK. So zero.

Secretary SNOW. Zero.

Mr. FRANK. And that is the point. The main goal here is to deal with this, to try, to the extent that we can, to neutralize the threat that terrorism poses to important segments of our economy, not to the overall economy. But I think that is what we ought to be clear about. And that is why, this is not some favor we are doing the insurance industry, this is an effort to prevent this threat of terrorism from paralyzing important segments of the economy.

I have one last question. And I mean this quite seriously. A lot of this has to do with the ability of the reinsurance industry to step up. These have not been the best of times for the reinsurance industry these days. Some of them seem to me to be distracted by some other factors. Are they well prepared at this point to make major efforts? I mean, there is some turmoil now going on in the reinsurance industry that we read about.

Secretary SNOW. Congressman, I think that there is more room for them to do more. You referenced theology earlier. I don't view

this as an issue of theology, really, I view it in I think the same way you and the chairman do and others. This is a matter of taking a good Federal Government program that has worked well, and looking at it and seeing if we can make it work better. And I think, until we give the market some more room to operate, we aren't going to know whether it can do more. That is—

Mr. FRANK. But we do go forward with the program, is your general—

Secretary SNOW. Yes, with the revisions we have suggested.

Mr. FRANK. Thank you.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Louisiana, Mr. Baker.

Mr. BAKER. I thank the Chairman. With regard to the flood insurance program, just for the record's accuracy, Mr. Secretary, isn't it true that it is a premium funded program, and every dollar paid out over time has been repaid from premium flow plus interest when a credit was extended and when the funds were deficient? And if we could model a reinsurance program that would ensure the taxpayers that every nickel would be paid back plus interest, this bill would probably get out of committee a lot quicker if we had those kind of guarantees. And I think, at least from my own perspective, one of the concerns is writing a $10 billion check to the industry when they have a $10 billion profit. In my slow—folks like me kind of figuring out that maybe the taxpayers have given insurance executives a little bump when they perhaps weren't entitled to it.

Now, I have a few concerns about information in the report, myself. For example, it appears that there has been more consolidation in the reinsurance industry rather than growth, which leads to some concern; that the trigger levels recommended may be a bit high, particularly in rural or a small community where you would have a $500 million event where you could probably buy most of Louisiana for that. And, if you did, you would take out most of my small insurance operators, which I don't think is the intended consequence.

So there has got to be the screens through which this triggering device sit, as distinguished from a New York City event which could easily exceed the triggers, versus communities which could be significantly dissipated and not get close.

We created this remedy out of whole cloth for the patient we had at the time. What has now happened is the suit is sagging a little bit in a few places and we need to do some alterations. For example, I think the repayment provisions which the chairman was so kind to make reference to could easily be strengthened and give assurances to those worried about taxpayer position that we could absolutely guarantee repayment. What is now contained in the bill is a possibility of repayment should the Secretary decide to assess premiums that are capped in a certain way over a certain period of time. A lot of wheels and spinners. I helped write that, and I think it could be made a lot better.

The thing that I stumbled across and I needed to get an explanation from you, Mr. Secretary, about that I don't know exactly how it fits in the overall view of the Department, but this is the language: Given the small size of nonresidential and commercial of-

fice construction, stimulating this sector would be neither effected or warranted. What does that mean? Does that mean that Treasury has reached the conclusion that commercial property market would remain healthy without a TRIA?

Secretary SNOW. No. What that is a reference to is that TRIA does not seem to be directly linked to the performance of that market sector. Even with TRIA, you know, the market sector has not come back anywhere close to the peak. And even with the good recovery that we have had over the last couple of years, the nonresidential construction industry has lagged. So in the presence of strong economic recovery and TRIA coverage, we have not seen a response there that, while it has grown some 3 or 4 percent, it is not anywhere close to where it was before. That is the only point we were making.

Mr. BAKER. Well, let me follow up. If we were to proffer a proposal which had significant guarantee of taxpayer repayment, some modification of the triggering mechanisms as outlined in the report, maybe some creative retention system that could be altered from the original proposal, wouldn't we be getting pretty close, given the view that something needs to be done but the current plan is not going to be reauthorized as it is, it is not a responsible remedy to the problem as now identified? And there is great interest, I take it, from the Treasury in moving forward, in getting resolution on this before the end of the calendar year. Is that fair?

Secretary SNOW. That is absolutely true.

Mr. BAKER. Thank you, Mr. Secretary.

Secretary SNOW. And we would look forward, Mr. Chairman, to working with you on those ideas and reforms that you suggested.

Mr. BAKER. I yield back.

The CHAIRMAN. The gentleman yields back. The gentleman from Pennsylvania, Mr. Kanjorski.

Mr. KANJORSKI. I am not sure, Mr. Secretary, what we are talking about. Do you see a lapse in the reinsurance business coming into the field? I see that the Reinsurance Association of America has indicated that private reinsurance market is currently only providing $4 to $6 billion of terrorism reinsurance capacity as compared to about $100 billion under TRIA. That is 4 to 6 percent of the field that is being covered by the private insurance industry. Is there a reason that you think that TRIA may be retarding that development?

Secretary SNOW. Well, I do, Congressman. TRIA really has the Federal Government occupying the reinsurance space. It has put the Treasury Department in the position of being a reinsurer and basically subsidizing the reinsurance costs. So that has had, I think, some impediment, some impeding effect on the reinsurance industry. And what we are suggesting is that as the Treasury Department recedes some from that area, still keeping the backstop but recedes some, it will create more room for the reinsurance industry. And it is our expectation then that you would see the reinsurance industry gain more coverage.

Mr. KANJORSKI. So, it is your sense that part of this failure of the private market to fill this vacuum or void that exists is that they need a stimulant in some way?

Secretary SNOW. I think that, as the Government recedes, you will see the private sector move in more.

Mr. KANJORSKI. But in your prepared remarks, you talk about that happening over years. That is not going to happen between the time this law expires and if we don't do something.

Secretary SNOW. No. Over the next few years, if the sorts of changes and reformatting that we have talked about occur, I think you will see, we have full expectation, you would see the reinsurers step up more and take over more.

Mr. KANJORSKI. In the past when we have seen vacuums and voids created in the private market, there have been various theories and methodologies used to stimulate entities filling that vacuum or void. Maybe I could suggest, if we want to stimulate the reinsurance industry in America, let us have a Government-sponsored enterprise take over there to be a Fannie Mae or Freddie Mac of reinsurance. That ought to stimulate the hell out of them. Don't you think?

Secretary SNOW. I am not sure I would want to recommend going down that road.

Mr. KANJORSKI. I don't think there is any difference. I mean, quite frankly, we were frustrated and waited for our leadership to introduce a bill. Although they did not, I think we finally did it in March, and it has been languishing. We haven't had a hearing on it. We have instead been waiting for your report. You know, I leave it up to the experts, Mr. Baker and the Chairman, to fill in the voids. If they want to up the caps, if they want to do some nice things, that is fine.

Now, if they want to make this an engine for tort reform, I think that is dead on arrival. We had that experience under Secretary O'Neill for a year when the Administration decided they were going to use this legislation to do tort reform.

I would just give my own impression. That is not a smart idea. If that happens, I don't think we will see a bill on the President's desk this year. And, quite frankly, I am not sure whose ox is going to get gored, but I don't suspect the Members on this side of the aisle are getting tremendous calls from these people that need terrorism reinsurance for business purposes.

I would just like somebody to take the bull by the horns and let us get the job done. Can we expect you and your Department to have a piece of legislation up here redrafted in such form that can expect to have the President's support for it and that we can move it? Or are you waiting for this committee to draft legislation? Who is waiting for whom to do what as time ticks on?

Secretary SNOW. We are prepared to be of service in any way we can, Congressman.

Mr. KANJORSKI. Then next week we should look forward to a comprehensive reinsurance bill prepared by the Administration that some soul on the other side can introduce as the bill to move through Congress? Is that what you see? Just everybody is saying, "Gee, we are all for it, we are all for it", and time is going. Six legislative weeks remain. That is it.

Secretary SNOW. I accept that. I think the modifications we are suggesting are easily draftable. We would be happy to put a pencil to paper and work with the legislative staff who do the drafting;

they would be better at it than we would. But we could certainly make an effort at it, and would certainly work with you and the Chairman and others to make sure that we do our part to meet this timetable.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from Ohio.

Ms. PRYCE. Thank you, Mr. Chairman. And, Mr. Secretary, welcome to the committee. And thank you so much for all the work that has gone into this.

Let me ask you, Chairman Greenspan testified not long ago that he is not yet convinced that terrorism risk is insurable, and yet you folks at Treasury are calling for reduced Federal participation. I don't think that there is anybody in this room that would disagree that you are both gentlemen of incredible intellect and impeccable judgment, and how could you two feel so differently about this?

Secretary SNOW. Well, I am not sure we do, Congresswoman. I think we both recognize the private sector ought to be allowed to work wherever it has a reasonable chance of working. I think the Chairman would accept that characterization. And in the case of terrorist risks, I think we both accept the TRIA model—that there are risks of such a scale that aren't modelable—and of such size, that it is very difficult at the present time for the private insurance industry to properly assess the risks in order to be able to provide coverage. And that is the TRIA model. All we are saying is that within the TRIA model, we think you can move a little further in the direction of letting the marketplace work.

Ms. PRYCE. Well, let us talk about modeling for a minute. You know, you were very specific in saying that the industry does have big challenges in modeling, and the probability of loss from terrorism is very hard to get our arms around. Why is that so, and what is there to be done? Can we do more to encourage the scientific development of models? Should this be a part of our bill? Is there more that we can do to see this come to fruition, or is it just an incalculable impossibility at this point?

Secretary SNOW. You know, I think in dealing with terrorism generally, we are being forced to confront something we haven't known in this country well before, it is fairly new to us, and it is extraordinarily hard to predict. And since we haven't had a lot of experience with it, I am sympathetic to the problem the insurance industry has of trying to put in predictable models, models of predictable events. I think they are getting better at scalability; they are getting better at trying to figure out, if this happens, what is the overall impact.

But no, I agree with your basic premise here, that the modeling isn't yet developed, and it is a question of how it will develop to the point that we can really assess these things the way you would assess other sorts of risks that insurance companies freely write policies for.

Ms. PRYCE. If we took NCBR out of it, would it be any easier if we made that a separate category?

Secretary SNOW. I think NCBR, given our limited experience with it in the United States, doesn't give us a framework for the sort of modeling that the insurance industry normally would do. I mean, we should be thankful that we don't have much NCBR expe-

rience. It is almost de minimis in this country. And we are going to continue to work through Homeland Security and others in intelligence to make sure it is de minimis. But the fact that it is de minimis is the other side of why we can't do the models to figure out how to lay out the risks more fully.

Ms. PRYCE. I mean, I am not expert by any means, but National Journal did a piece on what would happen if there were a nuclear attack between the White House and the Capitol building, and then laid out scenarios as to what damage—and certainly, I am certain it wasn't very scientific. But if they can get started, I know that there is the technology and the science available. And I just wonder if there isn't anything we as a Government can do to encourage this, to speed up the process. And you probably have already answered me, but if anything comes to mind, please let us know.

Secretary SNOW. I will.

Ms. PRYCE. Thank you very much, sir. I yield back.

The CHAIRMAN. The gentlelady yields back. The gentlelady from New York, Ms. Maloney.

Mrs. MALONEY. Thank you very much, Mr. Chairman.

And welcome, Secretary Snow. As one who represents New York City, I can tell you that, after 9/11, truly the most important action by Government that helped the people was TRIA. Business didn't move, development didn't move, nothing moved until we had the insurance in place. It is critically and tremendously important not only for New York, but I would say every city across this country and county. And I would just like to say, Mr. Secretary, that your report really makes me wonder whether the Administration is talking about the same Nation that I live in. Certainly your report is not talking to the people who run businesses in this country or the insurance industry or even your own terrorism experts.

The Administration tells all of us to prepare for another attack, but you propose to take away our ability to be financially prepared. Your report advocates raising the level at which TRIA would kick in to a point at which an event 10 times the size of September 11th would receive absolutely no TRIA coverage. There is not enough capital in the entire industry to cover an event of that size. In fact, the industry would be severely stressed by an event three times the size of 9/11.

If we as a country do not renew TRIA at a reasonable threshold level, terrorism insurance will simply not be available. You say, oh, go draft a bill, or we will have a bill up there. It is not having a bill here, it is whether or not it is workable, whether or not terrorism insurance will be available. And it will not be available at the threshold amounts in the report. That means that if we have another terrorist attack, God forbid, the taxpayer will bear the full brunt of the cost.

I have been talking to people not only in New York, but across the country about the damage that they would suffer without TRIA, and I think that you should talk to them, also. For example, one of my constituents in New York, Lisa Cramer, is the CEO of FOJP Service Corporation which obtains insurance for several New York City hospitals and medical facilities that provide services, necessary services to literally millions of New Yorkers. She was

planning to be here today, she wanted to talk to you directly, but due to the weather, the planes and transportation was cancelled. But she told me this morning that, after 9/11 and before TRIA was enacted, the property casualty insurance marketplace became an absolute nightmare for these hospitals and medical facilities. Their property insurance limits dropped from $8 billion to only $1 billion, and terrorism exclusions were added to all of the policies.

