S. HRG. 110–907

EXAMINING THE TERRORISM RISK INSURANCE PROGRAM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

MAINTAINING AND IMPROVING THE NATION'S SECURITY AND PROSPERITY THROUGH THE PUBLIC-PRIVATE PARTNERSHIP CREATED BY THE TERRORISM RISK INSURANCE ACT OF 2002 THAT PROTECTS AMERICAN WORKERS, JOBS, BUSINESSES, AND INFRASTRUCTURE FROM FUTURE ATTACKS

WEDNESDAY, FEBRUARY 28, 2007

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EXAMINING THE TERRORISM RISK INSURANCE PROGRAM

WEDNESDAY, FEBRUARY 28, 2007

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:36 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order, if we can. I thank all of you for being here with us this morning.

Earlier this year, upon assuming the chairmanship of this Committee, I stated that the Committee would focus on two overarching goals: maintaining and improving our Nation's security and prosperity. The subject of today's hearing—namely, a public-private partnership created by the Terrorism Risk Insurance Act of 2002 to protect American workers, jobs, businesses, and infrastructure from future terrorist attacks—is, in my view, critical to both the security and prosperity of our Nation.

This morning, the Committee will hear testimony from policyholders, insurers, and regulators, those who have firsthand knowledge of the challenges associated with buying, selling, underwriting, and regulating terrorism risk insurance. I would like to thank our witnesses—we have a long panel here this morning—for being here. I would also like to thank them for the testimony they are going to give this morning on this legislation.

Many of my colleagues on this Committee have worked very, very hard for a number of years on this issue. We have collaborated on a bipartisan and bicameral basis to enact both the Terrorism Risk Insurance Act, known as TRIA, in 2002 and an extension of the TRIA program in 2005. And I would be remiss at this moment if I did not thank my colleague from Alabama, who has some strong views on the issue and has been tremendously cooperative and helpful in trying to put together some worthwhile legislation in this area.

In 2002, the Senate voted by an overwhelming margin of 86–11 to pass TRIA. In 2005, the Banking Committee, under the chairmanship of Senator Shelby, reported by a unanimous vote legislation to extend TRIA for an additional 2 years. The bill later was approved by the full Senate, also by a unanimous vote.

I think it is important to take a moment to talk about the importance of TRIA and why I believe we must act again to establish a more permanent Federal initiative to provide coverage from potential terrorist attacks. In the aftermath of 9/11, the market for terrorism risk insurance disappeared—disappeared—and the American economy dealt with a great deal of uncertainty. We repeatedly heard from businesses, large and small, from labor unions, manufacturers, builders, and lenders, from the nonprofits like universities and hospitals, and from insurers about the need for the Federal Government to help stabilize the market and ensure the availability of affordable insurance against the risk of future terrorist attacks.

The critical U.S. industry sectors were in dire need of terrorism insurance to obtain credit, loans, and investments necessary for their normal business operations. Without terrorism risk coverage, the economy faced instability and dislocation, which is exactly what the terrorists hope to accomplish in many ways. The policyholder community and insurers together called for a response to the 9/11 attack on our Nation and our Nation's economy. Congress listened and we acted in 2002, creating the Terrorism Risk Insurance Act.

TRIA created a 3-year program, as many of you will recall. The Terrorist Risk Insurance Program, located within the Department of Treasury, established a Federal backstop against catastrophic losses in the property and casualty insurance marketplace. In December of 2005, a 2-year TRIA extension was signed into law. The provisions of that bill will expire, as many of you know, on December 31st of this year—hence, the hearing today and the sense of urgency about moving rather quickly here.

Under TRIA, the Federal Government shoulders a share of the financial risk of future attacks. The burden sharing makes sense, in my view. These attacks are against us as Americans and our way of life. The attacks are aimed at the American public and, therefore, require, in my view, a public role in addressing this threat in light of the circumstances we face. But TRIA also requires that the private sector bear a significant financial responsibility and help to impose market discipline in the claims and underwriting processes.

In the past 5 years, we have heard an overwhelming response from policyholders across the country. TRIA has worked, and it has worked very, very well. According to a recent study by the Wharton Risk Management and Decision Processes Center at the University of Pennsylvania, roughly 50 percent of commercial enterprises through 2005 purchased terrorism insurance. According to Marsh, Inc., and cited by the President's Working Group on Financial Markets, take-up rates have increased from 23 percent at the beginning of 2003 to 64 percent at the end of 2005 while the price of terrorism insurance has actually declined. The median cost of property terrorism insurance was 25 percent lower in 2005 than the 2004 rates. These trends demonstrate, in my view, that TRIA has achieved its primary goal: continued availability and affordability of insurance against future attacks. What we have seen and what we may hear and what many of our witnesses will explain today is that the re-emergence of limited terrorism risk insurance would not have happened without the enactment of TRIA. We will also hear that the private sector does not have the capacity to provide affordable terrorism risk insurance on its own without the existence of a Federal backstop.

In a 2005 Treasury Department survey, nearly 50 percent of insurers said that they do not plan to write terrorism insurance after TRIA expires. So the question before us today is: Do we do nothing to financially protect our country against future attacks? Do we provide another short-term extension to meet the current market needs? Or do we try to create a longer-term solution for the security of our people and our economy? I firmly believe that doing nothing is simply not an option and one that cannot even be considered here.

The world has fundamentally changed since 9/11. Nearly all of the data and the experts say that there is no reason to think that private forces alone could and would provide against this very unique risk. We have every reason to believe that the Federal role for terrorism risk insurance coverage is needed for the foreseeable future. Several industrialized countries have already recognized this fact. The United Kingdom, France, Germany, and others have created permanent Government programs to manage terrorism risk. We know from the tragic attacks in London, Madrid, India, and Indonesia—and elsewhere, I might add—that terrorism has increased since 9/11. In a world of more terrorism, we should be providing more security, not less.

Our Nation has truly been fortunate enough not to suffer the tremendous loss of life or destruction of property that we endured on September 11th of 2001. But by no means has the political climate, either domestically or abroad, returned to a sense of normalcy. We are engaged in a violent conflict in Iraq, and we have seen desperate terrorist attacks abroad in Europe and elsewhere. The threat of terrorism is not simply a short-term threat. It has potential to be a long-term reality. I think most of us recognize that.

As a result, I believe that we must act once again to ensure that stability, availability, and affordability remain in the market for terrorism risk insurance. But I do not believe that we should continue to extend the program for short-term periods, causing further uncertainty and confusion in our economy. A more permanent Federal commitment, I think, is not only something we should do but something we must do. I am committed to finding a solution that will address the long-term security needs of our people and our economy and ensure that our Nation is best prepared to deal with future terrorist threats. I believe that one of the most fundamental obligations of our National Government is to provide security and opportunity for our fellow citizens.

With the expiration of TRIA approaching later this year, it is important to gather information about the current market for terrorism risk insurance, to assess the impact that TRIA has had in this marketplace, and to develop some ideas for creating more permanent terrorism risk insurance. Today's witnesses offer an extraordinary range of expertise and experience that I think can be very useful to this Committee as it undertakes this important effort, and I thank them again for their attendance and participation.

More than 5 years after the tragic events of 9/11, we continue to see a need to provide a Federal backstop to protect our people, businesses, and critical infrastructure from these attacks. We have heard repeated dire warnings that terrorism will return to U.S. soil. We must be prepared against this threat, and in my view, providing insurance against those attacks allows our economy to function and is a critical part of our national preparedness. And I believe that by working together we can establish a more permanent solution.

So, again, I thank my colleagues for their work over the years on this issue, many of whom on this Committee were very involved as we went through this process now twice before. And, again, my thanks particularly to Senator Shelby, who has been a leader on this issue over the last number of years as he chaired this Committee.

So, with that, let me turn to my colleague from Alabama for any opening comments he has. I will then turn to my colleagues for any comments they might want to make on the subject matter. And I would ask them to be relatively brief, if they could, so we can get to our witnesses and their statements this morning.

Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Chairman Dodd.

In November 2002, Congress passed the Terrorism Risk Insurance Act, or TRIA, to address perceived failures in the terrorism risk insurance market stemming from the September 11th terrorist attacks. The stated purpose of the legislation was to establish a temporary Federal program that would ensure the widespread availability and affordability of terrorism risk insurance. This temporary program was intended to provide, and I quote, "a transitional period for the private markets to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses."

This year, the Committee will consider once again whether to reauthorize the Terrorism Risk Insurance Program. The reauthorization of a program typically involves a careful review of the program's success at fulfilling its legislative mandate. A review of the Terrorism Risk Insurance Program, however, is particularly important due to the disincentives that the program creates for the private sector to devise solutions to terrorism risk. Because the program involves a commitment by the Federal Government to pay for a large portion of the losses incurred by a terrorist attack, the market has significantly less incentive to create new ways to manage terrorism risk.

To prevent such crowding out of private sector solutions, I believe we need to ensure that the program is focused on addressing the market failure described in its legislative purpose. Considering the dramatic improvement in our Nation's economy and insurance market since TRIA was enacted, it appears that the program has made substantial progress in satisfying its purpose. In its report to the Committee, the President's Working Group on Financial Markets reported that the availability and affordability of terrorism risk insurance has improved since 9/11. It found that prices for terrorism insurance have fallen and take-up rates have increased. In light of the improved condition of our terrorism insurance market, additional scrutiny of the scope of the Terrorism Insurance Program appears warranted here.

Finally, as we begin our review of TRIA today, we should be mindful of the inherent limitations of Government solutions to complex and technical problems. We should recognize that it is very unlikely that Congress can create an insurance program better than market forces, given the opportunity to do so. Congress might be able to devise a quick fix to a temporary market failure, as we have done, but in the long run, the most durable solution will in all probability come from our private sector. The creativity of our financial markets and their ability to innovate are factors that should be given great weight in this debate. Although we are likely to hear testimony today about the difficulties in insuring against terrorism risk, it is important to remember that innovation springs from necessity. While we need to appropriately address any market failures in the insurance industry, we must also encourage at the same time the facilitation and innovation beyond the Government program as well.

I want to welcome all of our witnesses today, and, Chairman Dodd, I appreciate you bringing this to our attention and calling this hearing.

Chairman DODD. Thank you very much, Senator Shelby.

Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you very much, Mr. Chairman. Thank you, gentlemen.

I, too, want to commend Chairman Dodd and former Chairman Shelby for their leadership on this issue. Terrorism, regretfully, is still with us. In fact, open-source reporting suggests that Zawahiri and Bin Laden are somewhere in Pakistan attempting to re-establish their network. So this threat has not gone away. In fact, many people have suggested that it is high probability that the United States will be attacked again. So this is not an academic discussion today.

I think TRIA has worked very well. I think it should be extended on a more permanent basis. I think also, too, there are particular areas of concern that have to be addressed. One is workmen's compensation. Typically, the incidents that we have seen involve a concentrated attack on one facility involving in some cases employees of just one company or several companies. The workers' compensation insurers in those cases have an unusual liability and exposure. In fact, in my home State of Rhode Island, we have one agency, a quasi-governmental agency, Beacon. There are 26 other States, including New York, Utah, Colorado, Wyoming, Kentucky, Hawaii, Ohio, Pennsylvania, Idaho, and Montana, that have a similar arrangement. If there was such an incident in any one of these States, it is quite possible that that insurer would fail without reinsurance, and that failure would be now the burden of the State or some other ad hoc arrangement. So I do think we have to continue support this effort.

A final point I will make. We are concerned on this Committee—and I think the Chairman is going to lead us in our efforts—about the competitiveness of American financial markets and other markets around the globe. TRIA is one of those factors that provides a certain degree of certitude, safety, predictability that gives our market strength vis-a-vis other markets. I would hate to see a situation where we take this away and create competitive incentives to move business into other markets other than the United States.

For all these reasons, I think we have to press forward on this reauthorization. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Reed.

Senator Enzi.

STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you, Mr. Chairman. You and I got to head up the Subcommittee under the direction of Chairman Sarbanes and Ranking Member Gramm that did the original TRIA bill.

Chairman DODD. Right.

Senator ENZI. And I am glad that we are having this hearing. I hope that the testimony today and in future hearings on this subject will help us understand the state of the insurance industry since the 9/11 attacks, and specifically since the last reauthorization of the Terrorism Risk Insurance Act.

Following the September 11th attacks, our insurance market suffered losses of approximately $32 billion, an enormous amount by any standard. The Committee responded by crafting legislation to create a shared public-private partnership to allow the markets to stabilize and make terrorism insurance available again. This program was envisioned to be limited and temporary; however, as I am sure some witnesses will testify today, it has taken longer than expected for the markets to recover, so now in 2007, this Committee is meeting to consider another reauthorization of the TRIA program, or possibly to make it permanent.

As this Committee moves forward on this topic, I have some concerns that I will be focusing on. The first is taxpayer liability. In 2001, I supported a bill, along with other Members of this Committee, including Chairman Dodd, that would have created a temporary program containing explicit protections for the taxpayer in the case of terrorist attacks and lawsuits resulting from an attack. The bipartisan bill never came to a vote on the Senate floor. In fact, it never was allowed by Majority Leader Daschle to actually be introduced.

Many of the taxpayer protections, including a ban on punitive damages and the regulations of out-of-court settlements, were later added. I believe these protections against punitive damage payments and settlements are very important to the American taxpayer, and I will be looking to ensure that they remain intact should this Committee consider reauthorization legislation in the future.

I also supported the 2005 TRIA reauthorization because it represented a significant scaling back of the program, allowing the private market to grow in its place. And studies have shown that the insurance market has grown significantly in response. The 2006 report on terrorism risk insurance conducted by the President's Working Group on Financial Markets found that firms have had more success modeling and managing terrorism risk. Reinsurance capacity continues to grow, and insurance companies' net worth is rising. That is positive progress as a result of the 2005 reforms that increased event triggers and deductibles for the insurance companies and excluded number of eligible insurance lines. However, I am concerned that this progress will slow down or stop if the TRIA program is not allowed to continue along this projection.

In 2005, the Congressional Budget Office stated that if the Government continued to subsidize terrorism insurance, it would probably contribute to deferring the private sector's long-term adjustment to the increase in risk. This is a significant issue, especially if some are considering an expansion of the program. We must allow the markets to continue to innovate and price terrorism risk accurately. I do not think this can be done with such a large Government presence in the marketplace. In a free market, prices are accurate and competition leads to innovation. I am worried that the continued presence of the TRIA program would distort the market in both price and competition. And as this Committee evaluates TRIA, I will be looking for ways to allow the market to grow and strengthen without large Government subsidies and without leaving the taxpayer on the hook.

I thank you, Mr. Chairman.

Chairman DODD. Thank you.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman and Senator Shelby. I commend you for your leadership in scheduling today's hearing on such an important topic. I appreciate the witnesses for taking the time to come and share their perspectives on the proper roles for the Federal Government and for the private sector in responding to these terrorism risks.

I think these roles are dynamic ones. Each year we learn a little more. Each year our economy and our Government adapt and change in response to the challenges we face. I think this is certainly true of the insurance market.

In the wake of September 11th, we were, of course, stunned and uncertain as to what the future would hold. But the economy as a whole soon regained its footing, even though the economy since then and the recovery since then has benefited some Americans a lot more than it has others.

We talk a lot today about risk. Many families in Ohio are facing different kinds of risks—lost health care, lost jobs, lost homes—and are struggling to make ends meet. While this may not seem to be the topic of today's hearing, it should always be relevant. I want to be absolutely sure that the burden assigned to those people personally who are taking risks in their lives every day, that the burden assigned to them as taxpayers in my State and elsewhere is as small as possible.

The financial condition of the insurance industry, by contrast, seems to have grown stronger by many measures over the past few decades. While this country has experienced substantial losses due to terrorism and hurricanes, the headlines are not necessarily reflected in the bottom lines. At the same time, the ability of financial markets to disperse risk has become much more sophisticated over this period. This is not necessarily an unmitigated good, but it is a reality that we should bear in mind. We need to be careful that whatever action we take to extend the Terrorism Risk Insurance Program does not interfere with the assumption of more and more risk by the private sector. I am not sure that the Federal Government should be in the reinsurance business forever. I think our goal should be to withdraw the Federal Government from the market over time and permit private mechanisms to assume the risks now borne by taxpayers.