Pre-TRIA, the only coverage for terrorism losses they could obtain was for $50 million and limits at a premium of $4.2 million. With TRIA in effect, they secured property coverage with full terrorism protection at limits of $1.5 billion and a premium of $1.2 million. Without the renewal of TRIA, the maximum coverage they can secure for terrorism losses will be only $500 million, and the premiums will triple.

That is unworkable. Premium increases of this nature are simply not affordable for these hospitals and, I would say, for any business. Moreover, even if the money could be found, the maximum available insurance limits of $500 million would not be sufficient to replace even one hospital in a terrorist attack.

Mr. Secretary, my question is, what do you have to say to these hospitals and the people that they serve and what do you have to say to my constituents and other constituents across this country?

I have here also today Rick Barne from your State. He is a vice president of Corporate Insurance Management, which is located in Alexandria, Virginia. He has a client that owns and leases about 40 buildings in northern Virginia to the Federal Government and large corporations. Some of these buildings are located at the Dulles Airport.

Based on the scrutiny insurance companies give to these factors, without an extension of TRIA, it will be very difficult for this property owner to find affordable and adequate coverage. He may go out of business and his tenants may have to move.

The CHAIRMAN. The gentlewoman's time has expired.

Mrs. MALONEY. May I just place in the record, if I could, Mr. Chairman, letters that I have gotten, even from your State, Ohio, and Virginia, Mississippi, Louisiana, from people who are bringing to our attention the absolute necessity of reenacting TRIA. If I could, because I think it is very, very helpful to—

The CHAIRMAN. Without objection.

The CHAIRMAN. The Chair now recognizes the gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you.

Good afternoon, Secretary Snow. It is nice to have you back before the committee. We have talked before about antiterror finance policy, which is within your jurisdiction. Given some recent developments, I am going to take the opportunity, if I could, to ask you about something we have been concerned about for some time, and that is the massive amount of funding that terrorists are receiving on a global basis. We have taken some action in Congress, indeed in this committee, where with the PATRIOT Act, under section 311 we said Treasury can impose special measures on a foreign jurisdiction such as a country or a financial institution, and in so doing then section 311 would essentially close any access to the U.S. financial system for anybody so designated.

So I would like to know why Treasury has not imposed 311 sanctions on Syria. In testimony this morning before the Senate Banking Committee, Under Secretary Stuart Levy strongly condemned Syria. I will just lay out his argument.

He said as a serious national security threat and as a state sponsor of terrorism, Syria has been the object of targeted Treasury action for some time. Syria continues to meddle in Lebanon's affairs, allows the Iraqi insurgency to be partially funded and fueled from within its borders, and allows terrorist organizations and supporters to flourish there as well.

At Treasury we are addressing this threat with a spectrum of targeted actions aimed at reversing this course.

Well, as he says, you have issued a 311 against Syrian banks, against some senior Government officials where you have frozen their assets. But when it is clear that the terrorist financing is a systemic issue, as it is in Syria, why haven't we taken action against the entire jurisdiction? That is my question for you today. Why are we holding back on what would seem to be an obvious case for 311?

Secretary SNOW. Congressman, thanks for the support you have given us, and Congresswoman Kelly as well, over the years in these efforts. Syria is troublesome to us, as Under Secretary Levy indicated. We do have the pending 311, and the pendency of the 311 under the Patriot Act has produced some—not sufficient, we are not satisfied—but some actions. We are talking with them now about some other things they need to do, including returning substantial sums of money that belonged to the Iraqi people. We have had some success. They have sent back some and we are hopeful to get more.

Let me assure you we are far from satisfied, but they have taken a number of steps, and I can detail them for you at some other point, if Mr. Levy didn't today send you a note on it, that are in the right direction. Far from all, but they are in the right direction.

It is a situation we are continuing to monitor. We are not at all happy with a lot of their conduct, let me assure you of that. We have had delegations of people from Treasury over in Damascus and are continuing to be in close touch with them. Maybe that is all I should say for the record right now.

Mr. ROYCE. Well, I appreciate that, Secretary Snow. I think it is important that regimes understand that section 311 is a tool that can and will be used. In this particular case, if we do not get some relief in terms of the funding of the insurgency operation there or the allowing of that to be conducted on Syrian soil, as well as a return of the funds, I think—and more transparency in the process—I think it would be quite appropriate. So I wanted to use this forum for an opportunity to have a dialogue with you on that, Secretary Snow.

Secretary SNOW. I appreciate your doing that. Let me assure you, we are working this issue hard. We are not at all happy with Syrian behavior. We have observed financial wrongdoings on their part, including terrorist financing, and we intend to use 311 for the purposes for which you created it.

The CHAIRMAN. The gentleman's time has expired. The gentlewoman from California, Ms. Waters.

Ms. WATERS. Thank you very much. I am sorry I was delayed. We have a markup going on in Judiciary. I am delighted Secretary Snow is here. I know that the presentation that he prepared for today had to do with the terrorism risk reassurance program, I believe. However, I am fascinated with the line of questioning and discussion of my colleague from California.

While he has indicated his concerns about Syria, I suppose I should just share with you that some of us are just as concerned about Iran and just as concerned about Saudi Arabia and just as concerned even about Pakistan, where we have friends. We have just lost I think—I think the number is 20, Congressman Frank just indicated, as we talked about what happened on the border between Pakistan and Afghanistan, that we believe that insurgents and terrorism is emanating from all of these areas. Some we have, I suppose, greater relationships with than others and think we have friendships that will protect us from some of these terrorist acts.

But while we are talking about Syria, let us talk about Saudi Arabia and Iran and the borders of Pakistan and Afghanistan.

What are we doing to ensure that these terrorist acts are not emanating from these areas that is creating more of these problems?

If I may, just a continuation of the discussion you were just having with my friend from California.

Secretary SNOW. Thank you very much, Congresswoman. We are very much engaged with the countries, with Saudi Arabia, Pakistan and others, on the whole issue of terrorist financing. I have traveled to those countries, talked to the leaders of those countries, the Finance Ministers, the Prime Ministers, the ruling family, about our concerns on precisely the issues that you have raised.

In all of those places with whom we are engaged, we are not satisfied, but we are seeing progress. Saudi Arabia has put in much better controls over their charities. They are watching the money that goes through the charities. In Pakistan, they have put in much better rules to deal with the entities they call the hawallas, the money changers.

Ms. WATERS. If I may interrupt you for just a moment, do we know the members of the royal family who are directly involved in funding some of the so-called charities? Do we have that database put together yet? Because much of the money coming from there and to the madrassas are coming from members of the royal family. Do we know that information?

Secretary SNOW. We have some information about the sources of that, and have shared our knowledge, or at least our intimations, with the Saudi leaders; and the Saudi leaders have taken a number of steps against those people.

So this is a continuing effort on our part. We have people located right now as part of this effort in Saudi Arabia working in concert with their antiterrorist groups to identify and go after terrorist financing. And we are going to keep that up. It is very important we keep that effort up. I appreciate your raising it. I agree with you.

Ms. WATERS. Thank you very much. I yield back.

The CHAIRMAN. The gentlelady yields back.

The gentlelady from New York, Mrs. Kelly.

Mrs. KELLY. Thank you.

Secretary Snow, one of the questions we ought to consider in approaching this is why should the war on terror be treated differently from previous more traditional wars where the Government reimburses for damages inflicted by the enemy? I think we all realize that we are in a fight to the finish against a dedicated enemy.

In World War II, the Government didn't expect private insurance to pay the costs associated from enemy attacks on our soil, and I know that we all feel that defeating terrorism is no less important than defeating the axis powers. Surely we would not expect the private insurance industry to protect us if we thought that we would be attacked by an enemy with an organized military. We really need to ask ourselves what is different about this situation today.

When the TRIA law was passed in 2002, we didn't know half of what we know now about the enemy and its resolve. We all now acknowledge that the war on terror will be with us for a long time. It is a long-term war, and I firmly believe that we need a long-term solution to the terrorism insurance problem that is going to provide our economy with the stability to keep on growing and protect our citizens and their businesses from catastrophic loss when another major terrorist event occurs.

According to your transmittal letter, the report was based in part on surveys of the insurers and policyholders that were developed after extensive consultations with the National Association of Insurance Commissioners, policyholders, the insurance industry, and other experts in the insurance field.

Secretary Snow, this committee has also taken testimony from each of these groups, and none of them support the conclusions of your report. Which agencies have more expertise on insurance? The States, who have been regulating insurance for more than a century, or seven employees of the Treasury Department who do not administer any other insurance program?

Your transmittal letter states that the Administration only supports extension of TRIA if taxpayer exposure is minimized. Ironically, the Federal Government, including the Treasury, does not include any costs associated with terrorism risk in the budget. As a part of your commitment to lowering taxpayer risk from terror, will you begin submitting a reserve request for potential terrorism losses within your own agency to protect taxpayers?

Isn't it unfair to expect American taxpayers to pay the costs associated with self-insuring the Treasury Department? That is the question.

Secretary SNOW. That is the question? Well, that is about six or seven by my count.

Mrs. KELLY. That is okay. You can answer them.

Secretary SNOW. Let me try and give you a general response, because your question, really as I sense it, goes to the quality of the study. I think it is a good study. It is a study that was done in full cooperation and consultation with the insurance industry. They in fact helped shape the very questions that we presented to both the industry and to the users.

Nobody here is talking about ending that backstop. What we are talking about is, as I have tried to indicate, is revamping the TRIA

program in a way that it gives some more room for the private sector to operate.

Congress has left open in the very TRIA legislation events above the $100 billion level as something they would return to surely, hopefully, in consultation with whatever Administration would be in place.

So no, I don't think that is the issue. The issue is can we make some improvements in the program to give the private sector a somewhat larger role to play; and as long as the Government is playing such a large role in occupying the reinsurance space, it just stands to reason that the reinsurance industry will not be as vigorous as otherwise would be the case.

So this is an effort just to get to the middle of the road and find a balanced solution here.

Mrs. KELLY. Mr. Secretary, when you talk about letting the industry take more of a role, that is only going to be passed on to the consumers, whatever the costs are, and that is the taxpayers. So I again go to my question about how we are going to help the taxpayers afford terrorism insurance.

Secretary SNOW. Actually, Congresswoman, if our reforms are accepted, the policyholders would bear more of the obligation.

Mrs. KELLY. Exactly my point, sir.

Secretary SNOW. You said taxpayers.

Mrs. KELLY. The policyholders are taxpayers.

Secretary SNOW. They are not in their capacity as policyholders. They are taxpayers in their capacity as citizens. This is an effort, as I say, simply to modify the program in ways that give the private sector more room. I doubt you would disagree with me on the broad proposition that if the private sector can do it, we ought to allow them to do it.

The CHAIRMAN. The gentlewoman's time has expired.

The gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you. I would like to make just a couple of opening observations. One of those is that as terrible as a massive terrorist attack is, a natural disaster can have an equivalent economic impact, and I hope we are not only going to deal with the uninsurable or unreinsurable risks posed by terrorism, which are new and exciting, but that we also deal with the equivalent need for reinsurance or re-reinsurance by the Federal Government for massive disasters that are natural disasters. This has nothing to do with the fact that Northridge is in my district.

Second, we should not be waiting to the last minute, which is what we always do. This law is going to expire December 31st. If you had to predict the outcome, it would be we are going to extend TRIA the day before we leave town for the year.

Now, if we do that, we will have the same costs. The gentlewoman from New York was saying, hey, maybe there is a burden to the taxpayer. If we extend TRIA today or do it at end of the year, it has the same costs, but it doesn't have the same benefits.

Right now there are people thinking about huge projects, projects that would employ a lot of people, projects that might get somebody to wonder, well, will that be a terrorist target? Some of these projects aren't going forward because people are saying, well, of the

many concerns we have, there is not going to be terrorism insurance.

So every day that goes by that we don't extend does nothing to reduce the costs or disadvantages of extending TRIA, but diminishes the benefit. And the chief benefit is we want people building towers even larger than those that stood in southern New York, whether those be in Los Angeles, Chicago, or elsewhere. We want people to feel they can build something exciting and get insurance for it.

Mr. Secretary, as I understand TRIA, and may be reflecting, the policyholder is not getting something for free. There is a premium that the Government charges. Is that either the case now or in the proposed changes that you would make?

Secretary SNOW. Congressman, TRIA does not require the insurance companies to pay a premium, but it does give the Treasury Department the authority to recoup some portion of the Federal payments in the event of an event; to do a subsequent assessment, I think it is 3 percent a year on policyholders thereafter.

So there is a recoupment process. But you are correct that right now there is a subsidy that is being made available by the reinsurance, because Treasury is not charging anybody for it presently.

Mr. SHERMAN. Now, we have seen what happened in London, which underscores what happened on September 11th. In light of the continuing and evolving threat, and given that the reinsurers are apparently not providing much terrorism reinsurance, are you concerned that the insurance market could become more dysfunctional than it was after September 11 if we fail to renew TRIA in some form?

Secretary SNOW. Congressman, we are clear on this one. With these reforms, you would have a better product and we support doing it.

Mr. SHERMAN. And if we did nothing, could we, starting the beginning of next year, or perhaps starting after the beginning of next year when TRIA expired and there was some other terrorist action, huge or medium-size anywhere in the world, could the combination of TRIA being allowed to expire and even a new terrorist act—as if we have forgotten the old ones—cause the insurance markets to become even more dysfunctional than they were after 9/11?

Secretary SNOW. I would urge you to adopt the reforms and move the legislation.

The CHAIRMAN. Does the gentleman yield back?

Mr. SHERMAN. I yield back.

The CHAIRMAN. The gentleman from Connecticut, Mr. Shays.

Mr. SHAYS. Mr. Secretary, I like you. I don't agree with you on this position. I am not sure where your position is, because it is that you don't support it but you will help us write a bill. I guess what I am sensing from you is you are not advocating that we do a bill, but if we are going to do a bill you wanted to help us write it. Is that what you are really saying?

Secretary SNOW. No. Our view is that we support the reforms. We support revamping the program, because we think by revamping it we will create better coverage. We will enlist the private sec-

tor in ways that are more creative and cost effective in covering the risks, and with the reforms we are for the extension.

Mr. SHAYS. So the bottom line is, though, that you would like us to write the bill and your folks will work with us?

Secretary SNOW. We will work with you, yes.

Mr. SHAYS. Fair enough. Let me ask you, it would strike me that a general principle would be that we would ultimately want to wean the insurance industry from Government guarantees, but that we would have them over a fairly long period of time build up reserves but still make policies fairly affordable.

Is that the logic to this program? In other words, I spent 8 years focusing on terrorism, and what I see is that attacks are more likely in the future, and more devastating, and the consequence of chemical, biological, even nuclear attacks, is not out of the question. So it is not like in the future there be less attacks, it is more likely there will be more attacks as I see it.

So is the point to just have them start to build up reserves over time?

Secretary SNOW. That would be a piece of it. But another piece of it is to give the industry, which is quite innovative and capable, and the marketplace generally—

Mr. SHAYS. I don't know how to interpret innovative. It seems kind of basic.

Secretary SNOW. The modeling, getting a better assessment of things through the modeling, seeing if financial facilities develop securitization and other things that offer some opportunity here. I am not saying they will be there, but if we don't create room for them, we will never know.

Mr. SHAYS. Let me ask you, though, if you own an insurance comapny or you are managing one, running it, you are the CEO, without some guarantee from the Federal Government, aren't you playing Russian roulette with your company, because you may find that there is such a potential for devastation that you basically—your company goes under because of your unlimited liability?

Secretary SNOW. Congressman, insurance companies will not put more than X amount of their surplus in jeopardy. I agree with you. That is the way the insurance industry operates. What that means is if more than X would be put in jeopardy by writing a set of policies, for terrorism risk insurance or whatever, they won't write it.

Mr. SHAYS. If policies are not written, do you think mortgages take place and banks are willing to—

Mr. SNOW. Remember, the TRIA structure stays in place. The Government under the reforms that we are talking about, the revamping, the backstop is still there. We are talking about way below the backstop trying to get more reinsurance being provided through the private market. So the backstop structure is still there.

Mr. SHAYS. It just strikes me you are basically asking the industry to put up all their reserves.

Secretary SNOW. No, we would not. That would not be prudential. Far from that. In fact, the very point of study—and your question is taking me right to the heart of the study—is that the insurance industry has developed substantially more reserves now, but there are limits on the amount of reserves that a well-run, pruden-

tially run insurance company will make available, and that is how the insurance industry must function and should function.

Mr. SHAYS. Let me just say, my last question is what happens if TRIA expires January 1st without a replacement bill? That is my question. And my point to you would just be that I know you well enough to know—and your Department—that you will be working with this committee, and hopefully that will not take place. But I will ask you, what would happen if it did?

Secretary SNOW. I think the best thing is to follow the course that you are suggesting and I am suggesting, and I think the Chairman is suggesting, and that is to adopt the suggestions and move forward with the legislation.

Mr. SHAYS. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Secretary, I am a little bit confused. Let me just pick up from what was just stated. You say adopt. I have the confidence, as Mr. Frank indicated earlier, and Chairman Oxley, that we will come up with a strong bipartisan bill that is coming out of this committee.

Now, you seem to say that you want us to come up with a piece of legislation that you have written, adopt it, and make it law. What if this committee comes up with some recommendation as to how it feels the TRIA law should be, and then it comes to the Administration? Will you then say we must then have a bill so we can have it signed by January 1, that we don't have the expiration of TRIA? Or will you say no, it has to be as we want it, as we have proposed it?

Secretary SNOW. Well, I would hope there would be a good dialogue. There has been a good dialogue on a lot of other issues with this committee on both sides, and I would hope we continue to have a good dialogue, good set of understandings.

Let me assure you, Congressman, we know that you write the legislation, not us. And I have been asked to testify to offer our views on what a good outcome might be, and that is all I am doing, is giving you our sense of what a good outcome might be. But I fully understand that you are going to write the legislation and factor our recommendations in as you think they merit attention.

Mr. MEEKS. Now, in your recommendations and your testimony, one of the things I am trying to decipher—in questions to Ms. Kelly, for example—are you concerned at all about what the cost of terrorism insurance, the bottom-line cost for the policyholder is? You said they are not—she said they are citizens. You said it differently. But the cost that it would come—that the policyholder would have to get terrorism insurance, are you concerned about that at all?

Secretary SNOW. Absolutely. Cost and availability are the two things we looked at in the study. So they are both very important. Because if there isn't availability, there won't be the take-up rates that ought to occur, and if the price is too high, there wouldn't be the take-up rates. So availability and price are the two determinants of coverage.

Mr. MEEKS. You keep referring to studies you have had, but what I have been able to decipher, the studies and individuals I talked to, if we go in the direction the Administration would like us to go to, the cost would become prohibitive for many individuals, affecting—and I think this is what Mr. Sherman was talking about—in a lot of the markets, a lot of the economic development projects we currently have going on.

We talk often that we can't let terrorists and terrorism win. One of the reasons why they attacked New York—and a lot of other major cities are focused on this—they want to go after us financially and our economy.

When they talk about TRIA, we are really talking about a program where we should be coming together as a Nation, as opposed to ending it and saying, as I believe was stated, that the continuation of the program in its current form is likely to hinder the further development of the insurance market by crowding out innovation and capacity building.

I don't see how that is so. I think even while we are working here, innovation and the markets and everyone is working together so that we will not allow the terrorists to win. We are in Iraq now, spending a whole lot of taxpayer dollars, when a lot of taxpayers did not want to be there in the beginning.

Secretary SNOW. Well, look, I agree with you on the basic premise as I hear it, and that is we have got to protect the homeland. That is the first line of defense here.

I talked to Secretary Chertoff this morning on that very score. Of course, we put a lot more money into homeland security, and developed this comprehensive national strategy for homeland security. That is the first line of defense, good strong, homeland security initiatives, investigating terrorist activity, good intelligence on terrorist activity, bringing the whole government together to focus on it and the global community as well.

Mr. MEEKS. So you would agree with me—

Mr. SNOW. I agree the first line of defense is strong homeland security.

Mr. MEEKS. You agree it should be the priority of the Administration to make sure that we work and that you work closely with this committee to make sure that we do not allow TRIA to expire prior to January 1st.

Secretary SNOW. I think we ought to work to reform it in the way that I have suggested, because by doing that we are going to have a better TRIA. We are going to have a set of policies in place that encourage a more creative and cost-effective means of covering terrorist risks.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. Thank you, Mr. Secretary.

I don't know if I can do it justice, but President Reagan once said something along the lines of one of the closest things to eternal life on Earth is a Federal program. I, for one, on behalf of the taxpayers, hope I am not witnessing that today with TRIA. Having said that, we know all the obvious implications of 9/11, the tragic loss of life, the incredible blow to the economy, that we have done,

frankly, a very good job under this Administration of recovering from.

I believe that TRIA played a role in that recovery. I just don't want to see the taxpayers on the hook forever.

In your written testimony you state that TRIA has been effective in meeting its goals of supporting the industry during a transitional period. So to me that is really the key question: What is going to constitute this transitional period? I, for one, don't believe that 3 years is quite enough. I don't know if 6 years is too much. It is kind of like Goldilocks and the various porridges.

So what does the Administration believe is an ample transitional period?

Secretary SNOW. Well, Congressman, I share the sentiments you have expressed there. I think a couple of years' extension would help us understand better the situation. Over the weekend I read this recent OECD study on terrorism insurance and threats of terrorism in Europe, and it is a very thoughtful study. What they basically recommended was maximizing the role of the private sector, using the Government as a backstop, and continuing to evaluate it and not, in effect, making it a permanent program.

So it seems to me a couple of years, if we had it for a couple more years, we would be in a position to evaluate and have a better sense of where to go from there. But it was not intended, as you know, to be a permanent program. It was established as a temporary program.

Mr. HENSARLING. In your written testimony you also allude to the progress the industry has made since the enactment of TRIA and its capacity to write terrorism insurance. You didn't really elaborate upon that in your oral testimony. Can you elaborate a little bit more on what improvements we have seen in the market?

Secretary SNOW. Yes. One, we have seen the surpluses in the industry have gone up quite dramatically. Of course, it is the surpluses that determine how much insurance they will write. Underwriting profits, which were negative in 2001 and 2002, turned positive in 2004. The capital base of these industries has gone up a lot because back in 2001, then 2002, the equity markets took a big hit. Now the equity markets are much, much stronger. Economic growth for the economy has been much, much better. Unemployment rates have come down.

Then when you look at the industry statistics or metrics themselves, the take-up terrorism rate, which was in the mid-twenties in 2002, is now over 50; 54 percent as I recall.

The share of insurers who were pricing insurance, making it available with prices, has more than doubled over that period from some roughly 20 percent to the mid-fifties.

Policyholder costs, that is as a share of premiums, has gone up from about 1.2 percent to 1.7 percent, something on that score. But the policyholder cost in the high-risk cities has come down, which is interesting.

So overall we see a better insurance picture than we saw back then.

Mr. HENSARLING. I see in your testimony there has been some question about the Administration position on the extension. I see where you state that you are hoping the extension of the program

would recognize the temporary nature of the program, the rapid expansion of the private market development and the need to significantly reduce taxpayer exposure. In the seconds that I have remaining, I could not agree more, Mr. Secretary.

I yield back the balance of my time.

The CHAIRMAN. The gentleman yields back. The gentlewoman from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. Mr. Secretary, studies show that small businesses, even those located in high-risk cities, are taking up terrorism insurance at lower rates. The Treasury report supports this notion that as firm size increases, firms are more likely to have terrorism insurance. Often small businesses cite the high cost of policies as the reason for not purchasing it.

If small businesses are unable to afford coverage, they may move to lower-risk areas, leaving many downtown urban centers devoid of the economic vibrancy that they are known for.

On page 7 of your report, Treasury states: "Overall our assessment is that the immediate effect of the removal of the TRIA subsidy is likely to be less terrorism insurance written by insurers, higher prices, and lower policyholder take-up."

Clearly, letting TRIA expire will not help small businesses secure the insurance they need. If small businesses are unable to secure terrorism insurance, particularly those located in high-risk cities like New York, what effect might this have on economic development in downtown urban areas?

Secretary SNOW. Congresswoman, thanks for that good question. Small business, of course, is at the center of our economy. We need to make sure small businesses continue to thrive. What we are saying is that with the reforms, with the reforms, we think that there would be more creative and lower-cost insurance available, because the reinsurance industry, which is being crowded out now by the Government program, would come into play.

A lot of small businesses, according to the study, even though it has been available under TRIA, have not taken the terrorism insurance, making a judgment I guess that they aren't at great risk; others do. That is a normal sort of market set of choices.

Ms. VELAZQUEZ. Well, I have a lot of small businesses in New York City, especially in my district. They border Chinatown and they border the area of the World Trade Center. I have met with them. We do a lot of hearings or meetings with them. And that is not what they are telling us. They are telling us that is it is the cost that is making it impossible for them to get their insurance that they need.

Secretary SNOW. You are saying the cost with TRIA today?

Ms. VELAZQUEZ. Yes.

Secretary SNOW. I think we can probably do better as we go forward with the modifications that we are suggesting.

Ms. VELAZQUEZ. Sir, what will you do, or the Federal Government, to increase the affordability of terrorism insurance for small businesses?

Secretary SNOW. Oh, I would let the market work more.

Ms. VELAZQUEZ. It is not working now, even with TRIA.

Secretary SNOW. That is the very point I am making. There would be more room for the market to work if we had the Government recede some and let the reinsurers and the insurance business play a bigger role here, if we in effect cut back on the Government role.

Ms. VELAZQUEZ. I also want to follow up on Mr. Frank's question on flood insurance. The Federal Government has frequently interceded in insurance markets, offering the Federal Crop Insurance Program and the National Flood Insurance Program, providing deposit insurance and implementing the Price-Anderson Act, which then insures against nuclear accidents. These are just a few instances.

Given the Administration's opposition to TRIA, does the Administration plan to oppose other Federal insurance programs? Explain to me why the justification for these programs are different than for that of TRIA.

Secretary SNOW. Well, Congresswoman, as I have been careful to try to explain, with these reforms that we are suggesting we will make the program stronger, and then want to urge you to move forward and adopt them and keep the program in place with these reforms.

Ms. VELAZQUEZ. Thank you.

The CHAIRMAN. The gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Thank you, Mr. Chairman.

Mr. Secretary, is it your goal for the Federal Government to be out of the insurance business, out of this entirely, and if so, what is your sort of game plan for that?

Secretary SNOW. Go back to the original TRIA. It was intended to be a temporary program to serve an important need for a period of time. The evidence, as indicated in our report, is pretty clear that TRIA has been helpful. We have seen the surpluses rise, we have seen coverage rise, we have seen take-up rates rise. That is all positive.