I do not pretend to know at this point how long it might take or the exact route we need to follow to get there, but I think that needs to be our ultimate goal. I hope today's witnesses can help us find answers.

Chairman DODD. Thanks very much, Senator.

Senator Bennett.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. Thank you, Mr. Chairman. I have been honored to be a cosponsor with you of this legislation in the past and will do what I can to help move it forward. The one thing I think we should remember in this overall debate is that insurance companies do not take risks. Insurance companies manage risk. Insurance companies spread risk. Insurance companies make risk affordable. But if there is a huge risk that could eliminate the company, the company will not take it. And the cost, potential cost, of a huge terrorist act is so great that insurance companies will not take it.

Now, by putting a cap on the amount of risk that is involved by virtue of the TRIA legislation that we passed, we have allowed the market that can be quantified, can be spread, can be made affordable to thrive. I am afraid if we take that cap off so that the insurance companies are faced with the entire risk, they will simply say, "We cannot take it. It is too damaging to our shareholders. We will not write policies above a certain level." And if we do that, ironically, and there is a terrorist attack, the taxpayers will pay for it.

What we have done with TRIA is create, in effect, a huge deductible for the Federal Government, and we have said, OK, whatever the level is set at—$80 billion, $100 billion, wherever it might be—this amount the insurance companies cover. Well, that amount we can handle. So if the price is higher than that, we have created a deductible for the taxpayer to say, well, we only have to pay whatever above that amount.

I was here during 9/11. Most of us were. We remember the emotions that followed that. The attitude in the Congress was: Whatever it takes, we will pay. Whatever it costs to rebuild New York City, we will pay it. And there was no deductible.

So for those who say, "Gee, we do not want to put the taxpayer at risk," my attitude is we are doing the taxpayer a major favor when we are creating a very large deductible and thereby making sure the taxpayer does not have to pay the whole bill if we do not have TRIA and we have all of the problems of a future attack.

It is for those reasons, Mr. Chairman, that I have been with you on this legislation in the past, and I will do what I can to help move it forward now.

Chairman DODD. I thank you very much, Senator Bennett. You have been a great asset as we have—we have had clarity talking about this issue and the importance of it.

Senator Martinez.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Thank you, Mr. Chairman. I, too, appreciate this very timely hearing, and I have been a support of terrorism insurance, understanding that, as has been pointed out, the private markets cannot always adjust to a terrorism event, as we saw on 9/11. And more recently, I also want us to make sure that I allow the group to know my interest in another problem that we have had. This past couple of days ago, Governor Crist led a group of Southern Governors, the Southern Governors Association, representing 15 States, Puerto Rico, and the Virgin Islands, passing a resolution asking for the creation of a national catastrophic fund relating to natural disasters and other issues that have been difficult for the private market to undertake. While that is a completely separate issue and should not be merged into this discussion today of this particular issue, which I know is so important and I support its continuation, I did want to highlight this issue for the Committee because it is so important to my home State of Florida where truly a crisis in insurance is unfolding, and one that is impacting not only everyday families as they struggle to make ends meet, but really is having a broader impact on business and the quality of life.

So I hope at some point in the future we can also address this very, very serious issue facing the State of Florida.

Chairman DODD. Senator Martinez, I think I have told you and I have told your colleague, Senator Nelson, as Chair of this Committee, that we will have a hearing on the subject matter you raise here this morning. You are right. It is a separate issue, but a very, very important one, and certainly one that is deserving of this Committee's attention. So we are planning to schedule a hearing to talk about that and the ideas and suggestions coming out of the States that are most directly affected by it. So we look forward to working with you and your colleague as to a witness list and others so that we will have a good, comprehensive hearing on the subject.

Senator MARTINEZ. Well, thank you, Mr. Chairman. That is terrific. I appreciate that very much. Senator Nelson and I are working very closely together on this. He has expertise, having been Commissioner of Insurance in our State, and so we will look forward to working with you on a hearing.

Chairman DODD. Thanks very much.

Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Thanks, Mr. Chairman. I will be very brief. We have got a lot of witnesses here. I am anxious to hear from them, as I am sure we all are.

Mr. Chairman, you and our Ranking Member, and certainly Senator Bennett, have been very active on this front for a number of years. I hope I serve long enough in the Senate that we do not have to have this kind of program and that it is something that we talked about in the old days that we just do not need anymore. That would be a blessed event. But I thank you, especially, Mr. Chairman, for your leadership.

I met earlier today with some of the Commissioners, the 9/11 Commissioners—Lee Hamilton and others—to talk about the 9/11 bill that is back on the floor today to sort of clean up and finish up the implementing and trying to enact the last recommendations of the 9/11 Commission that we did not take up before. It is an important bill that enjoys strong bipartisan support. While on the one hand we prepare to address the calamity or catastrophe, should it occur, through TRIA, through our insurance and reinsurance program, on the other hand, we are working to make sure that we prevent those kinds of events. And so the two really go hand in glove, and we appreciate your advice today as we try to improve on the TRIA legislation that I think expires later this year, while at the same time literally over on the Senate floor we are working to try to prevent these kinds of incidents.

Thank you.

Chairman DODD. Thanks very much.

Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman. I am glad we are discussing this issue early in the year rather than waiting until the expiration of the 2005 extension of the Terrorism Risk Insurance Program. While I do believe that at this point in time Congress needs to take action to ensure continued availability of terrorism insurance, I do not think we should make the current program permanent. Congress first authorized TRIA in 2002 because the private insurance market would not or could not cover terrorism risk in that time of uncertainty. Since 2002, our Nation is more secure and our private insurance market is more developed. Congress must be careful not to promote programs that may endanger further development of that market. Any legislation we pass this year should encourage more private insurance coverage for terrorism risk and reduce taxpayer exposure.

Some of the witnesses today are going to ask for an expansion of the Federal program. To them, I would like to ask how industry can expand its own programs.

In the 2005 reauthorization, Congress asked for a report from the President's Working Group on the Financial Markets. Last September, that report was completed, and it made some very interesting findings.

First, private insurance has developed for almost all kinds of terrorism risk.

Second, further expansion of TRIA is not needed to keep growing private markets.

I am disappointed that the President's Working Group is not represented on today's panel, as I think the Committee needs to hear from them before we do anything. Instead of granting a blanket extension of TRIA, we should develop incentives to create private reserves. That may require tax incentives, which can complicate legislation, but we should not dismiss the possibility.

Another viable idea is the creation of a private pool for terrorism risk similar to what has been done in Britain. I would remind my colleagues to look at what has happened with flood insurance before we give up on the private marketplace. The National Flood Insurance Program has cost the taxpayers billions of dollars, has stalled innovation of products, and has discouraged insurance companies from entering the market.

Our financial service companies have some of America's brightest and most innovative people working for them. I have full confidence that they will develop better ways to address the terrorism problem if we give them the right tools.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Menendez.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman. I want to thank you for holding what I think is an incredibly important hearing today. I want to acknowledge, Mr. Chairman, your leadership on this issue over the past few years and the work of so many Members of the Committee. I appreciate Senator Shelby as well in terms of moving forward on such a hearing.

You know, Mr. Chairman, prior to coming to the Senate, I represented a district right across from Ground Zero. My State lost 700 residents on September 11th. That is an immeasurable, incalculable, priceless loss. But in addition to that priceless loss, what would have happened not just to the region's economy, but as a ripple effect, I would argue, to the national economy is if Congress has not passed TRIA, and the consequences that would have flowed from that would have even been more enormous, would have been magnified. The terrorists would have created much more damage than they did as it was.

So the reality is that for so many of our private sector initiatives to have a robust economy, TRIA was incredibly important. I am all for the private marketplace trying to come up with its own products, but to be very honest with you, Mr. Chairman, I just simply have not seen it. And I do not see it on the immediate horizon.

And so the question becomes what do we continue to do to ensure that economic security—which is how I view this. I do not view this as private sector security. I see this as economic security—that economic security is preserved. And so when I look at some of our own interests in the region, which are magnified, could be any place in the country for that fact, but, for example, we have the mega part of the east coast, the port of Newark and Elizabeth, the type of cranes, machinery, and equipment there to try to find them insurance in the marketplace, simply cannot happen. I know a lot of our colleagues are big promoters of trade. You cannot have that trade if you cannot get them in and out of ports, both for exporting our products and importing them. That is only one of many, many different dimensions.

And so, ultimately, I do think we need to clearly at least extend TRIA and look at it to see how, in fact, we can continue to provide economic security. That is what this is all about, Mr. Chairman, and as someone who was actively promoting it formerly in the House, I look forward to working with you to promote it here in the Senate.

Chairman DODD. Thank you, Senator, very, very much.

I would like to ask unanimous consent that the written testimony from the PCIAA, the trade association which represents small and medium-sized insurers, be included at the record. I would have liked to have had them here this morning, but, frankly, we just could not accommodate everyone at this table. So I appreciate their willingness to have testimony submitted. They are very important. We talk about the insurance industry as though it is a monolith. There are smaller insurers. I know Senator Enzi always reminds us on this Committee of the small and mid-sized companies out there that need to be represented at our tables, and I want to make sure that their thoughts and views on this are going to be included. And as we go forward, we will insist at later hearings, if we have them, they will be a part of the discussion as well. So I thank them very much for that.

Our first witness this morning is Charles Clarke, who is testifying on behalf of the American Insurance Association and is Vice Chairman of the Travelers Companies, based in my State of Connecticut—Hartford, Connecticut. Mr. Clarke has been with the company since 1958 and has held various management roles for Travelers Insurance Group Holdings, including President and Chairman and CEO, and I welcome you to the Committee. We are very pleased to have you with us.

Thomas Minkler is the President of Clark-Mortenson Agency and is testifying today on behalf of the Independent Insurance Agents and Brokers of America. Mr. Minkler has over 28 years of experience in the insurance industry, serves as Chairman of the Independent Insurance Agents and Brokers of New Hampshire. He has testified to the Banking Committee in the past, and we welcome you back to the Committee.

Michael Peninger is testifying on behalf of the American Council of Life Insurers and serves as President and CEO of Assurant Employee Benefits Company, a position he has held since 1999. He joined that company in 1985 as a corporate actuary and has held various senior positions within the company.

I am going to mispronounce this. I want you to pronounce your last name, Jamie.

Mr. VEGHTE. Veghte.

Chairman DODD. Veghte. Jamie Veghte is testifying on behalf of the Reinsurance Association of America. He is the Chief Executive Officer of XL Reinsurance America, Inc., based in Stamford, Connecticut. Mr. Veghte was appointed CEO of the company in 2004, Chief Executive of Reinsurance General Operations in 2006, holds these positions concurrently.

Michael McRaith is the Director of the Division of Insurance for the Illinois Department of Financial and Professional Regulation. He is testifying today for the National Association of Insurance Commissioners. Mr. McRaith represents the State of Illinois with the NAIC and serves on that organization's Property and Casualty Insurance Committee, is on the Reinsurance Task Force, and we welcome you here today. Thank you for being with us.

Travis Plunkett, an old friend we have had here many times, is the Legislative Director for the Consumer Federation of America. The Consumer Federation is a nonprofit association of 300 organizations and an advocacy, research, and service organization, and a regular witness, I might add, before this Committee.

Arthur Coppola is the President and CEO of the Macerich—is that how you pronounce that?

Mr. COPPOLA. Macerich.

Chairman DODD. The Macerich Company, and is here on behalf of the Coalition to Insure Against Terrorism. He has over 30 years of experience in the shopping center industry, all of which has been with his company. Mr. Coppola is a lawyer and a CPA and Chair of the Board of Governors of the National Association of Real Investment Trusts. We welcome you here today as well.

John Lieber is the Senior Vice President of the World Trade Center Properties and is responsible for managing the organization's efforts to rebuild the World Trade Center site. From 1994 to 1998, Mr. Lieber served with the U.S. Department of Transportation, first as the Deputy Assistant Secretary for Policy and later rising to Acting Assistant Secretary.

And, last, Don Bailey here, who is the Chief Executive Officer of Willis North America, and he is testifying today on behalf of the Council of Insurance Agents and Brokers. Mr. Bailey joined Willis in March of 2003 to lead the firm's North American Executive Risk practice and, prior to joining Willis, served as senior vice president and chief underwriting officer of the specialty risk lines for the Alliance Insurance Corporation in Chicago.

That is a long list of witnesses. I see my colleague from New York is here. Senator Schumer, do you want to make any opening comments?

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman, and I apologize. We had a JEC hearing, and I just got here.

I would just make three points, and obviously I have real concern about this issue because it affects the city of New York probably more than any other.

First, it is time for a permanent solution. We keep coming back and back and back. It discombobulates the markets. It leaves things hanging in doubt. Now is the time, if ever, to really make this permanent, if we can, Mr. Chairman.

Second, I hope we will make an effort to include nuclear, biological, chemical, and radiological coverage available. In New York that is a worry. In larger cities that is a worry. And if we are going to do this, we ought to do the whole thing.

And, finally, we ought to act swiftly. Right now contracts are being signed. When people think that we might not extend terrorism insurance or it would not affect them, it raises the cost of building at worst—or at the least, and at worst it prevents projects from not going forward in terms of jobs and growth and everything else.

And so this is something, I know, Mr. Chairman, you have worked long and hard on. We have worked together on this over the years. It is sort of like squeezing a little bit of toothpaste out of the tube. Every time you get a little bit, a little bit, a little bit. I think now the time has changed. With the change in the Congress, I think we are going to find less of the ideological opposition to this program that seemed to me to be based on sort of how many angels can dance on the head of a pin instead of realities on the ground. And I hope we can move it quickly.

Thanks, Mr. Chairman.

Mr. Clarke, welcome. Delighted to have you here.

By the way, all of your statements and supporting materials will be included in the record. I want you to know that, and that is true of my colleagues as well, any additional documents or statements they want to be included. And I am going to have a light on here, a clock on here. I am not so rigid about it, but try and keep an eye on it so we can move through the testimony and get to questions as well.

Thank you.

STATEMENT OF CHARLES CLARKE, VICE CHAIRMAN, THE TRAVELERS COMPANIES, INC., ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Mr. CLARKE. Good morning, Chairman Dodd.

Chairman DODD. By the way, all of your statements and supporting materials will be included in the record. I want you to know that.

It is true of my colleagues, as well, any additional documents or statements they want to be included.

I am going to have a light on here, a clock on here. I am not so rigid about it, but try and keep an eye on it so we can move through the testimony and get to questions, as well.

Thank you.

Mr. CLARKE. Good morning, Chairman Dodd, ranking member Shelby, and members of the committee.

As the Chairman said, my name is Chuck Clarke. I am Vice Chairman of Travelers. I really am an underwriter with a big title.

The red umbrella and I started together in the company about 50 years ago and now, as you know, we are back together. The Chairman predicted this a couple of years ago. Thank you.

Thank you for the opportunity to testify on behalf of the American Insurance Association. I would like to express my appreciation for the leadership shown by this committee, and Chairman Dodd in particular, in recognizing the importance of terrorism insurance to our national security and economy, and for supporting enactment and extension of the TRIA program.

Since its enactment in 2002, TRIA has achieved most of its goals. It has made terrorism insurance more available and the cost has dropped for most policyholders. However, it has not made protection from CNBR events readily available for most of our customers and that is a challenge we still face together.

In the past, AIA has testified about the factors that make terrorism an uninsurable risk. Rather than repeating that past testimony, I would like to discuss some themes arising from the President's Working Group report and offer some suggestions for framing TRIA extension legislation.

The PWG report looks at the markets for CNBR terrorism coverage and confirms the past, present and future actions from any private market. The reasons are well understood by insurers who are trying to grapple with this issue on a daily basis, like myself.

First, the loss estimates are staggering, exceeding $700 billion in the case of a nuclear attack in New York City.

Second, insurers have almost no ability to spread CNBR risk to reinsurers or the capital markets. Nobody wants it.

Third, CNBR losses just simply and unequivocally threaten the solvency of insurance in the absence of a Federal program.

The PWG report also examines the markets for conventional terrorism. Here, however, the practical realities that insurers face are at odds with some of the economic theories set forth in the report.

First, the report is correct in that improvements in insurer modeling are helping insurers to estimate their aggregate loss accumulations at specific locations. But that does little to increase overall insurance capacity. The modeling is in its infancy and does little to reduce concerns.