Now we are at the point of asking ourselves can we improve the program? Not eliminate it, but improve it. Because it is really important that we get—you weren't in when Chairman Baker talked about this, but get this balance right—maybe you were—between the sharing of the risks.

Mr. MCHENRY. I was.

Secretary SNOW. The risks between taxpayers and private industry should be balanced. It is our view that giving private industry more room to operate, they can share more of the risks, reduce the risks on taxpayers, and actually it is our view they will probably get a better product over time. We want to keep that process going.

Mr. MCHENRY. What is your time frame?

Secretary SNOW. Well, as I said, a couple of years' extension would seem to me to be reasonable.

Mr. MCHENRY. Why not a simple extension of what we have now?

Secretary SNOW. Because I think we shortchange the taxpayers with a simple extension. We shortchange taxpayers and we also, frankly, shortchange the capacity of the insurance industry to perform at a higher level.

Mr. MCHENRY. Okay. Now, in terms of in the past, certain States have said that you must make available—well, certain States, it is said that you have to make available the backstop. Let me rephrase this.

Under the current TRIA program, there is a requirement that companies make available coverage, coupled with a Federal backstop, to help make coverage more affordable. What would the new program do in those terms?

Secretary SNOW. It would, as we are proposing it, those components would remain the same.

Mr. MCHENRY. The exact same as we have?

Secretary SNOW. We would cut back some lines, we would reduce coverage on some lines, but change deductibles and copays. But that sort of model, framework, template, would stay in place.

Mr. MCHENRY. Have you thought about the ramifications with insurance packages, where you have Workman's Comp, you have commercial property insurance, but when you are eliminating lines like automotive and general liability, that increases the costs in the marketplace by not having that Federal backstop.

Have you considered the ramifications for how that transition is going to occur, the effects it is going to have on the market?

Secretary SNOW. Yes, that is the subject of the study. We concluded that those additional lines that you mentioned aren't subject to the sort of aggregation risks, like auto insurance, that are really not the appropriate subject for TRIA, and that is why we called for cutting back coverage on those lines. But we don't think other than that it would have a far-reaching effect.

Mr. MCHENRY. And this is my final thought or final question. With what just happened with the terrorist attacks in London, there is a lot of concern about the soft targets, not just on infrastructure being targeted, but on the soft targets. How is this new program going to encourage take-up rates when it comes to especially soft targets, that sector?

Secretary SNOW. Well, I have talked to the people in London. Our condolences go out to them, and concern. They have handled it well.

A London-size event, as devastating as it is, is not large relevant to the capacity of the industry to handle it.

Mr. MCHENRY. But in terms of increasing the take-up rates when we are talking about soft targets, just generally speaking, aside from the events that occurred in London—

Mr. SNOW. You mean like subways? This is a subject I mentioned earlier, a discussion I had this morning with Secretary Chertoff. It is clear the terrorists are looking for soft targets. They are looking for the things that they think aren't sufficiently protected or that are hard to protect, like subways. And our response has to be to toughen up our security processes on those targets. I think that is the better way to get at this; it is the only way ultimately to really get at it. That is partly intelligence gathering, it is partly surveillance, it is partly more security at the facilities. It is a whole range of things.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from California, Ms. Lee.

Ms. LEE. Thank you, Mr. Secretary, for being here today. I apologize for being late due to another conflicting meeting. I am trying to review your testimony very quickly. A couple of questions I have with regard to your testimony which I am not sure have been answered in this.

First of all, clearly we all agree, I think, that the risk of terrorism is very real and we must ensure that coverage is available. However, I wanted to get some specific dollar amounts in terms of just what the taxpayer subsidies have been since TRIA has been in effect. I am not sure if your testimony gives us that dollar amount.

What have the American taxpayers provided?

Secretary SNOW. Well, to date, fortunately there have been no incidents that are coverable under TRIA, so the direct outlays have been, as Ranking Member Frank said, zero; the direct outlays. But, of course, there is a potential cost that is there, which constitutes, in effect, a subsidy to the industry.

Ms. LEE. What, though, in terms of the reinsurance, what are your projections though?

Secretary SNOW. I don't think we have quantified that to any satisfactory degree, to be honest with you.

Ms. LEE. Just in terms of evaluating legislation, I would like to know what we are looking at, what your estimates are. I think taxpayers deserve to know that, should they have to do this, what they would be required to pay.

Secretary SNOW. Well, we can give you the math on that. That is pretty straightforward as laid out in the statutory framework itself. The Government is on the hook for a sizable amount of money over the deductibles and copays that would take you to the $100 billion cap. So there is a portion that would be retained by the industry and there is a portion that the Government would pay, and then there is a recoupment. I will send you an example that lays that out. That we know.

What we don't know is the year-in/year-out hidden subsidy that the program costs. Not to any high degree.

Ms. LEE. That will be very helpful. Some would suggest looking at the riot reinsurance program of the 1970's. I am not sure if you have had a chance to look at this. Some would say this is an example of how we should modify TRIA as we begin to reauthorize it.

Secretary SNOW. Thank you. I don't know that we have done that, but I will ask the staff to take a look at it.

Ms. LEE. Thank you very much, Mr. Secretary. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Staten Island.

Mr. FOSSELLA. How is that for a dramatic introduction?

Thank you, Mr. Chairman. And thank you, Mr. Secretary, for coming.

Let me just state for the record, as has been said, that TRIA has worked. It has been effective in stabilizing and allowing our economy to move forward. There are many people, I know, especially in New York City where I am from, of all shapes and sizes, all political views and ideologies, from "the government has no role" to "the government should do everything in life," who all agree, I

think, that TRIA has served its purpose. I do think it has to be renewed in some way.

You mentioned the fact that the take-up rate has almost doubled in the last couple of years, and I can appreciate your desire to try to stimulate more private sector involvement and minimize the exposure of the Federal Government. But how can you determine that take-up rate will at least continue at the current rate, at a minimum remain at the status quo, and not be adversely affected if the Government does pull out or change the formula or implement some of the reforms as you have suggested?

Secretary SNOW. Congressman, that issue is dealt with in the study. The market has developed well and it is our sense that as we give the reinsurance market, which hasn't developed as well, more room to operate—in other words, reduce the subsidy some—that the private market would play a bigger role.

It seems to me it is hard to argue with the fact that the subsidy crowds out some of the reinsurance that otherwise would be there. So it is the conclusion of the Treasury experts who ran the study that we would have a larger role for the private sector if we reduced the subsidy somewhat. We are not eliminating it, of course; we are just giving the private sector a somewhat larger role. But we are not eliminating it in any way in our proposal, the backstop or the fundamental structure of TRIA.

Mr. FOSSELLA. Along the same lines, earlier you said there were impediments, or at least you indicated if you implement some of the reforms, the policy rate premiums would come down. Just for the record, what are those impediments that are in place that prevent the policy rates from coming down right now?

Secretary SNOW. Well, I am not sure the rates will come down if we go forward, because the rates today, of course, reflect the subsidy, and we are proposing to narrow the subsidy. But we don't think there would be any material effect on coverage and rates. And over time, I think as we allow the private sector to play a bigger role here, including the financial sector, that we would expect to see innovations that would result in better products and better pricing and better coverage for the marketplace.

It is our trust in the markets, fundamentally.

Mr. FOSSELLA. I appreciate that as well.

Before I yield back, I think it was said earlier, let us not get ourselves in a position of putting all of us at too much risk, and God forbid another attack occurs a year from now or 2 years from now and we indicate that maybe we moved too fast in implementing some of the reforms. I believe in the market myself, but I see at some point in time it is appropriate for the Federal Government to step in and Congress to step in to provide that stability to the marketplace that is essential.

I yield back. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman yields back.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Secretary, I actually agree with I think virtually every general policy statement you have made today. I totally agree that, if possible, in a perfect world the Government should have no role in private insurance, and I think that is what I have heard today, and that is a great thing.

But, however, like many things I find in Congress, it is really not about the general policy goals that we have problems, it is about how we get from A to B. And I guess, just for general ideas, do you agree, do you believe that, God forbid—and I guess all of today is based on the premise that we may some day have another accident. If we all agree that we would never have another accident, we wouldn't be here today. So, God forbid, we have another event, a horrendous event in America. Do you agree that the United States Congress and the current Administration, probably every future Administration, is likely to be able or be desirous of considering Federal Government involvement either through reinsurance after an event just like we did after 9/11? Do you think that is a positive and a likely occurrence?

Secretary SNOW. Congressman, I think we have to continue to be focused on the issues of terrorism and use every means in our disposal to deal with it. It starts with the protection; the back end of it is in case a terrorist event that we don't want to see happen does happen. And all we are saying here is that, as you consider extension of TRIA, we suggest adding these reforms.

Mr. CAPUANO. I understand. I don't want to get into word games with you because that is not what I want to do today. I happen to think that it was the right thing for this Congress and this Government to be involved in the aftermath of 9/11, and I would argue that any time we had another terrorist event we should be considering that. Not that we always want to do it, but that it is a likely thing. I think the American people think that it is a likely thing. I think that businesses think it is a likely thing and the average person thinks it is a likely thing. And my expectation is that, since President Bush was so upfront after 9/11 in support of Government action, I would assume that he would be similarly situated in, God forbid, another situation.

For me, based on that belief and on the presumption that that is your belief and the Administration's belief, we are really not talking about anything here other than how do we get there. And TRIA, we all agree, was temporary. And you have discussed, you mentioned shortchanging taxpayers. But the only way we shortchange taxpayers is if there is an event. If there is no event, nobody gets shortchanged; nothing changes.

So, for me, between now and the time we actually come to a conclusion, we have to concern ourselves with two parts. I mean, I agree with you and the reason I want to echo the statements made earlier, the chairman's comments earlier about having a bill out, I agree. I look forward to working with him on it. And I think there is a good chance that we will do it. However, if there isn't, I also think we have to be honest about it. And if—the worst-case scenario is nothing. Under the situation of nothing, there is no backstop for anybody.

The second worst-case scenario, I think I agree with you on many situations, is a simple extension of TRIA. However, I also, with some of the things I have heard today, make me concerned about whether we can actually get to an extension or a modified extension of TRIA. Number one is the things that Mr. Kanjorski mentioned; namely, the games that might be played that have nothing to do with insurance on so-called tort reform and other things. But

I also want to comment very specifically on your proposal on the $500 million.

Now, I fully admit that when we did triggers, as far as I was concerned most of the numbers were just guesses. They weren't based on anything. Was your $500 million based on anything, or was it just a more educated, updated guess?

Secretary SNOW. Well, this isn't science, of course. There is no logarithm you can turn to to get the answer to that question. But it is more than a hunch or a guess. We look at the $500 million as a threshold that is high enough that it will reduce unnecessary Government intrusion into the marketplace and create the opportunity for more private solutions while maintaining broad coverage. And in doing this, arriving at this number, we had lots of consultations, Congressman, with members of the industry. This reflects those conversations and consultations with them and looking at their own retention rates—and I won't go into all the details—their own statements of what they think the market can bear.

Mr. CAPUANO. Mr. Secretary, again, I have no specific argument with the $500 million number because, again, to me it is just at the moment something pulled out of the air and I would like to hear more about it. But the reason I ask is because now and the time we have to renew this bill we have to come up with a real number. If it is $500 million, so be it. But for the sake of discussion, I don't think anybody here would argue that the London incident was an act of terrorism. I don't think anybody would argue that the Madrid train bombing was an act of terrorism, that Oklahoma City was an act of terrorism, and that Pan Am 103 was an act of terrorism. None of those would exceed $500 million. None of them. Not even all together would they exceed $500 million.

Now, and the reason I point this out is because, again, a number pulled out of the air is very good, and if it statistically backed up, fine. And $500 million is not some number. But I would argue that the question that really should arise is what is it that we really think is a threshold number, a trigger number for the type of event that we want to get. And I personally, at least sitting here without any further additional information, would argue that any of the items we just—that I just mentioned and probably many more would certainly rise to the occasion of me as a Member of Congress wanting to consider whether we should take action and therefore should be below a trigger that we might put into TRIA. Again, I understand.

The CHAIRMAN. The gentleman's time has expired.

Mr. CAPUANO. But I would just point that out as a point of information as we go through the discussion.

Secretary SNOW. While I acknowledge this is not a scientifically verifiable number, it is a number that reflects the best thinking of the Treasury experts who arrived at it, and with which I concurred after consultations though, Congressman, with a lot of people in the industry and looking at their own retention rates. And I think it is a reasonable number and we can debate it, we can discuss it.

The CHAIRMAN. The gentleman's time has expired. The Chair would indicate that the Secretary does have to leave in 25 minutes, so we will try to move through the questioning as quickly as possible.

The gentleman from New York.

Mr. CROWLEY. Thank you, Mr. Chairman. I will try to be as quick as possible.

Let me thank Mr. Capuano, Mr. Israel, Mr. Frank, and Mr. Kanjorski for helping to move at least on this side of the aisle some of the issues. And I just want to clarify for the record, the phone has been ringing off the hook in my office and I am from New York City and it is representative of both sides of the aisle, so to speak. And I do recognize the interest here that this is not a red or a blue issue, this is a red, white, and blue issue and one that needs to be addressed.

It just harkens me back to an old adage of, albeit a nuance to it, of: If it ain't broke, fix it. That is kind of what I am getting from you, Mr. Secretary. On one hand you are saying what is taking place with TRIA was something that was good and it is a good thing that happened, yet we have to fix it. And I am not so sure that I just sort of come at it from that avenue. I look at it from the point that it has been effective, it has worked, it has been able to enable tenants with cities like mine in New York to continue to operate—and I am talking about corporate America—to continue to operate and therefore employing a lot of my constituencies, therefore employing a lot of the taxpayers that work in those industries and ancillary industries.

The whole discussion before about the exposures of taxpayers or shortchanging taxpayers, when I point out that zero taxpayer dollars have actually been used from the, God forbid, an account after a terrorist attack, I mean, the whole thing here is about we hope that this never happens again, albeit we see what happened in London. We know that they have their intentions on doing something again, and unfortunately, I don't think we can wait. I don't think the terrorists are going to say, well, let us let them figure out how to deal with the long-term exposure with the threat of terrorism. They are not going to give us that luxury. Therefore, we have had this last 2-year period, and what we are looking for is an extension so that the industry itself can come to some conclusion in conjunction with Treasury, in conjunction with the committee in both Houses to come up with an overall final solution to the problem.

I will just ask quickly, what is your time limit? What do you perceive as being the time line that is necessary? I know you mentioned a couple of years. But specifically what do you see laid out in that period? And group life. Again, I think what Mr. Frank talked about before, we are going to cover property but not lives themselves. We know that the Victims Compensation Board did an admirable job. Is that how we are going to move forward in the future if, God forbid, there was another terrorist attack?

And before you answer that, Mr. Chairman, I would like to yield the balance of my time to the young lady from Chicago, Ms. Bean.

Ms. BEAN. Thank you, Congressman Crowley. Thank you, Mr. Chairman. Thank you, Mr. Treasury Secretary, for being here today. I just wanted to follow up on a point expressed by my colleagues Maloney and Capuano regarding the increase to $500 million as the trigger. I don't think you got an opportunity to necessarily respond to Congressman Maloney earlier. And certainly

Congressman Capuano talked about several other incidents that would not have been covered. At $32 million, even 9/11 wouldn't be covered. How can you say to areas like New York or Chicago—I represent a suburban district of Chicago - that you are really providing a viable backstop?

Secretary SNOW. You heard me describe how the $500 million came about, consultations with industry representatives, looking at current retention levels that they are able to put in place. The recognition that we have had over this last 3 years, much higher take-up rates have been observed. Even as the program's deductibles have gone up as required in the statute—you recall the framework or the statute is every year the deductible goes up. Even in the face of that we have seen these sorts of numbers I recited earlier indicating that coverage in take-up rates have broadened. So what we are seeing here is the insurance industry maturing, developing, probably doing better modeling, better assessments, and putting itself because of its stronger financial position in a better position to offer the very coverage that we want to see them offer.

Ms. BEAN. Thank you very much. I yield back the balance of my time.

The CHAIRMAN. The gentlelady yields back. The gentleman from New York, Mr. Israel.

Mr. ISRAEL. Thank you, Mr. Chairman. Mr. Secretary, thank you for your patience. Mr. Secretary, one of the things that we do very well around here is to snatch defeat from the jaws of victory. We had a victory on TRIA in the last Congress. There has been a lot of talk today about working out some differences, reaching consensus, developing a bipartisan approach with the Administration. Been there, done that. It happened in the last Congress. We were on the suspension calendar. We were a couple minutes away from a vote on a product of consensus from this committee, and then it got pulled at the last minute. Mr. Capuano, Mr. Kanjorski and I have introduced a bill that is very similar to the bipartisan product of consensus that was approved in this committee in the last Congress, and I really am hopeful that we can work together with the Administration and get something done that makes sense in this Congress.

Let me just ask you a question about process, the process by which you formulated the report. My district is about 50 miles from Ground Zero, and I hear regularly from the real estate community, from the insurance community, from the financial services community that they are exceedingly nervous about what will happen not if TRIA is not extended, but what is happening right now, what the trends are right now. Exclusion clauses are already being written into insurance contracts. Premiums are already becoming unaffordable for proposed developments next year and the years after. Instability has already set in against the uncertainty of a Federal role. It seems to me that the reality that I am hearing from the marketplace in my congressional district and near my congressional district doesn't necessarily square with the data that is reflected in your report.

One of the questions I have with respect to that data and that process is, at what point did you stop taking economic data from the various experts? In other words, and specifically, was second

quarter data included and reflected in the report that was submitted to Congress?

Secretary SNOW. The data I am advised ran through February of 2005. So it might not reflect some of these sentiments that I assume reflect uncertainty about the future of the program. Congressman, if you are suggesting that uncertainty is the enemy of well functioning markets, I agree with you. Business people need to have a sense of certainty in order to make market decisions. So, you know, I have said it over and over again, I hope we can move forward with these reforms to the program that we started with the opening comment by the Chairman on.

Mr. ISRAEL. Just so I make sure I am clear. Any submissions of data from various experts after February that may have reflected a growing uncertainty or more up-to-date trends were not able to be included—

Secretary SNOW. We did not—

Mr. ISRAEL. Fair enough.

One final point if I may, Mr. Chairman. You know, we have heard a lot of talk about taxpayer liability and the cost of TRIA to the taxpayer. Mr. Secretary, I appreciate your candor and honesty as a matter of common sense that there has been no cost to the taxpayer of TRIA. There has been some talk about how the Federal Government doesn't have an answer to every program; there is not a Federal program that can help every problem. I agree with that entirely.

I would say that in addition to national flood insurance, you know, we have a wonderful crop subsidy program. It is costing the Department of Treasury $19 billion this year to subsidize the agricultural industry not to grow crops. Now, I don't know how you can defend subsidies from the Federal Government in order to keep crop prices high but say there is no role for the Federal Treasury to play in not helping to create a backstop for insurance to keep premiums and consumer costs low.

Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. CROWLEY. Would the gentleman yield for just a moment?

Mr. ISRAEL. I yield to the gentleman.

Mr. CROWLEY. Mr. Chairman, if I could just ask, I am also hearing from industry about the timing of this; that if policies are not issued—or the sense that there is going to be a TRIA next year, that policies be issued in October of this year and not in December of this year. Is that something that the Secretary is aware of as well in terms of the timing of getting legislation passed?

Secretary SNOW. I am aware, having gone through the exercise here a year ago, that timeliness with respect to where this is going to go is very important to the industry, yes.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Kentucky.

Mr. DAVIS OF KENTUCKY. Thank you, Mr. Chairman.

Mr. Secretary, I would like to follow on your remarks just now on the comments of a sense of certainty, which is one aspect I think that is important to cover. Certainly in the September 11th attacks, one of the clearly articulated but I think culturally misunderstood aspects of the attacks were a goal to disrupt our economy, damage the financial markets as well as making a profound

visual statement and inflicting pain on our Nation. TRIA concerns me very much in the sense of not opening a window of additional vulnerability, knowing that there is a backstop of some kind of place to instill confidence in the markets.

I have a couple of questions along these lines. Are lenders now requiring that developers have terrorism coverage on new properties like large shopping malls and office buildings?

Secretary SNOW. Do they take an interest in whether they have them or not?

Mr. DAVIS OF KENTUCKY. I know many do take an interest. But as a—

Secretary SNOW. Yes.

Mr. DAVIS OF KENTUCKY. Basis of requirement for lending.

Secretary SNOW. In some cases, yes.

Mr. Davis of KENTUCKY. If that is the case, and I guess my question would be is if TRIA is not extended in some proactive form, what would be the consequences for these lenders and developers in what might be targeted or in—that is a bad choice of words—in, say, high-value structures?

Secretary SNOW. It would very much depend on the performance of the industry and the absence of TRIA, of course, and how much capacity it would have. What we are calling for is of course reforming the system, revamping it, making it more effective, and allowing the private sector to play a bigger role, and I think if we do what we are suggesting that we would see the private sector respond and we would get higher take-up rates even as the deductibles in the retentions go up.

Mr. DAVIS OF KENTUCKY. Do you feel, just as a final point, that were TRIA not extended do you think that lenders may determine that the risks are too great, that they would call loans early if insurers are unable to extend coverage?

Secretary SNOW. Congressman, I have not had a chance to assess that issue as such. It would be hard for me to be getting inside the minds of the lenders to give you an informed answer on that.

Mr. DAVIS OF KENTUCKY. Perhaps if one of your staff has a chance, I would be very appreciative if they might share a perspective on that question.

Secretary SNOW. Good. Thank you.

Mr. DAVIS OF KENTUCKY. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman yields back. The gentleman from North Carolina.

Mr. FRANK. Mr. Secretary, we have three more members—if you could promise us an additional 5 minutes, we have some of our most conscientious members who have been here throughout this. So I would ask for 5 minutes indulgence.

Secretary SNOW. Thank you.

The CHAIRMAN. I thank the Secretary. The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Secretary Snow, I support the extension of TRIA. I cosponsored the legislation in the last Congress and voted for it in this committee, and I have cosponsored the legislation in this Congress. But I have a concern about TRIA that no one really has expressed today, and that is the effect that it has on the market encourage-

ment for private sector preparedness. It appears to me that heavily subsidized reinsurance tends to undermine, to weaken the private sector encouragement for preparedness. And obviously some, a great deal of what we have to do to prepare for terrorist attacks is on the Government side. It is intelligence, it is law enforcement, but also some of it, a lot of it has to be on the private sector side as well.

The 9/11 Commission report said that 85 percent of our critical infrastructure was in the private sector. It said that witness after witness told us that, despite 9/11, the private sector remains largely unprepared for a terrorist attack and concluded that private sector preparedness is not a luxury, it is a cost of doing business in the post-9/11 world. It is ignored at a tremendous potential cost of lives, money, and national security.

Mr. Secretary, I was intrigued to read an article in the Boston Globe earlier this year, February 22, that said that the Department of Homeland Security was looking at using insurance or encouraging insurers to push private sector preparedness, and said the basic idea would be to have the Government or each industry develop a minimum set of security best practices, and then insurers would audit companies for compliance with those standards with the power to reduce premiums for those who comply.

That seems to be contrary, to be inconsistent with TRIA as it is now written, but it also is not anything that is included in the Department's, your Department's recommendations. What has become of those recommendations? Do you know, Mr. Secretary?

I was pleased to hear that you were speaking to Secretary Chertoff this morning. I hope you all talk all the time.

Secretary SNOW. Congressman, my testimony and the report I think both stress that one reason for the reforms or revamping changes that we are suggesting is to give the private sector more incentive to do mitigation. I think there would be mitigation, I think there would be adaptations that we don't see today because TRIA is there with the reinsurance. So absolutely I think the incentives for mitigation behaviors would be much stronger in the sort of environment we are suggesting be created.

Mr. MILLER OF NORTH CAROLINA. Was the only thing that you proposed to do to kind of ratchet back the extent of reinsurance, or are there other specific—as this article seems to suggest, that the Homeland Security Department is considering other specific measures to encourage—

Secretary SNOW. The Homeland Security Department, of course, is dealing with a lot of that in their consultations with individual industries. My old industry, the transportation, railroads and ocean shipper companies and barge lines and truck lines, which is my business, they are working with them to do just that.

Mr. MILLER OF NORTH CAROLINA. Right. I am happy for that. But what are they doing other than encouraging it? I want them to encourage, but are they—

Secretary SNOW. Well, there are consultations. They are pointing out risks.

Mr. MILLER OF NORTH CAROLINA. Great.

Secretary SNOW. They are pointing out—

Mr. MILLER OF NORTH CAROLINA. There is not any regulatory requirement?

Secretary SNOW. Not that I am aware of. But in my days, I remember Tom Ridge calling me and saying, "John, you have got to worry about this and worry about that."

Mr. MILLER OF NORTH CAROLINA. And is there any effort that is going to come from this Administration to try to encourage the insurance industry to differentiate in premiums based upon the level of preparedness?

Secretary SNOW. Well, the insurance industry itself has a huge incentive to do that if we let the marketplace play a bigger role. Because that is what insurance does. I mean, if you have got a brick house, your fire insurance policy is lower than if you have got a tinder wood house.

Mr. MILLER OF NORTH CAROLINA. Your testimony today with respect to the liability system—and I read that the way that Mr. Frank did, that the phrase "allow unscrupulous trial lawyers to profit from a terrorist attack" basically means you are going to ratchet back the civil liability system. I am sure as both the holder of a law degree and a Ph.D. In economics, you are aware of the wealth of economic theory mostly by conservative economists like Milton Friedman and Richard Posner that the civil liability system is a market mechanism to push preparedness. Are we not, if we protect ill-prepared, slothful private sector entities from the liability for the losses that come from their lack of preparedness, that we are going to undermine the market encouragement for preparedness?

The CHAIRMAN. The gentleman's time has expired. The Secretary may respond.

Secretary SNOW. That is not our intention.

The CHAIRMAN. The gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much. Thank you, Mr. Secretary. It is good to have you here. I represent the Atlanta, Georgia, metro area which is of course like so many other major cities in this country, but certainly its uniqueness being the center for headquarters for the Centers for Disease Control, the world's busiest airport, we have got real brand name companies like CNN and Coca Cola companies which terrorists—have been known to be on terrorists' targets. So we are very much concerned about this issue with TRIA.

I think the issue that concerns me is the phase of your testimony dealing with opening up the private markets, the markets would be more attainable in saving the taxpayers money and so forth. But I think our primary concern here is to understand the nature of our situation in this war on terror, homeland security being a Homeland Security, national security issue. So there is a primary responsibility for the Federal Government to make sure that our safety and security is at stake.