Second, TRIA has not reduced the demand for private reinsurance. In fact, demand far outstrips supply.

Third, increases in policyholder's surplus augment financial capacity but do not affect or offset the need for TRIA. Removing the backstop or raising retentions would impair solvency.

Recognizing that CNBR terrorism is uninsurable in the private market, we believe that Congress should consider recalibrating the current TRIA backstop to provide increased Federal financial participation in the event of such an attack.

With regard to conventional terrorism, we believe that the current backstop has worked and should remain in place. At the current industry retention, which many of you know is $35 billion today, the TRIA backstop would be accessed only in the event of a truly catastrophic conventional attack like a swarm or other multiple venue attack, that would exceed the dimensions of the 9/11 strike.

Experience has shown that the distinction between foreign and domestic terrorism is artificial, impractical and meaningless from an economic perspective.

Additionally, the State regulatory system poses significant challenges in managing this risk. We believe that State regulation of terrorism insurance, rates and forms that can undermine the program's basic objectives should be preempted.

In summary, we continue to need your help in doing what we just can't do by ourselves. Our business is based on dealing with random accidents, not intentional catastrophic injury. We are getting better at protecting ourselves from the potential of conventional terrorism but it is simply impossible to deal with a potential CNBR event without more of your help.

Unfortunately, one way or the other, you are the ultimate underwriter for the event we hope never happens.

Finally, we strongly believe that the program should be made permanent and we look forward to working with you to address these important concepts.

Thank you.

Chairman DODD. Thank you very, very much. It is very, very helpful.

Mr. Minkler, thank you again for being with us.

STATEMENT OF THOMAS MINKLER, PRESIDENT, CLARK-MORTENSON AGENCY, INC., ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA, INC.

Mr. MINKLER. Thank you and good morning, Chairman Dodd and ranking member Shelby, and members of the committee.

My name is Tom Minkler and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America to present our association's perspective on terrorism insurance.

I am the President of the Clark-Mortenson Agency, headquartered in Keene, New Hampshire, a regional insurance agency with eight locations and 55 employees in New Hampshire and Vermont. I also serve as the Chairman of IIABA's Government Affairs Committee.

I would like to begin by complimenting this committee and Congress for passing TRIA in 2002 and extending it in 2005. The Federal backstop created by these laws has worked well. It has insured that terrorism insurance is available and more affordable and has allowed businesses to continue operating and growing at virtually no cost to the Federal Government.

On behalf of IIABA and our more than 300,000 agents, brokers and their employees nationwide, I also want to applaud you for holding today's hearings to examine the future of TRIA. There is still no reason to believe that terrorism threat is on the decline or that the private passenger insurance market alone can adequately provide coverage. Therefore, we encourage Congress to develop a long-term solution for terrorism insurance that enables the private sector to serve consumers.

The original enactment of TRIA and its extension have been successful in stabilizing the insurance marketplace and have helped eliminate the market disruptions and uncertainties that were witnessed in the immediate wake of September 11th. As a result of the enactment of TRIA and its extension, our members are currently able to offer consumers options with respect to terrorism coverage.

Any analysis of long-term availability of terrorism insurance must acknowledge the unique nature of terrorism risk. Terrorist acts are nearly impossible to predict because they are intentional acts committed by those who wish to attack our country, our institutions, our livelihoods, and our sense of security. Given the unique nature of terrorism risk, the insurance market has proven unable to make meaningful assessments and judgments about possible terrorist events.

Additionally, although potential terrorism losses have been estimated in the hundreds of billions of dollars, the current reinsurance capacity is only estimated at $6 billion to $8 billion. Despite the warnings of experts, a specific plan for developing a private reinsurance mechanism to spread catastrophic risk from terrorism has yet to emerge.

Specifically, IIABA believes that a private/public partnership remains essential to the challenge of making terrorism risk insurance available after the expiration of the Act and at the end of the year. It would take decades for the insurance industry to close the gap between the current reinsurance capacity and potentially hundreds of billions of dollars in losses from a terrorist attack. As a result, public participation is necessary to encourage private markets to get in and stay in the business of insuring terrorism risk.

Without some form of meaningful solution, terrorism coverage will be extremely difficult if not impossible for most to obtain after December 31st of this year. Such an outcome would be especially troubling for small and mid-sized businesses which are already challenged by the current environment and are not in a position to self-insure.

While our members remain open to Federal intervention—opposed to Federal intervention in the insurance market in general, they nevertheless acknowledge the terrorism risk insurance coverage currently available to the policyholders they serve would not exist without TRIA. This is a clear case of marketplace failure. And in those rare instances, limited Federal involvement in a reinsurance capacity is warranted.

If TRIA is not extended, based on my experience from 2005, I would fully expect my business customers to receive notices of non-renewal for their terrorism insurance coverages beginning in January 2008. Federal legislation is necessary to ensure that policyholders continue to have access to such coverage.

I would like to stress that the interest in and the need for terrorism insurance backstop is not confined solely to large urban areas or to large businesses. IIABA represents agents and brokers selling coverages to consumers across the country. Our collective experience shows that terrorism insurance coverage is not just a big city or big business problem. It is truly a national issue.

In fact, in the area that I do business in, which is primarily New Hampshire and Vermont, at least 70 percent of the business customers are purchasing terrorism insurance.

Briefly, I also wanted to say that IIABA also believes that any long-term solution to protect the Nation's economy in the face of substantial terrorism losses must address the potential losses from nuclear, biological, chemical and radiological events. Although NBCR losses are perhaps the most catastrophic types of terrorist attacks, coverage for these types of losses is currently excluded from most existing terrorism insurance coverage.

The IIABA believes and always has supported the mandatory availability of insurance coverage for both conventional and NBCR losses, and we still do.

In conclusion, the IIABA applauds Congress for not ending TRIA abruptly in 2005 and for passing a 2-year extension. IIABA members, along with many in the insurer and policyholder community, recognize that we must find a long-term solution to our Nation's terrorism insurance problem and are committed to this process.

We look forward to working with the Congress in this matter that is crucial to our country's economy and security.

Thank you.

Chairman DODD. Thank you very much.

Mr. Peninger.

STATEMENT OF MICHAEL J. PENINGER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ASSURANT EMPLOYEE BENEFITS, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS

Mr. PENINGER. Thank you, Chairman Dodd, ranking member Shelby, and members of the committee.

My name is Mike Peninger and I am President and CEO of Assurant Employee Benefits, an operating division of Assurant, Inc., a premier provider of specialized insurance products, including group life insurance.

I am here today on behalf of the ACLI. The ACLI is the primary trade association of the life insurance industry, representing 373 member companies that account for 93 percent of the industry's total assets in the United States.

I would like to thank the committee for holding this hearing on the Terrorism Risk Insurance Program. While much of the ongoing discussion on extending TRIA has focused on property and casualty insurance, it is also important to discuss how this issue affects the life insurance industry, particularly with regard to group life insurance. While we certainly agree that there needs to be adequate terrorism insurance coverage for buildings, we also believe that the people who work or reside inside those buildings should be adequately covered.

If Congress decides to extent TRIA, the ACLI and I encourage you and your committee to add group life insurance as a covered line, as the House did in the 109th Congress. The NAIC has also adopted a resolution in support of group life insurance.

Group life insurance is a critical component of standard employee benefit packages. For millions of Americans, especially lower income workers, it is the only life insurance that their families have. In 2005, there were about 167 million group certificate holders with an average coverage amount of $49,500.

Due to the nature of the coverage, group life policies have high concentrations of risk. Members of an insured group are often gathered in single locations and they obviously live near their workplaces. A single catastrophic event could cause many or all of them to die at a single time.

For example, if a terrorist attack were to kill 20,000 insured individuals, group life insurers could collectively be liable for almost $1 billion in death claims. If 1 million people were to perish, potential claims would increase to almost $50 billion.

While these death totals and claim amounts may sound dramatic, unfortunately they are not inconceivable, especially of a nuclear, biological, chemical or radiological attach were to strike in a densely populated area such as New York, Washington, or Chicago. The amount of loss that a particular group insurer would incur would depend on many factors, including the amount of catastrophic insurance it has.

While the life insurance industry as a whole would be able to absorb tens of billions of dollars in death claims resulting from a catastrophic attack, those insurers that receive an unexpectedly high number of death claims could be forced into insolvency. Such insolvencies would impact payments to beneficiaries at their time of need. It could also affect the payments of benefits to all the policyholders of the insolvent companies, not just the life policy holders.

Group life policies are designed to provide simple, affordable protection for average Americans. They are not designed or priced to account for the immediate deaths of tens of thousands of people from a terrorist attack.

Group life insurers could, in theory, protect themselves from the terrorism risk either by excluding coverage for deaths due to terrorism or by purchasing catastrophic reinsurance protection. However, neither Assurant nor the ACLI are aware of any States, except for Kansas and North Carolina under very limited circumstances, that allow the use of terrorism exclusions by life insurers. Nor do we believe that it is good business or sound public policy to exclude coverage for deaths due to a catastrophic event.

Since exclusion are therefore not a viable solution, insurers must turn to reinsurance for protection. Unfortunately, such coverage continues to be unavailable in sufficient amounts. While such reinsurance has become slightly more available since 9/11, it comes with higher deductibles, various exclusions and most importantly, with overall coverage limits that are substantially lower than were available prior to 9/11.

Without adequate catastrophic reinsurance, many group life insurers risk financial ruin from a significant terrorist attack. We believe that catastrophic reinsurance would become more available of group life were included in a TRIA extension. This additional reinsurance capacity would significantly reduce the risk of insolvency that many group insurers face in the event of a large-scale attack.

If TRIA is extended again and group life is included, we urge that separate recoupment mechanisms be created for P&C and group life insurers. Recoupment of amounts paid by the Treasury for losses relating to P&C insurance should be made from P&C insurers. Similarly, recoupment for losses relating to group life insurance should only be made by group life insurers.

We look forward to working with your committee and others in Congress, at Treasury, and in the Administration to ensure that group life remains available to the millions of Americans who depend on it and that this vital protection is there when it is needed most.

Thank you for allowing me the opportunity to express our views on this very important matter.

Chairman DODD. Thank you very much.

Mr. Veghte.

STATEMENT OF JAMES H. VEGHTE, EXECUTIVE VICE PRESIDENT/CHIEF EXECUTIVE OFFICER OF REINSURANCE GENERAL OPERATIONS AND CHIEF EXECUTIVE OFFICER OF XL REINSURANCE AMERICA, INC., ON BEHALF OF THE REINSURANCE ASSOCIATION OF AMERICA

Mr. VEGHTE. Good morning, Chairman Dodd, ranking member Shelby and distinguished members of this committee. My name is Jamie Veghte and I am Chief Executive Officer of XL Reinsurance America, Incorporated, headquartered in Stamford, Connecticut. I will be testifying on behalf of the Reinsurance Association of America.

I want to thank Chairman Dodd and many members of this committee for the leadership shown on the terrorism insurance issue. Your role has been critical to the adoption and continuation of the successful TRIA program.

The reinsurance industry appreciates the hard work and support you have provided on this most important issue. It is important that the committee understand that XL Re and the RAA strongly supported the adoption of the Terrorism Risk Insurance Act in 2002 and its extension in 2005.

We believe the program has worked well to fill a vacuum in reinsurance capacity for this risk and help bring stability to the insurance marketplace and, indeed, the economy as a whole.

I would like to address two important questions policymakers have posed as it relates to consideration of a long-term program. One, has the TRIA program infringed on the development of the private reinsurance market? And second, what is the current status of the private reinsurance terrorism market?

Since the terrorist attacks of 2001, the global reinsurance industry has committed substantial resources and capital to develop a better understanding of terrorism risk. Despite these considerable efforts, the basic facts have not changed. Terrorism poses great challenges as an insurance risk. Unlike natural catastrophe exposures, where the reinsurance industry has models and underwriting expertise, the U.S. insurance reinsurance industry cannot adequately underwrite and model the scale and frequency of potential future terrorist attacks.

Despite the addition of considerable capital in the reinsurance market in recent years, over $32 billion since Hurricane Katrina, little of that has been deployed to terrorism risk. Accordingly, the insurance and reinsurance industry cannot provide significant terrorism coverage for this country without a long-term Federal role in terrorism reinsurance.

The TRIA program has not infringed on the development of a private reinsurance market. In fact, the opposite is true. Primary insurers seek to buy private reinsurance to help them reduce the large exposure they face for retention and loss-sharing provisions under the program. The large retention requirements under TRIA, estimated at $35 billion industry-wide, has left plenty of room for the private reinsurance market to provide capacity under the program. By establishing definitive loss parameters, TRIA has provided the defined layer for reinsurers to participate in sharing the retained risk primary companies face.

Even with this large window to provide capacity, reinsurers have been willing to put only limited capital at risk to manage terror-related losses.

To the second question, overall the RAA estimates the global terrorism reinsurance capacity written in the United States for 2007 at about $6 billion to $8 billion with TRIA certified stand-alone treaty reinsurance. Additionally, there appears to be no appetite in the capital markets to provide terrorism risk through catastrophe bonds or other financing products.

It's also important to emphasize that there's very little reinsurance appetite in nuclear, radiological, biological and chemical risk. According to the RAA survey of reinsurance underwriters and brokers, NRBC capacity is estimated to be 15 to 20 percent of the terrorism risk capacity I cited a minute ago. When NRBC is available, pricing for coverage is at a significant premium and coverage amounts restricted.

Some insurers have been able to add terrorism peril to their worker's comp reinsurance program, but this coverage would also typically exclude NRBC losses.

Due to the nature of the terrorism peril, the RAA believes that the private market mechanisms are insufficient alone to spread the risk of catastrophic terrorism loss. Since reinsurance is not covered under the TRIA program, the RAA chooses not to independently advocate suggested change or solutions for a Federal program.

The RAA has a close working relationships with the direct insurance community and will continue to support their efforts for a long-term solution.

In conclusion, without some form of a long-term Federal backstop, we would expect less coverage available at the policyholder level, increased prices for terrorism coverage, and more limited reinsurance capacity.

The RAA looks forward to working with the committee as it considers legislation. Thank you very much for the high honor of appearing before this committee.

Chairman DODD. Thank you very much, Mr. Veghte.

Mr.—is it McRaith? Did I pronounce that correctly?

Mr. MCRAITH. Yes, you did, McRaith.

Chairman DODD. Thank you.

STATEMENT OF MICHAEL McRAITH, DIRECTOR, ILLINOIS STATE DIVISION OF INSURANCE, ON BEHALF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Mr. MCRAITH. Chairman Dodd, ranking member Shelby, members of the committee, thank you for inviting me to testify today. I am Michael McRaith, Director of Insurance for the State of Illinois, and I speak to you today on behalf of the National Association of Insurance Commissioners.

My Chicago office is in a landmark building visited by thousands of tourists above the main switching station for hundreds of thousands of daily subway commuters, including those taking the El to O'Hare and Midway Airports. Within a mile are five of the Nation's 10 largest buildings, 10 tallest buildings, the world's premier commodities trading centers, and Lake Michigan, one of the Great Lakes that comprise 84 percent of all North American fresh water.

TRIA and its extension ensure the affordability and availability of terrorism insurance. The current program should not expire without renewal of an appropriate Federal backstop.

While some advocate for you to deregulate the insurance industry through a so-called "Federal charter", this Federal backstop illustrates when Federal support for a State-regulated private insurance market provides real value for consumers, your constituents.

The extension quickly approaches its expiration date but the NAIC remains convinced that a Federal backstop is an essential platform for our national economy. The U.S. economy remains vulnerable to terrorist attack and requires this backstop, in the absence of which terrorism insurance will become unavailable and unaffordable, thereafter causing the market disruptions and economic uncertainty seen in 9/11's aftermath.

By requiring insurers, through the make available mechanism, to offer terrorism coverage, the Federal backstop has been successful in bringing marketplace confidence and stability. The President's Working Group reported, as has been stated already, that the terrorism insurance market has grown to a take-up rate of over 60 percent.

Important urban markets demand terrorism insurance. And in the absence of private market innovation, available and affordable terrorism insurance depends upon a Federal backstop. Insurers need to understand frequency, severity and loss costs in order to price and offer insurance. Terrorist events cannot be predicted, either in approximate time, location, or level of tragic consequence. This reality, coupled with the geographic concentration of risk, makes terrorism extremely difficult to insure.