For the very nature of your moves and the tools that you are advocating in the reforms concern me. While you are saying we will, I think your conclusion is that we will move ahead with TRIA, but when you mention that you want to increase deductibles, you want to increase copayments, you want to do away with liability, you want to kick the auto insurance out, you don't want to include group insurance, and then you want to raise the trigger from $25

million to $500 million, that is like shooting holes in a ship and then putting it on out to sea. I mean, there is enough there to sink it before you even move.

In good times, when you use those figures, and the insurance company, insurance industries use those tools, deductibility, the copayments, but based upon some level of certainty, the two major issues we are faced with, with this new entity we are faced with in terror is the mass, the huge uncertainty, number one, of the events, and, number two, the hugeness of the cost. We are talking about billions of dollars. So I am concerned that, with your tools that you are using in terms of encouraging the free market to come in place, given the nature of our problem. I don't believe, I don't agree with you and maybe you can share this with me, that our insurance industry has the capacity to even deal with a problem of this magnitude. And so I am concerned that we move with caution as we revamp TRIA and that your remedies might be too drastic and could have a negative impact.

Secretary SNOW. Congressman, thank you for those observations. The insurance industry of course, as you know, writes policies based on the surplus that they have relative to the size of the risk that they are undertaking. Our study was careful to look at that critical set of relationships and concluded, as you know from the study, that insurance provision beyond some level was beyond the capacity of the individual private insurer. So we are agreeing with you.

What we are proposing here is take TRIA, use that framework, but revamp it some. And I don't think we are revamping it in a way that does damage to the ability—in fact, quite the contrary, we are revamping it in a way that encourages the ability of the marketplace to bear more of the risks. And as the implicit subsidy—there is no payout of any subsidy, but as the implicit subsidy gets reduced, it is going to expand the role for the private sector. And I think that even as the copays go up and the deductibles go up, we will see the take-up rates continue to rise because that is precisely what we have observed in the last 2 years as under TRIA those deductible levels have gone up.

But as I said earlier in response to questions with Congressman Frank, I agree with you, this isn't theology, this is a matter of trying to find a reasonable set of answers to how these risks should be shared between private sector and taxpayers.

Mr. SCOTT. Why wouldn't we adjust it and revamp it going forward based upon the most obvious need that is coming to us? For example, we know now that one of the—

The CHAIRMAN. The gentleman's time has expired. You may finish up your question.

Mr. SCOTT. If I could finish my point, is that this war on terror, the types of attacks are changing as we speak. The one thing that we learned about London is evolving is that these were not folks coming in or foreigners, they were citizens who were living there, they were young people who committed this. Loss of life is paramount in terms of infrastructure. Given that new phenomenon, why wouldn't we want to include group life insurance, for example? Why wouldn't we want to include them?

Secretary SNOW. Well, this again is a matter that Mr. Frank has raised with me. You will recall, the original TRIA statute passed in November of 2002, directed Treasury to look at group life and consider whether it should be included, to do a study and conclude. And you gave us two criteria. Basically, the two criteria were availability of insurance and availability of reinsurance. We found that there was an insufficient availability of reinsurance, but we found that insurance itself was generally and widely available. So we didn't meet the statutory test and therefore we did not feel that group life should be included. And we are at that same position.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Alabama, the cleanup hitter for today's activities.

Mr. DAVIS OF ALABAMA. Thank you, Mr. Chairman. To be as respectful, Mr. Secretary, of your time as possible, I am going to ask you three questions and then ask you to respond to them and try to move as quickly as we can so you can go home or go to your next meeting.

The first question I suppose relates to the whole premise behind the report from Treasury. The whole premise is that the market is slowly engaging in a series of correctives over the last several years and that you are confident that these correctives will continue without an extension of TRIA in its current form. My first question would be a fairly basic one. How much of the market's readjustment is itself linked to an expectation that TRIA will be renewed in its current form? That would seem to be a reasonable possibility to me. And a lot of the readjustment that is occurring is against a backdrop of Congress doing something that you seem to oppose is question one.

Question number two, this is a very real concern that I have about the event limit being raised to $500 million. There is every reason to think, unfortunately, that the strategy of al Qaeda or whatever passes for al Qaeda now will be to shift toward suicide attacks on soft targets, and that al Qaeda may very well have in its capacity, in its mindset an ability to start doing the kind of pinprick suicide attacks that are common in the Middle East, that were last week in London, and that these kinds of things could be done 4 or 5 times a year if we are unlucky. If we were to raise the event coverage to $500 million, given that a London scale attack, even though New York or Washington would fall way short of that, and any single limited suicide type bombing would fall well short of that, what about the possibility that we would enter this very uncertain environment if we raise the level to $500 million where there could be repeated attacks in the United States, none of them anywhere near the Government's backdrop but yet rising uncertainty in the market because of this new rhythm of attacks? That strikes me as a very real worry.

And finally, Mr. Secretary, the third point. If I understand your position correctly, you are not one of the theologists on this issue who believe that the Government just shouldn't be involved as a backstop. You reject that premise. You are for an extension provided event coverage is expanded. I am concerned given that stance about some of the language in the report that has been issued. One of the sentences in your report states, "We do not believe that the

elimination of the Federal terrorism risk reinsurance subsidy is likely to have a discernible macroeconomic impact or effect."

There are other sentences to the effect that expiration of TRIA will still lead to a continued instance of the market developing additional terrorism insurance capacity.

I am concerned, and I think you might want to be concerned, too, about some people taking some of the broad conclusions in this report and using it as an argument against any TRIA extension. The majority leader, frankly, in a talk that he gave several months ago questioned whether or not the Government should inject itself into the market in this manner and suggested that you could not have any extension of TRIA without doing real violence to the market.

So given the fact that you favor an extension of TRIA, are you not concerned that some of the language in this report could very well be used by someone like Mr. DeLay who doesn't agree with your opinion? Those are my three questions.

Secretary SNOW. I will leave it to Mr. DeLay to figure out how to use our report, and I will sit down with him and tell him what we think it says.

On your question about—and I think it is a good question, it is an important question about continuing series of small-scale attacks. I am just back from Europe, and that is a very real concern that is very much on the mind of European authorities. Under our proposal, the backstop would stay in place because it is an aggregate loss of $500 million. So it would cover a series of small attacks—five attacks at $100 million would aggregate to the trigger, if all were related.

Mr. DAVIS OF ALABAMA. But September 11th with 3,000 dead, and there was about $32 million. You would still be way short if you had a series of pinpricks.

Secretary SNOW. Billion you mean? That was $33 billion.

Mr. DAVIS OF ALABAMA. Right.

Secretary SNOW. So it would be way over the number here.

You know, the $500 million, we can debate the $500 million. As I have said over and over, this is a best judgment. Sometimes all you can do is render a best judgment because there is nothing else to return to.

Mr. DAVIS OF ALABAMA. What about the first question? I don't want you to miss the first question.

Secretary SNOW. The first question, which had to do with has the take-up rates been influenced by the fact that there is an expectation of TRIA being, as I got it right, being extended. Maybe to some extent, yeah. I think there is a sense in the marketplace that TRIA will be extended. I think that is something that we would acknowledge. And to save time, I think there is a case to be made, a good case for the sorts of changes that I have called for.

The CHAIRMAN. The gentleman's time has expired.

Mr. FRANK. Mr. Secretary, briefly, and I really appreciate your time, just two points. One, when we talk about what happens if we do or don't and whether or not—but this is one case where I think we need to do a dynamic model and not just a static one. That is, again, my conversations have been to a great extent with some of the end users. And it is not just a case of, well, if a given amount of construction goes forward, will there or won't there be insurance.

What I am concerned about is that the volume will go down, that the insurers will be out of it.

Secondly, I just want to make a philosophical point that is kind of important. And it is a philosophical point that justifies I think a continuing Government role. With regard to insurance—Mr. Miller's question raised this—we do want to put some substantial part of the burden on the insured so that the insured can take steps to avoid the problem. It is an incentive to do better. Terrorism for us today is a largely external threat against the United States based on people who dislike us, who hate us, who unfairly want to victimize us. To the extent that we put the entire burden of insuring against terrorism ultimately on those who would be the victims of it, I think that is philosophically not justified. This is not a case where people are victims because of their own misdeeds. This is a case where a certain number of Americans because of where they are and what they do may be bearing the brunt of attacks based on anti-Americanism in general. To that extent I think there is a philosophical justification for socializing the risk and to some extent through taxpayers; that is, people in the big cities, people who are particularly likely to be targets I think are entitled to some burden sharing because that is where it comes from.

The CHAIRMAN. The Chair wishes to thank the Secretary once again for his valuable time and sharing it with us. It was a most helpful hearing, and the Chair wants to continue to work with the Secretary and his very able folks at Treasury to craft an answer to this situation.

The committee is adjourned.

[Whereupon, at 4:40 p.m., the committee was adjourned.]

A P P E N D I X

July 13, 2005

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Hearing on the Department of the Treasury's Terrorism Risk Insurance Report

July 13, 2005

Good afternoon, Mr. Secretary, and welcome back to the Committee. We look forward to hearing your testimony today on the Treasury Department's recent report on the Terrorism Risk Insurance Act, or TRIA.

This nation suffered a series of brutal terrorist attacks on the morning of September 11, 2001. The massive destruction wrought by the enemies of America, including the total incineration of the World Trade Center, caused tens of billions of dollars in damages. No one knew how our economy would react in the immediate aftermath of these attacks.

The uncertainty that was felt in the wake of that tragic day greatly impacted consumers in the insurance marketplace. Insurers paid out record claims - in excess of $35 billion dollars – but industry surpluses were drained, reinsurers withdrew, consumers couldn't get new policies with terrorism coverage, and construction projects with real jobs were being put on hold.

President Bush immediately called on the Congress to pass terrorism insurance legislation to protect consumers and our economy. This Committee rose to the challenge and within three months of 9-11 we developed and passed in the House the initial version of TRIA that eventually became law. TRIA established a public-private partnership with a temporary backstop to protect against future catastrophic terrorist attacks through December 31, 2005.

In reviewing the Treasury's report on TRIA, it is clear that the U.S. economy has recovered quite well from the attacks of 2001. However, TRIA has not encouraged private insurance to return to the U.S. market. In fact, TRIA may be hindering the development of innovative private sector approaches to providing terrorism insurance. TRIA was constructed as a temporary program, and a simple extension of the current program could actually be detrimental to the nation's long-term economic health.

I agree with the Treasury's assessment that we need a new, revamped terrorism program. We need a terrorism program that will encourage the growth of private sector capacity, provide for greater tax payer protection, and reduce the role of the Federal subsidy over time.

Congressman Joseph Crowley
Statement – TRIA hearing
July 13, 2005

- I want to begin by thanking Chairman Oxley and Ranking Member Frank for holding this important hearing today on the issues that affect our nation's economic security

- I also want to recognize Mr. Frank's leadership on this issue, as well as the leadership of Rep. Israel, Kanjorski and Capuano in developing legislation to extend TRIA for another 2 years.

- Unfortunately, time is running short and I hope this hearing will kick this Committee into high gear to quickly mark-up legislation to extend TRIA, recognizing both some of the critiques of the Treasury Department as well as the needs of the market, and the need to include Group Life Coverage, as we should protect not only the buildings but the people in them

- The Terrorism Risk Insurance Act, passed in 2002, allowed for the re-issuance of terrorism insurance to private enterprise, allowed for the financing of new construction projects and provided coverage to thousands of businesses who wouldn't have insurance without it

- It was vital and we all agree on this point

- As Howard Mills, the New York State Insurance Commissioner has stated about TRIA, 'the nation's current economic strength is in large part due to the federal backstop put in place by TRIA,'

- He continued by saying, 'The removal of that type of protection could return the insurance market to the uncertainty experienced in the aftermath of September 11, 2001.'

- The Treasury report also states that the creation of TRIA 'was meant to address any market disruptions and ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk, and to allow a transitional period for the private markets to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses, while preserving State insurance regulation and consumer protections.'

- And the report goes on to say that TRIA has been effective in meeting its goals of supporting the industry during a transitional period and stabilizing the private insurance market

- Later, the same Treasury report states that the 'immediate effect of the removal of the TRIA subsidy is likely to be less terrorism insurance written by insurers, higher prices and lower policyholder take-up.'

- I agree with all of the above. TRIA has been a success, and without TRIA, our country will see serious market disruptions, like we saw in the months after 9-11 when there was no coverage, and no ability of insurers to assess risk

- Stating that, I too believe that TRIA should not be a permanent program, but rather a temporary program until the private insurance markets can develop its own additional terrorism insurance capacity

- As the Treasury report again states, they believe that over time the private market will develop additional terrorism insurance capacity.

- But the key term is "over time" and not "over night"

- And I plan to ask the Treasury Secretary about the timeframe for the development of a private terrorism insurance market

- We need to extend TRIA legislation for another few years as well as provide extensions for Group Life coverage and fill in certain gaps such as in the NBC field

- TRIA has proven one of the few successful economic policies of this Administration and it should not be allowed to expire as our markets, our insurance industry and our economy couldn't take such a blow at this point in time

- Again, I am pleased at the Treasury Department's report on TRIA, as well as the leadership of Mr. Frank in continually charging ahead on the importance of extending terrorism insurance.