A Federal backstop obviously cannot impact frequency but it does cap severity, giving insurers the knowledge to price and offer the coverage and not risk insolvency. 9/11, one of the most costly insured events ever, was carried out by a handful of men. We cannot choose to be naive and ignore the potential for even greater financial loss with another event.

Actuaries predict that a nuclear, biological, chemical or radiological event in Manhattan could result in as much as $778 billion in insured losses. Total capital and surplus available in the entire property and casualty market is roughly $427 billion, half of which is available for commercial lines and a fraction of which is available to any one company.

The private market lacks the wherewithal to survive the catastrophic risk of terrorism and to simultaneously cover all other losses without a Federal backstop. As Congress and this committee evaluate alternatives, we stress the following priorities: the duration of any program should allow for sustained stability that reflects the commercial insurance cycle.

Second, any program should avoid the fictional distinction between domestic and foreign acts of terrorism.

Third, any program should include coverage for group life insurance due to the concentration of risk and prospective insolvency.

Four, any program should consider inclusion of NBCR events at a level that leverages the private market strength against the challenge of insuring those events.

And finally, if you consider a shift to total private market responsibility, we do recommend amendment to the tax code to require companies to reserve for catastrophic events on a tax-deferred basis.

We ask that you act to ensure this essential partnership between the Federal Government and the private market is set before the expiration of the current program.

The NAIC stands with this committee and with Congress in your effort to develop and support that partnership. I pledge the NAIC's support for the constructive process that you begin today.

Thank you for your attention.

Chairman DODD. Excellent testimony, Mr. McRaith. Thank you very, very much.

Mr. Plunkett, welcome again.

STATEMENT OF TRAVIS B. PLUNKETT, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Thank you, Chairman Dodd, Senator Shelby, members of the committee. My name is Travis Plunkett. I am the Legislative Director of the Consumer Federation of America.

On behalf of myself and our Director of Insurance, Bob Hunter, I appreciate the invitation to appear before you today to examine the temporary Terrorism Risk Insurance Act.

In the wake of the horrific terrorist attacks of September 11th, CFA supported the creation of a broad Federal insurance backstop. We changed our views, however, to support much narrower Federal assistance when it became clear that during the year before TRIA was enacted, that the lack of Federal backup had not caused the crippling coverage gaps and economic disruption feared by many and predicted by the insurance industry.

In fact, as I listen to the arguments of insurers for the expansion and permanent extension of a temporary program more than 5 years after September 11th, I am struck by how little real acknowledgment there is of the truly dramatic improvements that have occurred in the insurance marketplace since the attacks.

In fact, there is very strong evidence that insurers no longer need TRIA subsidies to provide adequate terrorism capacity in all but the most extreme cases. NBCR coverage has been mentioned here, and we agree. That is an extreme case.

The property and casualty industry's three most profitable years in history were 2004, 2005 and 2006, with profits in excess of $157 billion, despite significant hurricane losses. Retained earnings or surplus for the industry stood at just over $600 billion at the end of last year. The very significant $12.2 billion in after tax losses experienced by insurers after September 11th amounts to about 2 percent of this unprecedented surplus.

As the Department of Treasury has reported, terrorism risk insurance is now much more available and affordable than after September 11th even though, as we have heard, insurer retentions have increased substantially and Federal assistance has declined. In fact, policyholders have enjoyed deep premium cuts in recent years in all insurance lines, which frees up money for businesses to pay for terror coverage.

As you have heard, the take-up rate has increased substantially.

The evidence is very clear that the TRIA program, as currently structured, is standing in the way of the development of a more vibrant private market for terrorism coverage. The Department of Treasury, for instance, has reported that although the amount of reinsurance available for terrorism has increased since September 11th, federally subsidized reinsurance has depressed the demand for private reinsurance. Insurers who have consistently come to Congress and said that they cannot offer more terror coverage because of a dearth of reinsurance capacity need to acknowledge that it is the TRIA program itself that has helped to keep demands, and thus capacity, low.

We have several recommendations for adapting the TRIA program, not ending it but adapting it, to these new market realities.

First, convert TRIA to a program that covers truly catastrophic terrorism events. As you have heard, there is very little coverage for chemical, nuclear, biological and radiation events, or for that matter for truly large-scale attacks of over $100 billion. In our written testimony, we lay out a detailed plan to cover all losses of between $100 billion and $200 billion, including those resulting form CNBR attacks.

Covering losses of over $100 billion—excuse me. Covering losses of under $100 billion is clearly within the financial grasp of property casualty insurers, who would be able to write off approximately $35 billion of the $100 billion in losses and who, as you have already heard, are responsible for over $30 billion in retentions under the current program.

Second, if TRIA is renewed, we urge you to end the practice of providing free reinsurance to an industry that can afford to pay for it. We estimate the taxpayers will have provided a subsidy for this reinsurance of at least $3.7 billion by the end of the year. As the Congressional Budget Office has noted, requiring insurers to pay premiums for this coverage, premiums that are slightly higher than are actuarially estimated, will encourage private insurers to quickly compete by offering lower rates. It will also encourage loss mitigation.

Third, we strongly urge you not to expand the lines of insurance covered by the programs, especially to group life. There is no meaningful evidence that justifies expanding TRIA to cover group life insurance, which is why the Treasury Department has twice rejected this idea. Treasury pointed out that group life coverage has been and is expected to continue to be widely available at rates that have been declining, despite the lack of TRIA coverage. This is because the market is so competitive.

In fact, we urge you to carefully consider reducing the lines of insurance covered by TRIA, for which there would likely be relatively few terror losses or low aggregate risk exposure. Candidates for such a reduction would include fidelity, boiler and machinery lines, and general liability.

Finally, if you do decide to renew TRIA, we strongly recommend that you keep the program temporary. Extending the program permanently or for more than 5 years would freeze the program in time, inhibiting the further ability of the private market to expand and making it very difficult, if not impossible, for Congress to adjust the program as market conditions change. We think this would be a significant error.

If we have learned anything about terrorism insurance since September 11th, it is that developments in the marketplace that were once thought to be highly unlikely can occur with startling speed. For example, very few people would have thought, in the wake of the significant terrorism losses incurred on September 11th, that the property casualty insurance industry would develop into a financial tiger, with record profits and surpluses and an enormous financial capacity to handle terrorism losses.

Thank you very much.

Chairman DODD. Thank you very much.

Mr. Coppola.

STATEMENT OF ARTHUR M. COPPOLA, PRESIDENT AND CEO, MACERICH COMPANY, ON BEHALF OF THE COALITION TO INSURE AGAINST TERRORISM

Mr. COPPOLA. Good morning, Chairman Dodd, ranking member Senator Shelby, and members of the committee. Thank you very much for allowing me to testify today.

My name is Arthur Coppola and I am President and CEO of the Macerich Company, one of the Nation's largest retail real estate investment trusts. We own and operate major retail centers in many of your home States, including Tysons Corner here locally.

I also serve as the Chair of the National Association of Real Estate Investment Trusts, NAREIT. I am on the board of the Real Estate Roundtable, as well as a member of the International Council of Shopping Centers.

Today I am here to testify on behalf of CIAT, the Coalition to Insure Against Terrorism. The diverse CIAT membership represents virtually ever sector of the U.S. economy. CIAT is the true consumer voice on terrorism risk insurance, as we are comprised of the principal policyholders of commercial property and casualty lines in the United States. It is from this perspective that we offer our testimony today.

We are gratified that you have so clearly made this issue a priority by scheduling this hearing as one of the committee's first items of business in the year. We hope that this hearing will be followed promptly with an introduction and passage of a bill that will ensure the modernization and the seamless continuation of the terrorism insurance program.

There is no question that TRIA accomplished one of its main objectives, which was to stabilize the U.S. economy following 9/11. TRIA and its extension in 2005 TRIA and its extension in 2005 were part of a series of measures that Congress passed to protect the U.S. economy from terrorism threats and continues today to be an integral part of our homeland security strategy.

For example, the U.S. airlines today are directly insured by the Department of Transportation for both terrorism and war risk. The Federal Government, through the Overseas Private Investment Corporation, OPIC, also directly insures U.S. investors overseas for both terrorism and political risk outside the U.S.

It would ironic and senseless of TRIA, which is the only similar protection of the domestic economy, and which unlike the DOT and OPIC programs is not a directly liability to the Federal Government, were allowed to expire or even linger in limbo throughout the remainder of this year.

Terrorism is the major threat facing our Nation today. We hear about it on a daily basis from the Administration, our national security team, and from almost every corner of Capitol Hill.

The market conditions that necessitated TRIA and then its extension have not gone away. Primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses without adequate reinsurance and the private reinsurance market provides only a fraction of the capacity needed.

At least 14 other major industrial nations have recognized that the private markets are unable to effectively manage terrorism risk and have adopted permanent national programs. The U.S. market is no different. Terrorism risk is a national problem that requires a Federal solution.

We believe that the Federal role should focus on what the private markets have been unwilling or unable to do, enabling policyholders to purchase insurance for the most catastrophic conventional terrorism risks and ensuring adequate capacity in high-risk urban areas, and providing meaningful insurance for nuclear, biological, chemical and radiological NBCR risks.

The CIAT proposal seeks to minimize over time the role of the Federal Government for conventional terrorism, but also to ensure that NBCR risks will be covered and that the Federal Government will have an insurance mechanism in place so that the Nation can more easily recover from a truly catastrophic attack, whether by conventional or unconventional terrorism.

For risk of conventional terrorism attacks, the CIAT proposal would leave in place the TRIA backstop with the insurer deductibles, industry retention, and program trigger, all maintained at no higher than their 2007 levels. This ensures that policyholders will continue to have access to coverage through the make available provision.

CIAT also suggests the committee consideration of a privately funded terrorism risk trust fund that would be maintained by the Treasury and used to help cover a portion of the Federal share of insured losses under the TRIA program. We believe that over time this trust fund will accumulate enough capital through pre-event surcharges and assessments that the likelihood of taxpayer exposure to terrorism risk will be limited to only the most extreme events.

NBCR terrorism risk is a different matter, however. Even if the Federal backstop exposure to conventional terrorism can be reduced over time to all but the most catastrophic attacks, the challenges are different for NBCR, according to all of the expert actuarial estimates. The GAO, the Treasury Department, and the President's Working Group, have all recognized that the market simply cannot price the risks associated with NBCR perils.

Accordingly, our proposal addresses this by adding NBCR perils to the make available requirement under TRIA and calling for lower insurer deductibles and copays with respect to NBCR risks. The proposal would also remove the annual $100 billion program cap to clarify that insurers are not liable for truly catastrophic attack, whether NBCR or conventional.

CIAT urges removal of the distinction between foreign and domestic terrorism in the statute's definition of acts of terrorism. As the London bombing demonstrated all too well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims.

Finally, in order to enhance the stability of our financial markets, the modernized program will be made permanent or will at least be in place until Congress declares that terrorism is no longer a risk.

In all, we believe that the CIAT modernization principles for TRIA are fair and we urge the committee and Congress to incorporate these features into the legislation it adopts this year.

I thank you very much for the opportunity to testify at this very important hearing.

Chairman DODD. Thank you very much.

Mr. Lieber.

STATEMENT OF JANNO LIEBER, SENIOR VICE PRESIDENT, WORLD TRADE CENTER PROPERTIES

Mr. LIEBER. Good morning. Chairman Dodd, Senator Shelby, members of the committee, I am Janno Lieber, Senior Vice President of Silverstein Properties where I have responsibility for overseeing the World Trade Center redevelopment.

I want to thank you for the opportunity to participate in this important hearing.

As most of you know, the Silverstein organization leased the commercial office portions of the World Trade Center just 6 weeks before 9/11. Today, after several years of planning and extensive public dialog, all parties, including the State of New York, the State of New Jersey, the city of New York, the Port Authority, are united in the vision of what will be built at the World Trade Center, four world class skyscrapers designed by renowned architects, new mass transit facilities, a performing arts center, and most important, the 9/11 memorial to commemorate those lost on those terrible day.

In order to accomplish this, of course, we need to do some very extensive financing which will require us to obtain terrorism insurance. The most important thing that Congress can do to assure the availability of terrorism insurance for projects in high-risk, high-density areas like lower Manhattan is to have a permanent TRIA program.

A long-term program is necessitated by the interplay between insurance, financing, contracting, and design in these kinds of large-scale projects. Large scale developments can take a very long time from start to finish: three to 5 years for design, planning, and approvals, several years of construction, then several years of lease-up following.

TRIA needs to be tailored to match the timelines that the construction industry, lenders and insurers are looking at when they make their decisions about whether to go forward with these kinds of projects. The failure to do so will impede new construction. And a short-term renewal just will not solve the problem.

Further, we do need, if the standard that you set, Mr. Chairman, in your remarks, the certainty of the ability to obtain insurance is to be met, we need to know that the Federal backstop is going to be there. Because lenders are making their decisions, in part, looking at what their risk is of the circumstances of insurance changing.

Often today, most large loans are securitized in order to create bonds that are purchased by institutional investors. Lenders often do not hold the loans that they originate, but sell off a portion of the loans for regulatory or liquidity reasons.

In order to receive investment grade ratings from rating agencies, which are required to get investors to purchase the bonds, the underlying collateral has to be secured. The lack of access to terrorism coverage may impact on a project's ability to obtain those kinds of investment grade ratings, and that is especially true of projects in these types of concentrated, high-risk areas like lower Manhattan.

Another point that I wanted to take up with you briefly today is that—and this is the species of the point that Senator Bennett made in his opening remark—is that the risk/reward is—although TRIA has been a success across the board, clearly the risk/reward is not working for every area. And lower Manhattan and certain high-risk areas are in that category. A major challenge faced by projects in these kinds of areas is the shortage of capacity which is prevailing today.

The World Trade Center rebuilding is going to cost something in the range of $13 billion to $15 billion in total. But according to leading insurance consultants and brokers in New York City, who we have consulted extensively, even with the current TRIA program in place, as is, there is a shortfall. There is currently less than $750 million total worth of coverage available to the entire lower Manhattan market.

And I should add, there is really no viable alternative to private insurance at all. In other words, even with TRIA, we are not meeting the test that, Chairman, you and Senator Shelby said in your opening remarks, which is availability, affordability and stability for these kinds of areas.

We strongly believe that a TRIA extension ought to address the capacity problems in high-risk, high-density areas and other types of areas where there is a maximum aggregation of risk and of value. Today you are hearing from Mr. Coppola of the CIAT Coalition, and others testifying about addressing the problem in the current program with respect to the foreign versus domestic distinction, and the NBCR issue. These general fixes to TRIA are badly needed in order to free up capacity for terrorism insurance.

However, even if these changes are made, there will still be questions about whether they will be sufficient to attract more capacity to high-risk areas like lower Manhattan. Therefore, we are suggesting that consideration be given to some additional actions, for example perhaps adjusting retentions or the current $100 million TRIA program trigger. We are not wedded to any particular solution but we ask the creativity and leadership of the committee in helping us in other areas like lower Manhattan to address the capacity shortfall.

Finally, there is one other step that Congress can take to free up terrorism insurance for these kinds of areas, and that is to clarify the scope of TRIA coverage to make it absolutely clear that the TRIA backstop applies to all proximate consequences of the terrorist attack, including a fire or collapse following the attack. There is currently some uncertainty in the marketplace about that, and it causes terrorism risk to bleed into other insurances. And therefore, you absorb capacity that otherwise should be made available in areas like lower Manhattan.

So I thank you for the opportunity to appear before you today. The TRIA program has been a success. It ought to be made permanent.

I just want to emphasize again that even with the fantastic program you have put in place, it would not be possible at the present time to adequately insure even one of the office buildings that are being built at the World Trade Center, let alone everything that his happening in lower Manhattan. So we would like to work with you to address that dysfunction in the market.

Thank you.

Chairman DODD. Thank you very, very much.

I want to congratulate you and others who have worked very, very hard over the last number of years in putting this project together. We have all watched it, obviously, Bob Menendez obviously very directly, and Chuck Schumer obviously very involved in this. It has not been easy. But you have done a good job so I commend you. The Silverstein Group deserves a lot of credit for doing that.

Mr. LIEBER. Thank you so much, Mr. Chairman.

Chairman DODD. Mr. Bailey.

STATEMENT OF DON BAILEY, CEO, WILLIS NORTH AMERICA, ON BEHALF OF THE COUNCIL OF INSURANCE AGENTS AND BROKERS

Mr. BAILEY. Good morning, Chairman Dodd and ranking member Shelby. My name is Don Bailey. I am the CEO of Willis North America, a unit of Willis Group, a global insurance broker.

It is a distinct pleasure and honor for me to join you this morning.

Willis works with corporations, public entities and institutions around the world on all matters of commercial insurance, reinsurance, risk management, financial and human resource consulting.

In addition to representing Willis today, I am also speaking this morning on behalf of the Council of Insurance Agents and Brokers. The Council represents the Nation's leading commercial property and casualty insurance agencies and brokerage firms.

With our North American headquarters located in lower Manhattan, not far from where the World Trade Center used to stand, we experienced firsthand the devastation wrought on New York City by the events of September 11th, 2001. Since that time, we in the United States have been fortunate that we have not experienced another terrorist attack on our soil. However, if you look to London, Madrid and other locations around the world, I think we can all agree that terrorism is a permanent problem for which we need a permanent solution.

Regrettably, the question of another terrorist attack here in the U.S. is a matter of when and not if. We thank the committee for convening this hearing to explore the long-term solutions to terrorism risk insurance.

Prior to September 11th, terrorism insurance was readily available. It was offered as an add-on to many policies at a very modest price because the threat of loss was perceived to be low. Clearly, after September 11, the paradigm shifted quite significantly and terrorism insurance was almost entirely unavailable. And the small amount that was available was prohibitively expensive.

Planes did not take off. Many constructionsites, as was just detailed, in what were now perceived to be high-risk zones, fell silent. And commerce in many cities came to a complete halt.

Congress, realizing the dire need, acted quickly by passing TRIA and subsequently the extension to provide available and affordable terrorism capacity for U.S.-based risk. The program has also allowed the private market to progressively increase its role in covering terrorism risks.

The Federal funds provided by the TRIA backstop have never been tapped. Not one taxpayer dollar has been spent on claims. But the program has been an unqualified success in stabilizing the insurance markets and allowing insurers to provide much-needed terrorism coverage at affordable prices.

Policyholders, the business of our economy, have not had to deal with extremely high and volatile terrorism insurance costs and have been able to budget for their business plans.

For many commercial policyholders, obtaining terrorism coverage means more than just piece of mind. It is essential to doing business. It may be required, sometimes by State laws and regulations, and often by contract, to obtain a mortgage, for financing of new construction, for the expansion of business or for a new entrepreneurial venture.

Some suggest that the private market can handle these losses. Consider: estimates indicate that there is only about $6 billion to $8 billion in global terrorism reinsurance capacity available. But terrorism losses from a single attack could reach $100 billion. Industry numbers indicate that there is a $1 billion to $2 billion in capacity available for nuclear, biological, chemical and radiological coverage. Yet the American Academy of Actuaries modeled the impact of a medium-sized nuclear, biological, chemical or radiological attack on New York City and put the losses at $450 billion.

Clearly, there is simply not enough February 28, 2007 capacity in the private market to cover losses due to terrorism. And the limits of such an attack are bound only by the imagination of terrorists whose thought processes are beyond the scope of models and calculations.

Some contend that dealing with the risk of terrorism insurance is a matter for the industry to handle on its own. Collect the premiums, assume the risk of potential losses as they do with other categories of risk. But consider that a terrorist attack is not perpetrated against a company or a building. The terrorists who flew planes into the World Trade Center and the Pentagon, and the plane that crashed in the Pennsylvania field, were attacking our country.

Could you imagine a scenario where the Federal Government knew an attack was going to happen and did not take the steps to either prevent it or to at least prepare for the aftermath? I suggest that not developing a long-term terrorism risk insurance program would be just that.

The objectives of TRIA are clear: harness private industry capacity to directly contribute to terrorism-related losses, deliver Federal assistance in a fair and efficient manner, and repay the Government for any outlays.

Because of TRIA, the terrorism insurance market has been largely stabilized, terrorism coverage has been steadily expanding, and the price of coverage has become more affordable. Now is decidedly not the time for the Federal Government to withdraw its involvement in the terrorism insurance market. The terrorism threats facing our country remain significant, unpredictable, our reinsurance industry still lacks sufficient capacity to address terrorism risks on its own, and the primary insurers are still not willing to expose themselves to enormous terrorism risks without charging prohibitively high prices.

Allowing TRIA to expire at this time will certainly cripple, if not completely paralyze, a significant portion of our economy. We must all work to keep that from happening. TRIA is not about protecting the balance sheet of insurers and brokers. It is about protecting commercial policyholders and creating and sustaining a national economy that encourages investment and development.

This is a matter that far transcends the insurance industry. It is a matter of our national economic security.

I thank the committee for your time this morning.

Chairman DODD. Let me thank all of you again. This is, I know, a real crowd. Senator Bunning, while walking out, said he thought this may be a record number of witnesses this Committee has had at one panel here at any given time. And I thank you for your patience and for being a part of this.

I am going to put a clock on ourselves for about 7 minutes here with Senator Shelby, myself, and my colleagues who are still here, and I am going to open up the record as well for the next several days for questions from members who were here or who did not make it here this morning but have an interest in the subject matter as well and ask you to respond to those questions in a timely fashion, if you would.

Let me just say at the outset to all of you here, I speak for myself at this point here. I wish we were not here talking about this, quite candidly. I mean, I would love to think the idea would be that actually a market would develop these products. There is no appetite that I know of from my colleagues for coming up with a program here to deal with this. There may be some, but I do not know of anyone who would opt for this option. The ideal option is, of course, to have the market produce a product that was available, affordable, that did not require any Federal intervention here at all. That is the ideal situation. It is what has happened in most areas. But I think all of you, one way or the other, including Mr. Plunkett and others, have pointed out that we are dealing with some very unique situations and growing problems.

I was looking at the numbers here. We have had actually -yes, here it is. The terrorist attacks worldwide have increased fourfold in the last year alone. We have a tendency—because we have been fortunate in this country not to be affected by it, there is sort of a distanced approach to this thing. But from 2004 to 2005, more than 14,500 people, noncombatants, have died as a result of terrorist attacks worldwide. According to the National Counterterrorism Center, 2005 was the first year in which the number of terrorist attacks worldwide exceeded 10,000—the number of attacks, 10,000. So the problem is growing, and obviously a lot of means are being taken to try and minimize this. And it is a major challenge for all of us to deal with this.

But it is very, very important that people understand that some—one of you said it. I think each one of you said here that this is not a question of if but when. That is the reality here. None of us want to say that, but the reality is we know, given the nature of our country, the openness of our society in many ways, that it is going to happen. And to say otherwise is to be terribly naive about this. So we need to do everything possible, obviously—in fact, we are debating today, I think, on the floor of the U.S. Senate measures we can take. Many of us here have fought very hard for the first responder records over the last 2 years to do everything possible, to the transit security issue, which this Committee dealt with here a few weeks ago and marked up a bill unanimously here to deal with investing more given the London and Madrid experiences.

So we have a lot of things we have to do here to deal with this issue—this is one of them here—in terms of how we minimize the kind of impacts economically to our country.

Again, I remember Senator Bennett and I working on the Y2K issue a number of years ago in anticipation of the problem of the computer glitches that occurred. We did not have any major problems, but I remember Alan Greenspan testifying before this Committee that, as a result of our work, a lot of efforts were made by the private sector to upgrade their information technology systems; and as a result, while we did not have major glitches here, we took steps to hedge against the possibility of having major disruptions occur economically.

So the purpose of these hearings is to look at an option here. And I am not overly enthusiastic about some absolutely permanent program here. I want one long enough here that gives us a chance to take a look at this and to make sure we are not back here every 2 years. I cannot come back here and Dick Shelby and I year after year coming back and trying to rewrite a bill again and getting 533 other Members of Congress and the administration to go along with this. It just does not make a lot of sense for us to do it. Clearly, this is a problem that we had hoped after 2002 would begin to emerge, that the ideal situation was that a market would begin to develop here and that the need for any extension—I remember making the case I did not think we would have to come back. Of course, we did in 2005.

So we are here for those reasons, and I have just a couple of questions I want to raise with you about—and I will ask Mr. Coppola and Mr. Lieber, although the rest of you jump in if you want, if you feel compelled to talk about these things. I think it may have been Jack Reed, maybe Chuck Schumer, who raised the issue here earlier. We are hearing a lot of reports about global competitiveness in financial services, and one of the concerns is, of course, what is going on in the London markets and so forth.

One of the worries I have here is that if we—given the fact that the U.K. and Germany and France and others have come up with their own ideas on how to have a permanent program to hedge against terrorist attacks from an economic standpoint and the fact that we have not done that yet here, is there any danger in your mind that some of these projects we are talking about here could end up going offshore where there is a more reliable system in place to deal with these risks as they emerge? Is that a legitimate concern for the Committee to raise here with this issue?

Mr. LIEBER. Well, thinking about how this works in New York, if we cannot build the real estate that will hold onto the first-class jobs that you are talking about, the high-value-added securities industry type jobs, because they want new—they need first-class new real estate. If we cannot build that, those very large projects, those very complex projects of the kind I was referring to, and in these densely populated areas, they will be built elsewhere. It is a fair question that you have raised, Senator Dodd, about where they will be built. Whether they would be built abroad I think is a very fair question in light of some of the other dynamics that you have identified in the market encouraging those types of companies to relocate operations abroad.

Mr. COPPOLA. Certainly in the area of global financial services, that is definitely a possibility. Separate from the terrorism issue, it has already happened in places like Canary Wharf, where many of the global firms have decided to locate. And were they to have the opportunity or the desire to do that here in the U.S. and should developers not be able to build because of a lack of proper insurance, then clearly they will land in other countries if need be.

Chairman DODD. So you believe that is a legitimate issue.

Mr. COPPOLA. It could be, yes.

Chairman DODD. And you have alluded, Mr. Lieber—all of us have noted here over the last 5 or 6 years some 300,000 manufacturing jobs in this country have disappeared. I would point out a million of those in the defense production areas. But, clearly, as you start talking about it, this becomes a ripple effect and people begin to look elsewhere. Then, obviously, the effects on manufacturing jobs and construction jobs would also be certainly a casualty of this process.

Mr. COPPOLA. Yes. You know, 6 years ago seems like a long time ago, but we cannot forget that in the 14 months following 9/11, it is estimated $15 billion of new construction was put on hold or canceled and some 300,000 construction jobs were displaced. While in most cities in any corner that we look, we see construction cranes today and so we may feel complacent, if terrorism insurance were not to be made available, those construction cranes would begin to disappear, and there is no question about that.

Chairman DODD. Does anyone else want to comment on this at all, this specific question?

Mr. PLUNKETT. Senator, I would just add that the Treasury Department's 2005 report is one area—this question of construction is one area of where the broader Treasury view of the market would disagree with what you just heard. There was considerable concern at the time that TRIA was initially enacted that construction would be affected. I remember the President talking about let's put the hard hats back to work. But in looking at the marketplace retroactively and in talking about the effect of the lack of terrorism coverage on construction, Treasury concluded that there was not a significant impact.

So I think it is important to keep in mind that Treasury, at least, has done broad reviews of the entire marketplace and is in a better position than any of us in most cases to draw conclusions about these questions.

Chairman DODD. I am glad to see the Consumer Federation of America embracing the Treasury these days here.

[Laughter.]

It has been a strong advocate of the TRIA program, of course, over the years.

Yes, Mr. Coppola

Mr. COPPOLA. If I might just add one thing, I cannot speak for Treasury, but I can speak for myself. And we had a $300 million expansion of a major retail center in New York City, in Queens, that was scheduled to break ground in early 2002. And we waited for TRIA to ultimately get put into place because we knew that we would not be able to obtain the proper construction and permanent financing. And had it not been put into place, we would not have started that job, and we would not have completed that major $300 million expansion.

So speaking from my own personal experience, I can assure you it is a big factor.

Chairman DODD. Thank you.

Did you want to say something?

Mr. MCRAITH. One other angle to the question about construction, Mr. Chairman, is that every construction project requires workers' compensation insurance. There are no exclusions from workers' compensation insurance. To the extent that one insurer has to be more invested in one project than another, workers' compensation will not be available—insurance will not be available for another project.

Chairman DODD. That is a good point. This is Mr. McRaith, by the way, for the record—I appreciate that—for the Insurance Commissioners.

Senator Shelby.

Senator SHELBY. It was kind of interesting, the question Senator Dodd asked and the one several of you picked up on. But I personally believe that maybe Sarbanes-Oxley is running some jobs to London, but I am not sure that it is a lack of building in New York or elsewhere is. I agree with Mr. Plunkett on that.

Mr. Plunkett, I also believe that if Treasury and Consumer Federation of America are together, Treasury must be doing something.

Mr. PLUNKETT. They sure are, Senator.

Senator SHELBY. I think that is a good sign.

Mr. PLUNKETT, I want to ask you three quick questions.

First, is group life widely available in the private market?

Mr. PLUNKETT. Yes, sir.

Senator SHELBY. Second, is group life presently offered at affordable rates, falling rates?

Mr. PLUNKETT. It is, yes. And there was——

Senator SHELBY. Third, can life insurers obtain reinsurance for group life?

Mr. PLUNKETT. Well, the Treasury report says that reinsurance capacity is growing. It also said, Senator, that life insurers have fallen behind their property casualty colleagues in modeling risk, that they are not as aggressively improving their risk modeling as property casualty insurers.

Senator SHELBY. Mr. Clarke, since the passage of TRIA, the insurer deductible has increased from 7 percent to 20 percent. During that same period, take-up rates for terrorism insurance have risen substantially, according to the President's Working Group. These facts suggest that increasing the insurer deductible had little impact on the willingness of insurers to underwrite terrorism insurance because they had the big risk on behalf of the Government.

Accordingly, should the insurer deductible be increased further in order to create additional room for the private market to grow? And if the purpose of TRIA is to provide a backstop for only those risks insurance companies are unable to handle, shouldn't the insurer deductible be as high as possible as long as the market worked?

Mr. CLARKE. It is interesting. Some of the reason why the rates have come down as the deductible has gone up—we have personally in Travelers a $2.2 billion deductible. What happens as we retain risk within the deductible, we are not in the business of selling terror insurance. We are in the business of protecting ourselves against it. So if we write the whole——

Senator SHELBY. You are managing risk, are you not? That is what you are into.

Mr. CLARKE. We manage risk.

Senator SHELBY. You insure it, but you do this by managing it the best you can based on your experience and your model.

Mr. CLARKE. Well, we manage the whole account, the whole risk, and if terrorism is in there, we then protect ourselves by whatever model we have. But we basically charge almost nothing for terrorism. In fact, if somebody—I would give back the last 5 years at a multiple if someone would relieve us of this responsibility.

Senator SHELBY. Say again explicitly why do you charge very little, if anything, for the terrorist risk?

Mr. CLARKE. I cannot get——

Senator SHELBY. It is because the Government backs up the big risk. Is that correct?

Mr. CLARKE. No. It is my retention——

Senator SHELBY. It is?

Mr. CLARKE. It is my $2 billion.

Senator SHELBY. Well, what about the Government's risk? That is what you want out there. That is what has worked. That is what has caused the—that is why this program has worked, I believe.

Mr. CLARKE. If you would like us to pay more or pay for the reinsurance, it will just detract from what we will take.

Senator SHELBY. Well, I am not interested in wanting you to do anything except I want the insurance market to work.

Mr. Plunkett, would you please comment on the importance of keeping TRIA a truly temporary program as opposed to making it permanent?

Mr. PLUNKETT. Senator Shelby, I think the main issue here is what I raised in my testimony, that adjustments to the program would be very difficult politically to make as the market changes. We are not calling for a 2-year extension or a 3-year extension, but we think 4 or 5 years would give the program some continuity, but give you adequate time to also make changes, if necessary.

Senator SHELBY. Thank you.

Mr. Peninger, in its report to this Committee last year, the President's Working Group found that, despite not being covered by TRIA, group life insurance was available in the private market and that prices for group life have generally declined since September

11, 2001. Mr. Plunkett just echoed these findings on the availability and the affordability of group life.