- I look forward to today's discussion and I yield back my time

Opening Statement

Congressman Paul E. Gillmor (R-OH)

Committee on Financial Services

July 13, 2005

Hearing entitled: *"Treasury's Report to Congress on the Terrorism Risk Insurance Act (TRIA)"*

Thank you, Mr. Chairman, for calling this important hearing and for your continued leadership on this issue.

Our committee passed the Terrorism Risk Insurance Act (TRIA) in 2002, to address serious concerns regarding the continued availability of insurance against acts of terrorism. Without this important federal backstop, such coverage may easily have ceased to exist for commercial policies given the uncertainty surrounding the cost of possible losses.

TRIA addressed these issues by ensuring the widespread availability of affordable terrorism insurance for the duration of the Act and provided a transitional period during which insurance market participants could diversify their exposure and develop resources and mechanisms that would enable the private sector to offer affordable terrorism insurance after TRIA expires on December 31, 2005.

I look forward to further explanation by Secretary Snow on Treasury's evaluation of the TRIA program and the Department's findings contained in the recent report. If the private insurance and reinsurance markets have yet to adapt to the economic risks associated with catastrophic terrorist events, I would hope the Secretary can help Congress come up with a more permanent, market-based solution.

I would like to thank our distinguished Chairman again for calling this hearing, and I look forward to an informative session.

OPENING STATEMENT OF
CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON THE TREASURY'S REPORT TO CONGRESS ON THE TERRORISM RISK INSURANCE ACT

WEDNESDAY, JULY 13, 2005

Mr. Chairman, I am pleased that we are finally meeting this year to examine the need to extend the Terrorism Risk Insurance Act. This law is critical to protecting our economic security.

In the wake of the 2001 terrorist attacks, reinsurers unfortunately curtailed the supply of terrorism reinsurance and insurers began to exclude such coverage from policies. Eventually, we belatedly approved the Terrorism Risk Insurance Act to address these pressing problems.

Our efforts to address this predicament appear to have worked. After all, the Treasury Department's recent study on the law found that the program has helped to stabilize our insurance markets. Several other studies have also determined that TRIA has worked to increase the availability of terrorism risk insurance and advanced economic development projects.

Last year, we were also able to reach an agreement in the Financial Services Committee to extend TRIA for two years and to modestly expand it to cover group life insurance. Unfortunately, our bipartisan efforts fell short of their goal and that bill did not become law.

Nevertheless, I continue to believe that we need to move aggressively now to extend this economic stabilization law. Our failure to reach quick agreement on this important issue, according to Treasury's TRIA report, would likely result in less terrorism insurance, higher prices, and lower policyholder takeup.

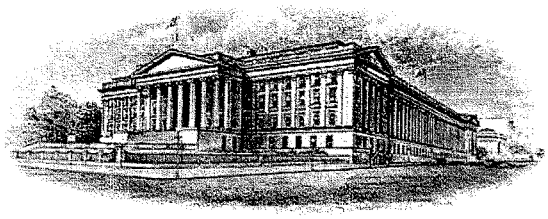
A recent report by the RAND Corporation also found that TRIA is needed, but because of its gaps, it is not robust enough to protect against evolving threats. Another report by the Organization for Economic Cooperation and Development found that private markets are still unable to comprehensively cover the large losses that could result from terrorist acts.

Despite the Administration's preference against extending TRIA in its current form, last week's terrorist attacks in London highlight the genuine need for us to do so. Terrorism is unpredictable. Many others, including regulators, trade associations, insurance risk experts, and commercial mortgage investors, have also called upon the Congress to act expeditiously in these matters in order to prevent short-term market disruptions. We need to heed their wise advice.

In debating any plan to extend TRIA, we ought to work to incorporate group life insurance. These products, after all, have characteristics similar to commercial property-and-casualty insurance in that there is often an excessive concentration of risk within a small geographic area.

Today, I also hope that Secretary Snow will expand upon the need for the "reasonable" legal reforms the Administration is requesting in any TRIA extension. I am very concerned that such a posture could once again stall legislative efforts, as it delayed consideration of the original law.

In closing, Mr. Chairman, time is of the essence. This is not a Democratic or Republican issue. It is an American issue; it is a business issue; it is an economic security issue. I therefore stand ready to work with you and all other interested parties on these matters.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

Embargoed Until 2 p.m. EDT
July 13, 2005

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Testimony of Treasury Secretary John W. Snow
before Committee on Financial Services
U.S. House of Representatives
on the Terrorism Risk Reinsurance Program

Thank you, Chairman Oxley, Ranking Member Frank, and other members of the Committee. I appreciate the opportunity to discuss the Treasury Department report on the Terrorism Risk Insurance Act (TRIA).

As you know, President Bush signed TRIA into law in November of 2002 to help safeguard America's economy following the terrorist attacks of September 11, 2001. The September 11 losses led the insurance industry to reduce its exposure to future losses largely by excluding coverage for terrorism risk in many policies. The pullbacks in terrorism coverage and the quotations of rapidly increasing premiums raised concerns that this period of adjustment to the reality of global terrorism risk in the insurance market could have a negative effect on the economy.

In response, TRIA was passed. It was meant to address any market disruptions and ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk, and to allow a transitional period for the private markets to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses, while preserving State insurance regulation and consumer protections.

TRIA required the Treasury Department to assess the effectiveness of the Terrorism Risk Insurance Program. It also required Treasury to assess the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program.

The report finds that TRIA has been effective in meeting its goals of supporting the industry during a transitional period and stabilizing the private insurance market. Consistent with TRIA's design to encourage the development of the private market, the Administration opposes a straight extension of the program. Extending TRIA in its current form is likely to discourage the private market development needed to deal with the risk of terrorism. The Administration has outlined principles that any extension should recognize and we look forward to discussions with the Congress on them. Before I review the main findings of the report, however, I would like to discuss the approach that the Treasury Department took in the course of evaluating TRIA.

Treasury Approach to TRIA Evaluation

Treasury contracted with an outside survey research firm to conduct two independent, nationally representative surveys. One survey sampled insurers in the commercial property and casualty line, which is eligible for the federal reinsurance provided under the Program. The other survey sampled policyholders, businesses and other organizations that purchased commercial property and casualty insurance in TRIA-eligible lines. Respondents were asked to provide information on an annual basis from 2002 (prior to passage of TRIA), to the first two months of 2005. The data therefore give a unique, comprehensive overview of the availability and affordability of terrorism risk insurance coverage in the private market.

From insurers, the surveys collected information on the amount of terrorism coverage written, the cost of terrorism coverage, terms and conditions on terrorism coverage and the purchase of reinsurance. From policyholders, we collected information on take-up and cost of terrorism coverage, the characteristics of firms and other organizations that purchase terrorism coverage, special terms and conditions associated with that coverage, reasons why the mandatory coverage offer was declined, and loss-mitigation efforts.

To safeguard the confidentiality of the business information requested in these surveys, Treasury took great care to ensure that the data were assembled at arm's length from the government. All identifying information was removed or masked prior to analysis by Treasury staff and officials.

I have been insistent throughout this process, consistent with Congress' direction to us in TRIA, that we draw upon as many sources of information and input as possible. Treasury has in fact consulted with a broad range of experts representing the insurance industry, the National Association of Insurance Commissioners (NAIC), policyholders, and taxpayer groups in developing the survey instruments. Preliminary survey instruments were reviewed by insurance industry representatives, NAIC representatives and others experts, including the American Insurance Association (AIA), and the Alliance of American Insurers (AAI)[1] after consultation with its members. Members of the Coalition to Insure Against Terrorism (CIAT) also met with Treasury staff to review the policyholder survey.

We are very pleased with the extensive collaborative process that Treasury undertook to conduct this assessment, and believe that it reflects fully the extensive input of the industry and other groups. The completed survey results, and information derived from these other sources forms the basis of the Report to Congress.

Structure of TRIA

TRIA established a temporary federal program of shared public and private compensation for insured commercial property and casualty losses resulting from foreign acts of terrorism. TRIA represents a form of publicly-provided and subsidized terrorism risk reinsurance, which essentially transfers risks associated with terrorism losses from the private to the public sector (taxpayers).

Under TRIA, companies that provide commercial property and casualty insurance are required to offer ("make available") terrorism coverage on the same terms and conditions as offered in their non-TRIA coverage. To be eligible for TRIA reinsurance, an act of terrorism must be certified by the Secretary of the Treasury, with the concurrence of the Secretary of State and the Attorney General., and must have resulted in aggregate property and casualty losses of $5 million or more. TRIA defines an act of terrorism as (1) a violent act or act that is dangerous to human life, property or infrastructure, that (2) has resulted in damage within the United States or outside of the United States in the case of an air carrier or vessel (as defined by TRIA) or on the premises of a United States mission, and (3) has been

[1] The Alliance has merged with another association and is now the Property Casualty Insurers Association of America (PCI).

committed by an individual or individuals acting on behalf of any foreign person or interest, (4) as part of an effort to coerce the U.S. civilian population or influence the policy or affect the conduct of the U.S. government by coercion.

The federal government would have to cover 90 percent of insured losses beyond an insurer deductible, up to $100 billion per year. In the first full Program Year (2003) the deductible was 7 percent of 2002 premiums, in 2004 the deductible was 10 percent of 2003 premiums, and in 2005 the deductible is 15 percent of 2004 premiums. The purpose of the graduated deductible amounts was to encourage development of private market capacity over time. Insurers are also liable for 10 percent of losses above the deductible threshold.

In the event that the federal government provides compensation for insured losses for an act of terrorism under the Program, TRIA requires recoupment of at least a portion of the federal compensation through policyholder premium surcharges. Recoupment is mandatory in cases where the aggregate industry insured terrorism losses (deductibles and co-pays) are below a specified aggregate retention amount. The annual aggregate retention amount was $10 billion for 2003, $12.5 billion for 2004 and is $15 billion for 2005. The government is required to collect the difference between these recoupment amounts and the aggregate industry insured terrorism losses through an industry-wide surcharge, not to exceed 3 percent of the premium paid on a policy. If the aggregate industry insured terrorism losses exceed the aggregate retention amount, the federal government may require recoupment at the discretion of the Secretary of the Treasury, but the statute does not require recoupment.

To encourage the development of private market capacity over time, provisions in TRIA have gradually shifted more of the risk to the private sector.

Impact of TRIA on Insurance Markets

The Treasury Department report finds that the Program provided support in a transitional period, during which the capacity of the insurance industry to write terrorism risk insurance has improved.

I will elaborate on four main findings in the report:

- Industry capacity to provide coverage for terrorism risk has improved, as has take-up of such coverage.
- Insurers are increasingly pricing terrorism risk insurance, and the price of coverage with an explicit charge has decreased.
- Industry surplus has improved.
- Many insurers reinsure a substantial portion of their retained risk under TRIA, but overall reinsurance purchases have not increased substantially.

Availability and Take-up of Terrorism Coverage

Results from both the survey of insurers and the survey of policyholders show that the availability and the take-up (purchase) of terrorism insurance increased while TRIA has been in effect.

Insurers now provide terrorism coverage on a greater share of commercial property and casualty insurance policies than in 2002 (the year before TRIA). While 60 percent of policies written in 2002 included terrorism insurance coverage, fully two-thirds of such policies included such coverage in 2004. Terrorism insurance was also more widely available in the market, as the share of insurers providing any terrorism coverage rose from 73 percent to 91 percent over the period.

Policyholders as well are now more likely to purchase terrorism risk insurance than in 2002. The data show a doubling in the take-up rate of terrorism risk coverage: from 27 percent of policyholders in 2002 to 54 percent of policyholders by 2004. The finding that just under half of policyholders do not take-up such coverage does not necessarily reflect a problem in the market. The decision to purchase terrorism insurance reflects a tradeoff between the benefits and cost of the coverage. Firms that perceive a low risk of terrorism attacks or that have some form of self insurance (for example, through diversified portfolios) may simply not place a high value on terrorism insurance. It is useful to note that TRIA did not mandate the purchase of terrorism insurance, but rather that such coverage be made available.

Pricing and Cost

Both insurer and policyholder surveys show that insurers increasingly began pricing terrorism risk insurance during the time TRIA was in effect. More than 75 percent of insurers providing coverage for terrorism risk in 2002 did not charge for it, but only 40 percent in 2004 provided coverage for free. These numbers are very similar to those reported by policyholders.

The average cost of terrorism insurance (measured as the share of total premiums paid for terrorism coverage) generally rose during this period. Overall, insurers reported costs ranging from 0.9 percent of premiums in 2002 to 1.8 percent by 2004. Among insurers who charged for terrorism insurance, the share of premiums charged for terrorism coverage first declined from 3.7 to 2.4 percent of premiums between 2002 and 2003, but then increased to 3.1 percent of premiums by 2004.

The average costs reported by policyholders increased from 1.2 percent of premium in 2002 to 1.6 percent in 2003, and further to 1.7 percent of premium by 2004. Among policyholders who reported paying for terrorism coverage, cost declined steadily over the period: from 4.0 percent of premium in 2002 to 2.8 percent in 2003 and further to 2.7 percent of premium in 2004.

Policyholders located in high-risk cities faced overall declining costs for terrorism risk coverage that varied from 2.8 percent of premiums in 2002, 3 percent in 2003 and 1.9 percent in 2004.

Industry Surplus and Reinsurance

Industry surplus, a key source of insurer capacity, has returned to pre- September 11th levels. Insurers are financially stronger and more able to bear unexpected losses than they were prior to the enactment of TRIA. Reinsurance, another important component of an insurer's capacity to absorb losses, has not increased substantially, however. Seventy percent of insurers reported purchasing reinsurance for terrorism risk in 2003, but only 65 percent in 2004 reported purchasing reinsurance in 2004. Preliminary data from the first months of 2005 are encouraging and suggest a rebound to 75 percent. Smaller and medium-sized insurers generally reported greater use of reinsurance for terrorism risk exposure (TRIA deductibles and co-payments) between 2003 and 2005. During this same period, however, larger insurers reported less use of reinsurance for terrorism risk exposure.

Summary

The findings from the surveys of insurers and policyholders point to the success of TRIA in achieving its short term goals. TRIA effectively "addressed market disruptions and ensur[ed] the continued widespread availability and affordability of property and casualty insurance for terrorism risk." While we don't ascribe a direct causal effect to TRIA, we note that insurer financial strength has improved substantially over this period. More generally, TRIA allowed both insurers and policyholders time to adjust to the post-September 11th view of terrorism risk.

TRIA provisions shifted an increasing share of expected terrorism losses back to the private sector, as the deductible was increased from 7 percent of premiums in 2002 to 15 percent of premiums in 2004. Had there been no improvement in capacity, we should observe a pullback of terrorism coverage in response to this shift in cost. The expansion of terrorism risk coverage availability and take-up, and the decline in cost even as the TRIA deductible has increased therefore highlights the improvement in the industry's ability to cover terrorism risk.

Industry Capacity to Cover Terrorism Risk After TRIA

Congress also directed Treasury to assess the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after expiration of the program. TRIA provided a federal backstop for terrorism losses that effectively subsidized terrorism risk insurance. It is reasonable to expect that the removal of the subsidy will result in adjustments in coverage and pricing. In the Treasury report, we present a framework to evaluate the impact of a TRIA sunset in more detail, and provide evidence from our surveys and from insurance industry statistics, data, and discussions with industry and other experts. Two important determinants of insurers' ability to effectively write coverage for terrorism in the near-term are the ability to model terrorism risk and the industry's financial capacity – including both surplus and access to reinsurance - to cover terrorism losses.

Modeling Terrorism Losses

To provide and price insurance efficiently, insurers should be able to quantify their exposure to losses from terrorism risk. The primary tool available for quantifying loss exposure is modeling terrorism risk. Our assessment of developments in risk modeling over the past few years is positive, but we note that challenges do remain.

Modeling terrorism risk has two critical components: the ability to identify and quantify the severity of an event in terms of insurers' losses, and the probability of the loss occurring. Our study concludes that insurers' ability to identify and quantify the severity of an event in terms of insurers' losses has improved greatly. In particular, insurers are much better able to assess their exposures or accumulations of risk for a given terrorist event on an overall and individual customer basis. The industry – particularly the primary insurance industry - has made great progress in tracking aggregate exposure by location to estimate exposure to losses from physical damage and considerable progress in tracking aggregates of employees down to the level of individual locations to estimate exposure to workers' compensation losses. Modelers have created and implemented sophisticated probabilistic loss estimates that are said to take account of terrorists' shifting goals and strategies. Insurers writing coverage for high risk exposures are able to use multiple methods of assessing terrorism risk. This is important because it allows insurers to more effectively underwrite coverage. We acknowledge that the industry faces some difficulty in assessing the probability of the loss from terrorism. The uncertainty surrounding their predictions reduces the usefulness of these models.

Financial Capacity

An insurer's capacity to write coverage is limited to the maximum coverage it could provide, while retaining its ability to meet current and future obligations to its base of policyholders. An important determinant of insurers' capacity to cover terrorism losses is financial strength, which incorporates both balance sheet strength and operating performance. The financial health of the insurance industry, especially surplus, has improved greatly in the past three years. Among insurer groups providing coverage in TRIA-eligible property and casualty lines, surplus was higher in the third quarter of 2004 than it was in the third quarters of 2001, 2002 and 2003. Between the 3rd quarter of 2001 and the 3rd

quarter of 2004, surplus[2] increased from $256 billion to $341 billion. Measures of the industry's capacity to cover terrorism risk, including the ratio of net premiums to surplus, the return on surplus, and the capital adequacy ratio (accounts for underwriting, investment and credit risk) have all improved since the losses following the September 11 attacks.

By purchasing reinsurance, insurers can write additional coverage without increasing their financial holdings. Our survey results show that reinsurance is available, and purchased, for a sizable portion of the retained risk under TRIA. Seventy percent of insurers purchased reinsurance for TRIA-eligible risks in 2003. The results also indicate, however, that over the time period covered by our study, purchases of reinsurance have not increased substantially.

Insurance Market Outcomes

The expiration of TRIA will change the business environment in which insurers operate and will therefore change their behavior. Insurers will likely consider factors such as the possibility of insolvency from terrorism losses given the levels of surplus available and the effect on credit ratings. Experience with natural catastrophe risk underwriting and assignment of agency ratings suggests that in order to avoid ratings downgrades, insurers may significantly alter their approach to terrorism risk insurance after TRIA's expiration. Among the changes insurers may institute are increasing the use of private reinsurance, building surplus by tapping into capital markets, and raising premiums or placing exclusions on some policies.

Our surveys included direct responses on the availability of coverage after the expiration of TRIA. Responding to questions about policies written in early 2005 that continue into 2006, nearly 50 percent of insurers reported that they are not writing coverage for terrorism risks in 2006 (after the scheduled expiration of TRIA) that is similar to the coverage they write under TRIA. One-quarter of policyholders with terrorism risk coverage indicated that their coverage excludes terrorism coverage after the expiration of TRIA.

TRIA's expiration will conclude the transitional assistance first provided to the insurance markets in the uncertain economic environment of 2002. While the immediate effect of the removal of the TRIA subsidy is likely to be less terrorism insurance and, higher prices, we expect that over time the private market will develop additional terrorism insurance capacity. We anticipate that the initial response of premiums in the market will spur the buildup of surplus as insurers tap into capital markets; and the development of additional private reinsurance and other risk shifting mechanisms.

Macroeconomic Effects

We do not believe that the elimination of the federal terrorism risk reinsurance subsidy is likely to have a discernable macroeconomic effect. In late 2001 and 2002, there was concern that there could be macroeconomic effects associated with the transition between a world in which terrorism coverage was provided for a negligible price and one where terrorism risk was considered a non-negligible risk. The economic climate during the discussion of TRIA and its enactment was highly uncertain. Industrial production had peaked in mid-2000, and by September 2001 had already fallen more than 5 percent. The terrorist attacks of September 11 created macroeconomic uncertainties that most analysts believed would translate into a further sharp downturn in economic activity that would last at least two additional quarters. Nonresidential building activity tumbled about 33 percent at an annual rate in the fourth quarter of 2001, and continued to experience declines well in excess of 15 percent in the subsequent three quarters. It was difficult at the time to assess whether the substantial declines in nonresidential

[2] The total surplus of all the consolidated insurer groups and companies writing insurance with premiums above $10 million in the TRIA-eligible commercial property & casualty lines.

building were due to the chilling effect of terrorist activity, terrorism insurance issues or the result of a cumulative unwinding of activity more typical of a recession and even the excesses of the late 1990s.

Helped by tax cuts and monetary stimulus, the economy has since improved substantially. GDP growth rose from just 2.3 percent in 2002 to 3.9 percent in 2004 (fourth quarter over fourth quarter). The unemployment rate, which was 6 percent in December 2002, fell to 5.1 percent in May 2005. However, despite the rising economy and the enactment of TRIA, nonresidential building has rebounded only slightly. Nonresidential building is currently 4.2 percent higher than the trough reached in the first quarter of 2003, but remains substantially below the previous peak. From our current perspective it appears that neither the potential lack of terror risk insurance nor a general economic downturn were responsible for weakness in nonresidential building activity.

Overall Assessment and Policy Recommendations

The risk of terrorism changed fundamentally and permanently after the events of September 11, 2001. In the words of the President:

> *...Our country is safer than it was on September the 11th, 2001, yet, we're still not safe. . . . We are a Nation in danger. We're doing everything we can in our power to confront the danger. We're making good progress in protecting our people and bringing our enemies to account. But one thing is for certain: We'll keep our focus and we'll keep our resolve and we will do our duty to best secure our country."* [3]

It is our view that continuation of the program in its current form is likely to hinder the further development of the insurance market by crowding out innovation and capacity building. Consistent with TRIA's original purpose as a temporary program scheduled to end on December 31, 2005, and the need to encourage further development of the private market, the Administration cannot support a straight extension of TRIA.

Any reform of TRIA should be consistent with several principles. It is the Administration's view that extension of the program should recognize the temporary nature of the program, the rapid expansion of private market development (particularly for insurers and reinsurers to grow capacity), and the need to significantly reduce taxpayer exposure. The Administration would accept an extension only if it includes a significant increase to $500 million of the event size that triggers coverage, increases the dollar deductibles and percentage co-payments, and eliminates from the program certain lines of insurance, such as Commercial Auto, General Liability, and other smaller lines, that are far less subject to aggregation risks and should be left to the private market.

It is also important to keep in mind that the program would cover damages awarded in litigation against policyholders following a terrorist attack. Current litigation rules would allow unscrupulous trial lawyers to profit from a terrorist attack and would expose the American taxpayer to excessive and inappropriate costs. The Administration supports reasonable reforms to ensure that injured plaintiffs can recover against negligent defendants, but that no person is able to exploit the litigation system.

The events of the past week in London have been an unwelcome reminder that the risk of terrorism is real and that the war on terrorism is one that will be waged over a long period of time on many fronts. Some believe the fact that terrorism risk is real suggests the need for a permanent and obtrusive federal role in the market for terrorism risk insurance. I agree that the risk of terrorism is likely to remain a part of our lives for some time to come, but that is precisely why the federal government needs to encourage the development of the most creative and cost effective means of covering terrorism risks. The Administration looks forward to working with the Congress to achieve this end.

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[3] http://www.whitehouse.gov/news/releases/2004/09/20040911.html

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June 24, 2005

The Honorable Barney Frank
United State House of Representatives
2252 Rayburn House Office Building
Washington, D.C. 20515

Dear Representative Frank:

On behalf of the Commercial Mortgage Securities Association ("CMSA") and its members, thank you for meeting with me and my members last week. As we noted in our meeting with you, last week's meetings with members and staff on Capitol Hill and others in the Administration represents the first time CMSA has engaged in any lobbying activities in its eleven year history. This is because there is no more important issue to CMSA's membership than the extension of the Terrorism Risk Insurance Act ("TRIA") in some form to the continued vibrancy of the commercial mortgage backed securities marketplace and the steady creation of new capital for commercial real estate investment. The availability of capital for commercial real estate is an important driver of the nation's economy and it is threatened by the prospect of the unavailability of terrorism insurance.

Because CMSA members span the gamut of CMBS participants, it stands at a unique position to advocate the necessity of a terrorism insurance program. In our eleven years as a trade association, CMSA has seen the commercial mortgage-backed securities (CMBS) industry grow from roughly $5 billion to now $500 billion dollars. Both the size of our industry and the amount of new capital created for new development, however, are threatened if TRIA is not reauthorized

In our meeting, you asked us to address two issues in follow-up correspondence to you: 1) The effect that expiration of TRIA will have on pensioners; and 2) the urgency of the issue generally.

Pension Benefits: The First Casualty

The unavailability of terrorism insurance threatens far more than real estate development. In fact, the level of benefits pension beneficiaries receive are endangered as well. Because commercial mortgage backed bonds have been viewed as steady investment vehicles, pension plans nationwide have purchased a great number of these securities. However, the price volatility that will follow the expiration of the TRIA program will be directly responsible for a decline in pension benefits.

Investors acquire bonds that hopefully will generate a certain stability of performance. If TRIA expires and there is no mechanism to succeed it, bonds backed by existing commercial real estate will be subject to volatility. This volatility comes in two forms. First, terrorism insurance can be forced placed. In that case, the property may not have enough cash flow to meet obligations and securing insurance becomes an expense that the trust must cover. This situation is referred to as an interest shortfall which is detrimental to bonds. In that case, bonds may experience downgrades which contribute to price volatility. Second, bonds may be downgraded simply because of the profile of the property if it is not covered by terrorism insurance.

The ratings volatility is mollified by increased capital reserves. The subsequent retention in capital is made at the expense of funds otherwise distributable for benefits. Increases in capital reserves translate into decreases in benefits.

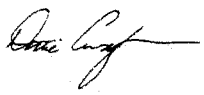
In short, lack of terrorism insurance for commercial real estate investments via CMBS introduces elements of risk to an investor's portfolio which must be mitigated.

Reauthorization is Urgent

Today, borrowers seeking capital for new commercial projects are receiving terrorism insurance coverage that is conditioned on the continued availability of the TRIA backstop. After December 31, 2005, borrowers will be unable to obtain the required level of risk coverage on economical terms if the program is not extended which may make their loans unsuitable for securitization. The prices of bonds securitizing outstanding commercial loans also will suffer, decreasing available capital for new economic activity and reducing benefits available to the nation's pensioners who have a large stake in the CMBS market.

It is my sincere hope that you view the unparalleled collective experience of our members as an asset to you as Congress and the Administration continue to evaluate the TRIA extension options. We are available to assist you in these efforts in any way that you believe would be beneficial.

Sincerely,



Dottie Cunningham,
Chief Executive Officer
Commercial Mortgage Securities Association

cc: Ken Swab
Erika Jeffers

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