In the absence of any evidence of market failure in the group life market, it appears that your proposal to have group life covered by TRIA is another example of an insurance company seeking to reap the profits of insurance while transferring the losses ultimately to the taxpayer.

Would you comment on that?

Mr. PENINGER. I can make a few comments, Senator.

First, I guess I do not believe that—our experience at Assurant—and that is what I can speak most credibly to—is that catastrophe reinsurance is not, in fact, available. We have scoured the market every year since 9/11. We have been unable to get catastrophe protection in anywhere near the limits that we had prior to 9/11. So I think to say it is available in the market is in our experience false.

I would also say that we cannot use exclusions to protect ourselves against deaths due to terrorist events. And if you say we should just exit the business, I would say that it is very difficult to exit one of the most highly desired benefits markets in a coverage that for millions of Americans it is their only means of protection.

So I think right now, we are in a situation where in the event of a major catastrophe, group insurers will potentially fail, and you will have to deal with chaos after the fact.

Senator SHELBY. Mr. Clarke, in your testimony you indicated that TRIA has achieved its goals by making terrorism risk insurance widely available and help stabilize the market for terrorism risk insurance. Based on your testimony, is it fair to conclude that you believe that both the program's insurer deductible and insurance marketplace aggregate retention amount are set appropriately? The system seems to be working under this.

Mr. CLARKE. For everything except NBCR.

Senator SHELBY. Except what?

Mr. CLARKE. The nuclear——

Senator SHELBY. OK.

Mr. Chairman, thank you.

Chairman DODD. Thank you.

Senator Menendez.

Senator SHELBY. Mr. Chairman, could I ask, I have several more questions that I would like to submit for the record in the interest of time.

Chairman DODD. The record will remain open.

Senator SHELBY. Thank you very much.

Chairman DODD. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman. I am going to have to preside, so I just want to get one question out there, the core of the differences. I am normally with Mr. Plunkett and not the Treasury Department, so I find it interesting today, I am not with him today.

But I want to ask you all to—or those of you—some of you to comment on the core of what I understand his statement is, which is that the TRIA program as currently structured is standing in the way of development of a more vibrant private market for terrorism coverage that would have the capacity to handle all but the most catastrophic attacks; and, second, that you have heard the Treasury Department referred to here several times has, in essence, said that federally subsidized reinsurance has depressed the demand for private reinsurance.

What is wrong about that statement? Is there something underpinning it that is missing?

Mr. VEGHTE. As a reinsurer, if I may comment, it has not depressed demand for reinsurance. We——

Chairman DODD. Could you speak up, Mr. Veghte? It is a little hard——

Mr. VEGHTE. We are often asked to provide private reinsurance for terrorism. The difficulty in underwriting it as opposed to, say, a natural catastrophe, the analytics, the predictability of severity and frequency just simply does not allow us to provide the same leverage off of our balance sheet. Providing capacity for a risk such as terrorism—which is virtually impossible to model from a frequency perspective. We are making some progress on the severity side, but it is a much different dynamic to underwrite.

Senator MENENDEZ. So it is the frequency versus severity?

Mr. VEGHTE. It is both. It is both.

Senator MENENDEZ. Both.

Mr. VEGHTE. But, clearly, if terrorism exposure was sort of blended into natural catastrophe reinsurance, nat-cat reinsurance for States such as Florida would actually be constricted because the reinsurance industry would have to reduce their limits because of the uncertainty of the terrorism risk embedded in the private reinsurance market.

Senator MENENDEZ. Mr. Plunkett, what do you say about the GAO's report last year that said the risks from nuclear, radiological, biological, and chemical threats are distinctly different from those hazards that are predictable, measurable in dollar terms, random, and unlikely to result in catastrophic losses for an insurer. Given those challenges, the GAO found that, "Any purely market-driven expansion of coverage for these specialized terrorism risks is highly unlikely to be seen in the foreseeable future."

Mr. PLUNKETT. Senator, we agree with the GAO, and others have made the same observation. That is why we proposed a higher-level program that would cover nuclear, biological, chemical, and radiation attacks. And we think it is one of the parts of the market that is not yet working.

Senator MENENDEZ. And if that were to be the coverage, then what would be the problem for those of you who are involved in the insurance, if that were to be the coverage? For those of you who are insurers, what would then be the issue? If you were to concentrate it, as Mr. Plunkett suggests, would that still meet the market's challenges?

Mr. VEGHTE. I would suggest there would still be a major amount of uncertainty as to the precise exposure to non-NBCR and, therefore, still make underwriting the risk very difficult, and potentially contract capacity in the non-terrorism exposures.

Senator MENENDEZ. One last question. Mr. Lieber, even as we talk about having reauthorization of a Federal program, aren't there some challenges on the private existing insurers today? I have been following the problems of the former World Trade Center insurers, and aren't there those who seek to walk away even from the existing insurance?

Mr. LIEBER. Yes, and this is—you are right—a separate issue. We have to obtain financing to rebuild, and the TRIA program and Federal terrorism insurance are essential to that. Separately, we do have to resolve the outstanding claims with the insurance companies who provided coverage on the World Trade Center, and after two jury verdicts affirmed by the U.S. Court of Appeals, some of them are still unwilling to make good on that.

So while we are thrilled to be at the same table on the same side of an issue with our friends in the insurance industry on TRIA, obviously, to make sure the World Trade Center is rebuilt, we are going to have to resolve those disputes as well and make sure we collect them from our friends in the insurance industry.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Menendez.

Let me just raise a couple more questions, if I can here. I want to come back to the group life issue that was raised by Senator Shelby and others here as well. Let me ask you, Mr. McRaith, to comment on this as an Insurance Commissioner and looking at these questions. How do you answer the criticism that since most, if not all, group life policies currently cover terrorism losses, that seemingly the capacity already exists to cover those losses?

Mr. MCRAITH. As insurance regulators, Mr. Chairman, our priority concern is that the promises made to the consumers are kept. The primary obligation we have to fulfill that responsibility is to ensure that—to examine and regulate companies for solvency.

If, for example, one company in a group life policy had 1,000 participants in one location, they would normally expect three to four people to die during the course of a year. When that same company has—that site is the location or the target of a terrorist attack, you can lose 1,000 people, hypothetically, in one event on 1 day. And at the same time, all the other policyholders of that company around the country are still dying at their normal rates. Solvency is the issue, and that is why we encourage consideration of group life in the renewal or extension of the current TRIA.

Mr. PENINGER. Senator, could I add to that?

Chairman DODD. Certainly.

Mr. PENINGER. My company in the early 1990's happened to insure Cantor Fitzgerald. We did not have them insured at the time of the attack, but that company cost their insurer $700 million due to 9/11, at which they had full catastrophe reinsurance protection. That would not be available for them today, so I think that speaks to the solvency risk.

Mr. PLUNKETT. Senator, I would like to say that our Insurance Director, Bob Hunter, recommended to the NAIC shortly after 9/11 that the NAIC push group life insurers in the direction of cross-insurance. When you have these highly concentrated risks in distinct geographic areas, he recommended that group life insurers use cross-insurance mechanisms similar to what are sometimes used in the property casualty area to cross-insure each other, a building in San Francisco cross-insuring with a building in New York, so to speak, to deal with the unique aspect of aggregate risk that we are talking about here. To the best of our knowledge, not much has been done here by group life insurers.

Chairman DODD. What is your reaction to that, Mr. Peninger?

Mr. PENINGER. There has been some talk about that. It is a very complicated problem. I will not say it is impossible, but I think you have to have mechanisms for ranking the risk of various areas. There are just lots of factors that would go into that. It sounds great in theory. I think the devil is definitely in the details on that.

Chairman DODD. Do you agree with that, Mr. McRaith?

Mr. MCRAITH. Absolutely, Mr. Chairman. We certainly respect the opinions of the Consumer Federation, and they often make valuable points. That is not one, however, that is valuable beyond a hypothetical discussion.

Chairman DODD. Yes. Let me come back to a question. Senator Bunning raised this in his opening comments, and Senator Menendez talked about it. It is the capacity issue, and I am trying to project ahead in questions that my colleagues will have and others will have about this. It is maybe not a sophisticated question in your minds, but one that I can see them raising all the time. You know, this is a very talented and creative industry, the insurance industry, and it has been able to model in all sorts of areas to be able to assess risk and to make judgments about it, and in a very sophisticated economy.

Now, obviously, I think all of us understand with terrorist attacks we are dealing with a unique feature here, but let me raise this. A study conducted by the Treasury Department in 2005 found that 50 percent of the insurers surveyed would cease providing terrorism risk insurance if TRIA expired. They would cease it, 50 percent said that they would.

The Marsh report found—I am quoting them here—"If TRIA is not renewed or if there is no permanent solution in place, the stand-alone insurance market is unlikely to have sufficient capacity to meet demand."

I have basic questions, and I will ask who may be the most competent to address it. How much capacity is currently available in the private sector? And how has that capacity changed over the last few years? And what are the factors limiting—and this is the question—the private sector from expanding that capacity?

First of all, does someone have the answer to that first question on how much——

Mr. MCRAITH. Our estimates, Mr. Chairman, are that the entire property casualty industry has a capacity of about $427 billion. Approximately one-half of that is for commercial lines.

Chairman DODD. You mentioned this earlier.

Mr. MCRAITH. Right. And each company is some fraction of that.

Chairman DODD. OK. Well, give me some of the factors, again, this limiting capacity issue here, and the response to the question of why can't the industry begin to address and deal with this question of capacity.

Mr. BAILEY. Mr. Chairman, maybe I can jump in on a little bit of this. The whole concept—and I have listened to some of it—of a private solution is a complicated one for a lot of reasons. Our industry has not done, frankly, a lot of mundane things well. Mastering just the art of getting an accurate policy issued is not something that we would put in the to-do list at this point.

The extraordinary at that it would require, the effort that it would require for all of these parties to come together to create a private solution that was effective in every aspect is just impractical. It would be a big bet for us to say let's shut down TRIA and hope that everybody will come together, the private sector, and come up with a reasonable solution. And given what is at risk, it is just not a bet we should make.

Mr. PLUNKETT. Mr. Chairman, couldn't Congress facilitate such a private solution? We recommend as part of our higher-level TRIA proposal that, under the NAIC's direction, Congress facilitate the construction of a private pool at lower levels of losses, under $100 billion. That is an approach, if done fairly, that could involve a public-private partnership with Congress merely facilitating, allowing, encouraging, and mandating that NAIC do it under certain specific conditions.

Chairman DODD. It is a thought. Well, listen, thank you all very much. We are going to try and move on this. And I am pleased to see even—and I thank you, Mr. Plunkett, as well here—that the need for some continuations here may differ on—and obviously you do on the length and some of the areas we cover, but my sense is here that there is a general consensus we cannot let this—the option of doing nothing is really not acceptable. I think, Mr. Plunkett, you would agree with that. I am trying to get your attention, Mr. Plunkett.

Mr. PLUNKETT. Oh. Excuse me. Pardon me.

Chairman DODD. Doing nothing is not an option.

Mr. PLUNKETT. We agree.

Chairman DODD. All right. And so what we need to try to pull together is—if we cannot—what I do not want to have happen is us to get into next fall, late fall, with this clock ticking on us here. So I am going to try and urge my colleagues here on the Committee to come up with some proposals on this and then move the process so we get some clarity on this, and earlier, rather than waiting later, when I think the clock can become a tremendous disadvantage with people who just want to be obstructionist for the sake of being obstructionist.

Senator Reed has, I know, indicated—I don't want to try and speak for him here, but a strong interest in the subject matter as well, and I am very appreciative of his concerned about this. So we will be trying to move as quickly as we can here, but listening to people and trying to package something together.

I want to say how grateful I am to Senator Shelby. He and I differ on this issue to some degree, but he has been very cooperative in the past in trying to work on something here that will allow us to build a consensus here that will work.

So I am grateful to him for his cooperation, and I am thankful to my colleagues here who showed up today as expressing their interest in the subject matter. It is very important, and I am very grateful to all of you who bring a wealth of knowledge to this, and understanding. It has been very helpful to hear your testimony here this morning.

This Committee will stand adjourned.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

American Insurance Association

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

HEARING ON

"EXAMINING THE TERRORISM RISK INSURANCE PROGRAM"

FEBRUARY 28, 2007

WRITTEN STATEMENT OF

CHARLES CLARKE

VICE CHAIRMAN, THE TRAVELERS COMPANIES, INC.

ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

My name is Charles Clarke, and I am Vice Chairman of Travelers, where I have held various executive and management positions since joining the Company in 1958. I am appearing today on behalf of the American Insurance Association. AIA represents approximately 350 major insurance companies that underwrite about one-third of the U.S. commercial insurance market covered by TRIA and TRIEA; the membership includes half of the top ten commercial lines writers in the U.S. Terrorism insurance is among the highest priority public policy and marketplace issues for our members.

We appreciate the opportunity to testify this morning and commend the leadership shown by this Committee, and Chairman Dodd in particular, in steadfastly supporting enactment and extension of the TRIA program. Your leadership in this area is widely acknowledged, and we are grateful for it.

The Terrorism Risk Insurance Act (TRIA), as modified and extended through TRIEA (also known as the TRIA Extension Act), provides a federal backstop for commercial property-casualty insurance in the event of a catastrophic terrorist attack on U.S. soil. Since its enactment in 2002, TRIA has achieved its goals of making terrorism risk insurance widely available to U.S. businesses – even for urban areas, high-risk industries, and iconic properties – and stabilizing the private marketplace for a risk that has many features that make it uninsurable. Unfortunately, despite the government's success since 9/11 in interdicting several terrorist plots and preventing another major strike in the U.S., most experts agree that it is not a matter of if, but when, another catastrophic attack will occur on U.S. soil. A continued, vibrant federal terrorism risk insurance program therefore remains vital to the national security and economic well-being of our nation for the foreseeable future.

Terrorism Remains an Uninsurable Risk

The characteristics that make terrorism an uninsurable risk remain as strong today as they were immediately following September 11, 2001. These include the: 1) difficulty of predicting the likelihood of a major terrorist attack; 2) concentration of insured lives and property values in business centers; 3) magnitude of potential loss from an extreme terrorist attack, particularly those that involve the use of unconventional weapons; 4) limits of mitigation in reducing terrorism losses; 5) lack of available public information necessary to analyze the risk; and, 6) legal, regulatory, and financial hurdles inherent in the current state-regulated insurance system. While TRIA and its extension do not erase any of these criteria that make the risk uninsurable or otherwise constrict the free market, they put a box around the volatility associated with terrorism risk and, therefore, facilitate both coverage availability and affordability.

In the past, AIA has testified about each of the aforementioned aspects of terrorism risk. They remain fundamentally unchanged because the nature of terrorism remains largely unchanged. If anything, the threat is growing over time, as terrorists have more time and resources to identify potential targets and plan for an attack.

Rather than repeating past testimony, I would like to discuss some themes arising from the recent report of the President's Working Group on Financial Markets (PWG), and offer some suggestions for framing long-term federal terrorism risk insurance legislation, utilizing the existing TRIEA framework.

The PWG Report

As you know, the PWG issued its TREIA-mandated report on October 2, 2006. The report reinforces the past, present, and future absence of a private market for chemical, nuclear, biological, and radiological (CNBR) terrorism risk insurance, but expresses more optimism about the private sector's ability to manage "conventional" terrorism risk. These conclusions are correct as applied to CNBR terrorism risk. However, they are unsupported with respect to "conventional" attacks, insofar as private sector capacity remains severely inadequate to bear the risk of a catastrophic "conventional" terrorist attack in the absence of a federal backstop.

CNBR attacks pose insurmountable challenges for insurers

As mandated by Congress, the PWG report looks specifically at the market for CNBR terrorism risk coverage and concludes that no private market for CNBR terrorism risk insurance existed prior to September 11, none exists today, and none is likely to exist in the foreseeable future. More specifically, the report finds that, unless mandated by state law, coverage for CNBR risk has not been generally available, and reinsurance capacity for CNBR terrorism has been virtually non-existent. Looking to the future, the report observes that "there may be little potential for future market development" in this area. These conclusions are entirely consistent with those of a contemporaneous report by the Government Accountability Office on CNBR terrorism risk.

I would like to comment a little more fully on insurers' concerns regarding the CNBR issue.

First, while the loss estimates are staggering—exceeding $700 billion in the case of a nuclear attack in New York City—questions remain about whether CNBR terrorist attacks can even be modeled, given the huge number of variables involved. Among the special difficulties in modeling CNBR terrorism risk are the timing of losses (damages could take years, if not decades, to quantify) and their geographic range (the potential for widespread dispersal of contaminants makes it difficult to limit losses by managing aggregate exposures).

Second, insurers have almost no ability to spread CNBR terrorism risk to reinsurers or the capital markets. While reinsurance for conventional terrorism losses remains scarce, the situation is far worse for CNBR terrorism risk, insofar as most of the available reinsurance coverage specifically excludes coverage for CNBR losses. Similarly, the capital markets—which to date have expressed no real appetite for investing in terrorism risk bonds or similar instruments—cannot be expected to be willing to take *any* significant position in CNBR terrorism risk.

Third, CNBR terrorism losses threaten the solvency of insurers in the absence of a federal program. The lack of private reinsurance means that insurers must retain the virtually limitless costs of CNBR terrorism risk in the absence of a federal backstop. As the PWG report recognizes, a large-scale CNBR event could result in losses that would overwhelm an insurer's capital and surplus, and therefore its claims-paying ability. Moreover, a widespread CNBR event could paralyze the economy and shut down sources of outside capital that insurers might otherwise access to pay claims.

Practical realities of managing "conventional" terrorism risk are at odds with certain economic theories.

With respect to conventional terrorism risk, the PWG report is at odds with several practical realities involving modeling, reinsurance capacity, and insurer surplus.

First, despite the PWG report's optimism, improvements in insurer modeling will not create significant new capacity for the foreseeable future. As the report notes, these improvements are helping insurers to estimate their aggregate loss accumulations at specific locations, based on assumed event scenarios, thus better understanding and more efficiently managing their terrorism risk. However, there is no logic to the implication that an insurer's ability to model losses from a hypothetical event *increases* capacity. Rather, improvements in modeling improve efficiency in the allocation of *existing* capacity, which could create availability problems in highly concentrated areas.

Second, TRIEA has not reduced the demand for private reinsurance. In fact, demand outstrips supply. Additional capacity generally is not available at prices that are affordable for insurers or their policyholders. Like insurers, reinsurers lack sufficient confidence in the models and therefore are unwilling to put a substantial amount of their capacity at risk. This is the reason that private reinsurance capacity has grown only incrementally since the September 11 attack, and not much additional improvement can be expected, according to reinsurance experts.

Private terrorism reinsurance costs more than the amount of terrorism premium that primary insurers are able to obtain from policyholders, due to state rate regulatory restrictions, state restrictions on coverage limitations and exclusions in certain lines of insurance, as well as the policyholders' interest in purchasing coverage. As a result, insurers are buying as much reinsurance as they can afford and/or self-insuring their retentions by exposing more of their capital to risk and thus requiring capital commensurate with the increased risk.

Third, increases in policyholder surplus augment financial capacity but do not offset the need for a federal backstop or enable insurers to utilize higher retentions. The financial condition of the insurance industry has improved since the September 11 attack, and policyholder surplus has increased beyond pre-attack levels. This does not mean, however, that insurers are in a better position to assume significantly more terrorism risk, since this surplus must be available to meet all of an insurer's potential claim obligations. Moreover, many insurers—particularly those with large, diversified client portfolios—manage their terrorism accumulations to a level that is significantly less than their very substantial TRIEA retentions (due in large part to the manner in which individual insurer retentions are calculated as a percentage of commercial lines premium, rather than premium associated with terrorism risk). Removing the backstop or raising retentions would not alter this situation, but could impair solvency in the event of a large scale terrorist attack and create insurance availability concerns outside of terrorism risk.

Solutions

Since the days immediately following 9/11, AIA has been working diligently with Chairman Dodd and others in Congress, the Treasury Department and the White House, the policyholder community, and our colleagues in the insurance industry to develop the most operationally effective and fiscally efficient federal program for the public-private management of terrorism risk. Meaningful solutions must augment existing capacity and spread loss beyond current private sector parameters, while at the same time encouraging the growth of private sector capacity and protecting the taxpayer.

Recognizing that CNBR terrorism risk is uninsurable in the private market, we believe that Congress should consider recalibrating the current TRIEA backstop to provide increased federal financial participation in the event of a CNBR attack. With regard to conventional terrorism risk, we believe that the current backstop has worked and should remain in place. At the current levels (20 percent of subject premium in 2007), the TRIEA backstop would be accessed only in the event of a truly catastrophic conventional attack – most likely a "swarm" or other multiple venue attack – that exceeds the dimensions of the 9/11 strike.

Additionally, experience has shown that the distinction between foreign and domestic terrorism is artificial. Since TRIA was first enacted, events such as the London Underground bombing have reinforced the practical difficulty of making this distinction and underscored that it is meaningless from an economic perspective, and impractical from an insurance perspective.

In an effort to stimulate capacity, Congress should give consideration to a program trigger that provides meaningful protection for small companies. Additionally, the state regulatory system poses significant challenges in managing this risk. We believe that state regulation of terrorism risk insurance rates and forms that can undermine the program's basic objectives should be preempted.

Finally, we strongly support Chairman Dodd's view that the program should be made permanent, or at least remain in place until the U.S. has won the war on terrorism—our ultimate goal.

We look forward to working with you to address these important concepts. Thank you again for your unwavering commitment to a strong national economy through a strong TRIA program.

Independent Insurance Agents
& Brokers of America, Inc.

TESTIMONY OF:

Mr. Thomas Minkler

On behalf of the
Independent Insurance Agents & Brokers of America

Before the Senate
Committee on Banking, Housing,
And
Urban Affairs

United States Senate

February 28, 2007

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Independent Insurance Agents
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STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

February 28, 2007

Good morning, Chairman Dodd, Ranking Member Shelby, and members of the Committee. My name is Tom Minkler, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA) to present our association's perspective on terrorism insurance. I am the president of the Clark-Mortenson Agency, Inc., headquartered in Keene, New Hampshire, a regional insurance agency with eight locations and 55 employees in New Hampshire and Vermont. I also serve as the Chairman of the IIABA's Government Affairs Committee, and am a Past-Chairman of the Independent Insurance Agents and Brokers of New Hampshire.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, representing a network of more than 300,000 agents, brokers, and employees nationwide. IIABA represents small, medium, and large businesses that offer consumers a choice of policies from a variety of insurance companies. Independent agents and brokers offer a variety of insurance products -- property, casualty, health, life, employee benefit plans and retirement products -- and sell nearly 80 percent of all commercial lines policies in the country. Members of the Big "I", as we are known, write the coverage for America's businesses and serve as the conduit between consumers and insurance companies, and therefore we understand the capabilities and challenges of the insurance market. From this unique perspective, we urge Congress to develop a long-term solution for terrorism insurance that enables the private sector to serve consumers and that limits federal intervention and protects taxpayers.

Please let me begin by complimenting Chairman Dodd, Ranking Member Shelby and Members of this Committee and Congress for recognizing the importance of a federal role in terrorism insurance and enacting the Terrorism Risk Insurance Extension Act (TRIEA) of 2005. This extension Act and the original law, the Terrorism Risk Insurance Act (TRIA) of 2002, have worked to ensure that terrorism insurance is available and more affordable, protecting our nation's economic security.

We applaud you for holding today's hearing to examine the future of terrorism insurance. Clearly, the leadership of this Committee understands that the insurance market's ability to protect the American economy from the financial consequences of terrorism risk is a critical component of our national security and vitality during the ongoing war on terror. Your efforts are crucial to finding long-term solutions for the economic and physical risks associated with terrorism, and we thank you for your continued leadership.

Background

It is well known that the insurance community performed admirably in the immediate aftermath of September 11th, 2001, honoring its commitment and providing resources needed to quickly and fully pay claims and thus playing a pivotal role in the recovery-and-rebuilding process. However, even though the insurance marketplace responded effectively to the 9/11 losses, it was quickly apparent, and remains so today, that insurers could not handle the risk of further large-scale terrorist events without a federal backstop.

Not unexpectedly, insurers reacted in late 2001 and 2002 to the new perception of exposure and lack of scientific terrorism modeling with exclusion clauses and outright cancellations of coverage. This left agents and brokers in the always difficult position of being unable to meet consumers' needs for coverage. But beyond our own professional dilemma, it quickly became clear that the absence of coverage presented an immediate threat to our country's economy that had to be addressed – construction and other important economic activity were being impacted by the lack of coverage.

Fortunately, through the leadership of the Administration and many in Congress, particularly in this Committee, the government did respond to address problems in the marketplace with TRIA. Those of us in the market, however, do not need to be reminded of how acute the problem was before Congress and the President enacted the Terrorism Risk Insurance Act in late 2002. Economic activity, especially significant new construction projects, was beginning to be impacted by the inability of owners to satisfy demands of current or prospective lenders to demonstrate adequate insurance coverage. Fortunately, TRIA was put in place before the worst effects of this availability and affordability crisis further injured our national economy.

However, as TRIA neared expiration at the end of 2005, many insurance policies covering businesses of all sizes and types extended past the program's December 31, 2005, sunset date. Because state insurance regulators approved conditional terrorism exclusions in most states to protect insurance company solvency after TRIA, there were continued concerns that policyholders could again face potentially harmful gaps in coverage as the Act expired. With the risk of catastrophic attacks on U.S. soil still very real, and the capability of both insurers and reinsurers to offer comprehensive terrorism coverage for an uninsurable risk still very limited, Congress wisely passed TRIEA, which provided a two-year extension of the federal backstop under TRIA with some modifications to encourage the private sector to take on additional risk.

The current public-private partnership created by TRIA, and extended in TRIEA, has worked well and generally as intended, allowing businesses across America to continue operating and growing, and preserving jobs in the process. TRIA and TRIEA have saved our economy millions of dollars by making terrorism insurance broadly available to all businesses that want and need this coverage at virtually no cost to the federal government. Prices have come down, capacity has grown, and demand is up in many geographic areas.

Unfortunately, the program is scheduled to expire at the end of this year, and there is no reason to believe that the threat of terrorism is on the decline, or that the private insurance markets alone can adequately meet our nation's need for coverage. As such, IIABA encourages Congress to develop a long-term solution to this problem, and we applaud the Committee for holding this hearing to explore these important issues.

Post-TRIA Availability of Terrorism Risk Insurance

Although potential terrorism losses in the United States have been estimated at over $100 billion, current reinsurance capacity is only estimated at $6 to 8 billion.[1] As former Federal Reserve Chairman Alan Greenspan and other notable experts have asserted, the private insurance market is simply not in a position to handle the unpredictable nature and possible immense size and scope of terrorist attacks.[2] Despite the warnings of these experts, a specific plan for developing a private reinsurance mechanism to spread catastrophic risk from terrorism has yet to emerge.[3] Now is the time to develop a long-term public-private partnership.

The original enactment of TRIA in 2002 and its extension in 2005 have been successful in stabilizing the insurance marketplace and have helped eliminate the market disruptions and uncertainties that were witnessed in the immediate wake of September 11th. A failure to reauthorize the federal program could have meant economic hardship for countless small and large communities across this country and would have had an especially devastating impact on financial and commercial centers, such as New York. As a result of the enactment of TRIA and TRIEA, our members are currently able to offer consumers options with respect to terrorism coverage.

However, months before the extension of TRIA in December 2005, these interested policyholders were concerned that exclusions and sunset clauses would eliminate their coverage as insurers prepared for the termination of the TRIA backstop. Although TRIA was extended, these policyholders – including small and mid-sized businesses – continue to worry about the impact of terrorist events in this country and their access to insurance coverage to help them get back on their feet should another event occur. This concern is evident in the increased take-up rates for terrorism insurance as consumer demand for terrorism insurance continues to grow.

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[1] *See* Franklin W. Nutter, President, Reinsurance Association of America, Testimony at the Public Hearing of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners 5-6 (Mar. 29, 2006), *available at* http://www.naic.org/documents/topics_tria_testimony0603_RAA.pdf. Some industry representatives, however, fear that capacity is much smaller. *See* Warren W. Heck, Chairman and CEO, Greater New York Mutual Insurance Company, Testimony at the Public Hearing of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners 4 (Mar. 29, 2006), *available at* http://www.naic.org/documents/topics_tria_testimony0603_NY_Mutual.pdf.

[2] *Greater N.Y. Mutual CEO Makes Case for Terror Coverage*, Insurance Journal, July 27, 2005.

[3] In fact, the Department of Treasury's (Treasury) June 30, 2005 report to Congress concerning the terrorism risk insurance program did not analyze this problem. *See* U.S. Dep't. of Treasury Office of Economic Policy, *Report to Congress: Assessment: The Terrorism Risk Insurance Act of 2002* 5 (June 30, 2005).

We would like to stress that the interest in, and the need for, a terrorism insurance backstop is NOT confined solely to large urban areas or to large businesses. IIABA represents agents and brokers selling coverage to consumers across the country. Our collective experience establishes that terrorism insurance coverage is not just a 'big city' or a 'big business' problem. It is a business customer problem throughout the country; this is truly a national issue. As take-up rates have gone up across the country, we have seen terrorism coverage purchased by a wide and diverse variety of interests, from small towns in Mississippi to small and large businesses in New York City. As the intermediaries between those customers and the insurers, our members remain concerned that the needs of many policyholders will not be met with affordable and good quality coverage for this peril if there is no terrorism insurance program in place after December 31, 2007.

Long-term Availability and Affordability of Terrorism Risk Insurance Coverage

In addition to the potential magnitude of losses from a future terrorist attack, a number of other factors will determine the long-term availability and affordability of terrorism risk insurance coverage, including: (1) the ability to accurately predict the severity and, most importantly, the frequency of terrorism given the increased threat; (2) the effectiveness of mitigation efforts; (3) the insurance market's capacity for substantial catastrophic losses combined with policyholder take-up rates for terrorism coverage; and (4) whether or not insurers are required to "make available" coverage for terrorism risk. Although most of these factors are considered in the context of many types of perils, their impact on the availability and affordability of terrorism is unique due to the nature of terrorism risk.

While modeling has shown us that the size and severity of a terrorist attack could easily threaten the capacity of the insurance market, the risk cannot be assessed in traditional ways. Insurers lack confidence in modeling terrorism risk due to the lack of past statistical records for such risk.[4] Unlike other types of catastrophic risks, insurers and actuaries know very little about where or when terrorism might occur; how it might occur; how often it might occur; or the nature, effects, and costs of such an attack. Much of the information that does exist is available only to governmental agencies that fiercely guard it for security and law enforcement reasons. As a result, underwriters shied away from terrorism risk before the creation of the TRIA backstop. Indeed, since the enactment of TRIA, insurers have proven unable to introduce wide-ranging, new products for insuring terrorism risk. There is currently no indication that the ability to accurately predict and underwrite terrorism risk will improve significantly in the future and certainly not before the Act's expiration at the end of this year.

The unpredictable nature of terrorism also hinders the ability of the consumers who agents and brokers serve to effectively mitigate against acts of terrorism. Although policyholders may invest in increased security measures to thwart the efforts of terrorists, the effectiveness of these measures is limited due to the proven adaptability of terrorists. Moreover, the incentives offered by insurers frequently fail to match the expense of such measures.

[4] *See* Letter from Dennis Fasking, Chairman, Extreme Events Committee, American Academy of Actuaries, to Rep. Richard Baker, Chairman, Subcommittee on Capital Markets, U.S. House of Representatives (August 2, 2005), *available at* http://www.actuary.org/pdf/casualty/tria_080205.pdf.

Notwithstanding the gap between potential losses and available capacity, policyholder take-up rates for terrorism risk insurance coverage have increased since the enactment of TRIA.[5] Increased take-up rates translate into greater capacity to cover losses and spread risk, in addition to reducing taxpayer exposure to post-event and ad-hoc government funding. Likewise, as capacity grows, policyholder take-up rates should continue to increase.

While our members remain opposed to federal intervention in the insurance market in general, they nevertheless acknowledge that the terrorism risk insurance coverage currently available to the policyholders whom they serve would not exist without TRIA. This is a clear case of marketplace failure, and in those rare instances, limited federal involvement in a reinsurance capacity is warranted. Once the backstop expires, the challenges discussed above will likely paralyze the private insurance market's ability to make terrorism risk insurance coverage available and affordable for policyholders. Federal legislation is necessary to ensure that policyholders continue to have access to such coverage.

Potential Solutions to Increase Private-Market Insurer and Reinsurer Capacity for Terrorism Risk

Any analysis of the long-term availability of terrorism risk insurance must acknowledge the unique nature of terrorism risk. Terrorist acts are nearly impossible to predict because they are intentional and heinous acts committed by those who wish to attack our country, our institutions, our livelihood, and our sense of security. Given the unique nature of terrorism risk, the insurance market has proven unable to make meaningful assessments or judgments about possible terrorist events.

Specifically, IIABA believes that a private-public partnership remains essential to the challenge of making terrorism risk insurance available after the expiration of the Act at the end of this year. Although some potential solutions might allow for the reduction of federal involvement in the years to come, it may be difficult to substantially reduce such a role in the immediate future without disrupting the market. Indeed, it will take decades for the industry to close the gap between the estimated $6 to 8 billion in current reinsurance capacity and potentially hundreds of billions of dollars in losses from a terrorist attack. [6] As such, public participation is necessary to encourage private markets to get in and stay in the business of insuring terrorism risk. [7]

The creation of an effective and long-term mechanism is essential for managing the risk posed by terrorist events. Without some form of meaningful solution, terrorism coverage will be extremely difficult – if not impossible – for most to obtain after December 31, 2007, and, as noted above, the

[5]A survey conducted by the Mortgage Bankers' Association and reports by the RAND Center for Terrorism Risk Management and Marsh suggests that policyholder take-up rates have increased since the enactment of TRIA. *See* Survey: Lack of Terror Coverage Would Hurt Commercial Mortgage Market, *Insurance Journal*, June 8, 2004; Peter Chalk et al., *Trends on Terrorism: Threats to the United States and the Future of the Terrorism Risk Act* 8 (RAND Center for Terrorism Risk Management Policy 2005), *available at* http://www.rand.org/pubs/monographs/2005/RAND_MG393.pdf; Marsh, *Marketwatch: Terrorism Insurance 2005* 6-14 (2005), *available at* http://www.marsh.dk/files/Marketwatch_Terrorism_Insurance_2005.pdf.

[6] *See* Marsh, *Marketwatch: Terrorism Insurance 2005* 33 (2005), *available at* http://www.marsh.dk/files/Marketwatch_Terrorism_Insurance_2005.pdf.

[7] Countries such as the U.K., France and Spain, which have a longer history of protecting against terrorist threats, have long accepted that government must play a role in insuring against terrorism losses.

impact will likely be felt before then. Such an outcome would be especially troubling for small and medium-sized businesses, which are already challenged by the current environment and are not in a position to self-insure. The vast majority of businesses in this country are of this size, and the nonexistence of some form of a terrorism insurance program could have devastating effects on the national economy. For these reasons, IIABA urges Congress to continue analyzing long-term strategies before the expiration of the federal backstop next year.

Insurance Coverage for NBCR Events

We believe that any long-term solution to protect the nation's economy in the face of substantial terrorism losses must address potential losses from nuclear, biological, chemical or radiological (NBCR) events. Other than coverage included in statutorily mandated lines (e.g., workers compensation), little coverage is available for NBCR events. Although NBCR losses are perhaps the most catastrophic types of terrorist attacks, coverage for these types of losses is currently excluded from most existing terrorism risk insurance coverage.

The American Academy of Actuaries (AAA) recently estimated that insured losses from a conventional truck bomb attack, as well as medium and large NBCR events caused by terrorism, could reach $778 billion in New York City.[8] The AAA estimated that losses in four U.S. cities could reach the following levels:[9]

	Losses from a Truck Bomb Attack	**Losses from a Medium NBCR Event**	**Losses from a Large NBCR Event**
New York City	$11.8 billion	446.5 billion	$778 billion
Washington, D.C.	$5.5 billion	$106.2 billion	$196.8 billion
San Francisco	$8.8 billion	$92.2 billion	$171.2 billion
Des Moines	$3 billion	$27.3 billion	$42.3 billion

The difficulties of developing adequate capacity to cover terrorism losses due to terrorism and diversifying risk are aggravated in the context of NBCR events. Currently, there is essentially no reinsurance capacity for NBCR losses. NBCR terrorism risk is even more difficult to predict and underwrite than non-NBCR terrorism risk. Moreover, as discussed during the NAIC Terrorism Insurance Implementation Working Group's public hearing on terrorism insurance availability last year, it could take many years to quantify the damages from a NBCR attack.

During our participation in the development and extension of TRIA, IIABA supported mandatory availability of insurance coverage for both conventional and NBCR losses. Based on our experience in the market, we know that policyholders desire a long-term solution to the availability of terrorism risk insurance, including coverage for NBCR events. Policyholders want certainty for their business planning and operations, and they clearly do not want to be subject to on-again, off-again terrorism insurance mechanisms, and exclusions for NBCR losses. Terrorism is perhaps the greatest

[8] *See* Emily Crane, IIABA, *The Potential Costs of Terrorism*, Insurance News & Views, Apr. 6, 2006, *available at* http://www.iiaba.net/IAMag/NewsViews/040606.html.

[9] *Id.*

threat to our nation's economic future, and we believe that the reality of potentially large losses from NBCR events must be addressed to protect our economy, as well as policyholders and taxpayers.

Given the potential magnitude of NBCR losses, a catastrophic attack in a line not covered under the TRIA program (e.g., NBCR) would almost certainly lead to a substantial government bailout. In light of the potentially enormous burden that taxpayers could face as a result of NBCR risk, it is imperative that policymakers work to help develop the private insurance market's capacity for losses. As demonstrated with non-NBCR coverage under TRIA, we do not expect the private insurance market to view NBCR risks as insurable or move toward developing capacity to cover such risks without encouragement from the federal government. Public participation is a vital requirement for any long-term solution for increasing private market capacity to cover these types of events.

Nationwide Need for Terrorism Risk Insurance

In addition to the capacity problem, we believe that insurers' ability to diversify risk will also pose challenges to the long-term availability and affordability of terrorism insurance. The nature of the risk presented by terrorism requires that any long-term solution enable the market to spread the risks associated with terrorism and develop as broad a funding base as possible. This means focusing on increasing take-up rates in all communities, which is closely related to the availability and affordability of coverage. As former Washington, D.C. Insurance Commissioner Larry Mirel noted in Congressional testimony, businesses in New York City, Washington, and other prominent "target" areas pay very high premiums for terrorism coverage – even with the existence of the federal program – yet they are not the true targets of terrorists.[11] Terrorists, as the Commissioner noted, want to attack America, and an attack on any particular town or city is actually an attack on our nation as a whole.[12] Accordingly, it is both appropriate and fair for policymakers to identify solutions that truly help protect America's national economy and identity through a wide spreading of this distinctive risk.

Domestic v. International Terrorism

Although domestic terrorism is excluded from the current federal terrorism risk insurance program, we would recommend that any long-term response eliminate the distinction between domestic and international terrorism. Domestic terrorism, which presents many of the same characteristics of international terrorism, is a very serious threat and coverage for this risk is largely unobtainable in the marketplace today. IIABA believes that such distinctions are likely to prove irresolvable in the aftermath of an attack. Distinguishing between domestic and international terrorism can be difficult (if not impossible) as the anthrax incidents of 2001 and the London Underground bombings of last summer demonstrated. In short, IIABA continues to believe that the terrorism peril should be treated on a seamless basis without such distinctions.

Conclusion

[11] The Future of Terrorism Risk Insurance: Hearing Before the Subcomm. on Markets, Insurance and Government Sponsored Enterprise of the H. Financial Services Comm. 3 (July, 27, 2005) (statement of Laurence H. Mirel, Commissioner, District of Columbia Department of Insurance, Securities and Banking, Testimony before the House Financial Services Committee); *available at* http://financialservices.house.gov/media/pdf/072705lm.pdf.

[12] *Id.*

IIABA applauds Congress for not ending TRIA abruptly in 2005 and for passing a two year extension, TRIEA. Although it seems the terrorism insurance program was only recently extended, it is time to start looking ahead, and we thank the Committee for beginning this process today. The need for action is actually more urgent than many might realize, as policyholders are renewing policies with contract terms that extend beyond December 31, 2007. If a solution is not in place early this year, insurance markets may once again face significant disruption and uncertainty, and we anticipate that insurers would exclude terrorism risks from policies where authorized.

We also hope that any solution will draw on the experiences of the current program in order to assist the private markets in handling this risk. For example, despite the fact that TRIA does backstop losses arising from NBCR attacks, commercial customers generally are unable to get that type of coverage in the market today.

IIABA members, along with many in the insurer and policyholder community, recognize that we must find a long-term solution to our nation's terrorism insurance problem and are committed to this process. We look forward to working with Congress on this matter that is crucial to our country's economic security.

ACLI
Financial Security. For Life.

Statement of

Michael J. Peninger
President and Chief Executive Officer
Assurant Employee Benefits

on behalf of the

American Council of Life Insurers

on

Examining the Terrorism Risk Insurance Program

before the

United States Senate
Committee on Banking, Housing and Urban Affairs

February 28, 2007

Introduction

Chairman Dodd, Ranking Member Shelby and members of the Committee, my name is Michael J. Peninger and I am President and Chief Executive Officer of Assurant Employee Benefits – an operating division of Assurant, Inc., a premier provider of specialized insurance products (including group life insurance) and related services in North America and other selected markets.

Assurant is a multi-line insurer with approximately $24 billion in assets and $7 billion in revenues with more than 12,000 employees. The company is headquartered in New York City at One Chase Manhattan Plaza. Our offices used to be located in the North Tower of the World Trade Center when it was first bombed in 1993.

I am here today on behalf of the American Council of Life Insurers (ACLI). The ACLI is the primary trade association of the life insurance industry, representing 373 member companies that account for 93% of the industry's total assets in the United States. ACLI members offer life insurance, annuities, pensions (including 401(k) plans), long-term care insurance, disability income insurance, reinsurance and other retirement and financial protection products.

My colleague, Ed Harper, Senior Vice President of Assurant, is chair of the Group Life Coalition (an organization of some of the industry's top group life carriers) and the ACLI's Federal Legislative Strategy Group for Group Life.

Overview

I would like to thank the Committee for holding this hearing on the Terrorism Risk Insurance Program (TRIA).

We are all, unfortunately, well aware of the risks that our country continues to face from various domestic and international extremist and terrorist groups. In addition to implementing effective homeland security measures that will help prevent large-scale terrorist attacks, we must also sufficiently insure our nation's most vulnerable assets, including its critical infrastructure, and its citizens in case such attacks do take place. Terrorism insurance is a vital component of maintaining our robust economy and providing a safety net to those who financially depend on the victims of such attacks.

While much of the ongoing discussion on extending the TRIA program has focused on the property and casualty (P&C) insurance industry, it is also important to discuss how this issue affects the life insurance industry and its policyholders and beneficiaries, particularly with regard to group life insurance. While we certainly agree that there needs to be adequate terrorism insurance coverage for buildings, we also believe that the people who work or reside inside those buildings should be adequately covered for such events as well.

If Congress decides to extend TRIA, the ACLI and I urge you and your Committee to add group life insurance as a covered line (as the House did in the 109th Congress). The National Association of Insurance Commissioners (NAIC) has also adopted a resolution in support of the inclusion of group life insurance as well.

The Importance of Group Life Insurance

Group life insurance is a critical employee benefit and is usually part of an employee's benefit package that contains medical, disability and other coverages, and remains available and affordable (as it did before September 11, 2001). For millions of Americans, especially lower-income workers, it is the only life insurance that their families have and can rely on if they were to unexpectedly die. Almost $20 billion in death benefits were paid to group life beneficiaries in 2005 (which represented about 37% of all death payments).

Group life insurance represented about 45% of all life insurance in force - $8.26 trillion out of a total $18.4 trillion at the end of 2005. There were about 167 million certificate holders of group policies, with an average coverage amount of $49,500.

In addition, approximately 60% of ACLI member companies sell group life insurance. Group life insurers received about $29 billion in net group life insurance premiums in 2005 (which is a little more than 20% of the $142 billion of total net life insurance premiums received).

Potential Exposure to Group Life Death Claims

Unlike individual life policies whose insured individuals are generally scattered throughout a particular area(s) or region(s), group life policies usually have very high concentration risks. By its very nature, most, if not all, individuals of an insured group are often gathered in one or several locations (e.g., office buildings, factories) and a single catastrophic event in a particular city could cause many or all of them to die at once, resulting in a high number of death claims.

For example, if a terrorist attack were to kill 20,000 individuals insured under one or more group plans, based on an average coverage amount of $49,500, group life insurers could collectively be liable for almost $1 billion in death claims. If 100,000, 500,000, or one million people were to perish, potential claims would increase to almost $5 billion, $25 billion and $50 billion, respectively.

While these death totals and claims amounts may sound exaggerated, unfortunately they are not inconceivable, especially if a nuclear, biological, chemical or radiological (NBCR) attack were to strike in a densely populated area (e.g., New York City, Washington, D.C, Chicago, San Francisco). The amount of loss that a particular group insurer would incur would depend on several factors, including the amount of catastrophic reinsurance it has (if any) and the amount of available surplus that can be used to pay off its claims.

Insurers' Limited Capacity to Cover Catastrophic Losses

Life insurers are required to put aside reserves and maintain surplus accounts for expected and unexpected death claims. For deaths that fall within a company's expected mortality rates, claims are paid from allocated reserves and pooled mortality charges. For deaths that exceed its expected mortality rates (such as those resulting from a major terrorist attack), payments come from allocated reserves and its surplus accounts.

However, only a portion of a company's surplus is generally available for unexpected claims (approximately 40-50%), and this amount may not be enough to meet its financial obligations. If surplus funds are insufficient and a company becomes insolvent, state guaranty associations would have to step in to provide a mechanism for outstanding claims to be paid to beneficiaries (up to certain statutory limits). In order to obtain the necessary funds to pay off these claims, these associations would then assess the remaining solvent insurers according to certain formulas (e.g., premium volume). Most states have separate guaranty associations for P&C and life/health insurance companies.

Therefore, while the life insurance industry as a whole would be able to absorb tens of billions of dollars in death claims resulting from a catastrophic attack(s), those small to medium-sized insurers, and possibly some larger-sized insurers, that receive an unexpectedly high number of claims (especially those whose main line of business is group life) would be forced into insolvency. Such insolvencies, besides affecting the employees and owners of the companies, also would affect the payment of benefits to all of the policyholders of the insolvent companies, not just the group life policyholders.

Group Life Insurers' Vulnerability to Large-Scale Attacks

In addition to concentration risk, there are several other reasons why group insurers are highly vulnerable to major terrorist attacks. First, group policies are not currently designed or priced to account for the immediate or short-term deaths of hundreds of thousands or more people from a terrorist attack.

Unlike deaths from accidents, diseases, murders and natural disasters, which have been tabulated and analyzed over dozens of years and incorporated into mortality and morbidity tables (which helps determine pricing of policies), there is insufficient historical data in this country relating to deaths from terrorism that can be factored into such tables. Terrorism is by its nature, unpredictable, so it cannot be accurately forecasted or priced.

You may ask why insurers do not simply exclude terrorism coverage from group life policies. There are several reasons why this approach is problematic:

First, neither Assurant, nor the ACLI, are aware of any states (except for Kansas and North Carolina under very limited circumstances) that allow the use of terrorism exclusions (including those for NBCR events) by group (or individual) life insurers.

Second, we do not believe that it is good business, or sound public policy, to exclude coverage for deaths due to a catastrophic event. The importance of coverage would in fact be highlighted by the horrible nature of a terrorist attack.

Finally, unless the entire industry took the same approach, any group insurer that tried to prudently manage its risk exposure by excluding terrorism coverage would be placed at a severe competitive disadvantage in the marketplace.

You might also ask why group insurers do not purchase reinsurance protection for the terrorism risk. The short answer is that such coverage is not available in sufficient amounts. Immediately after 9/11, group life insurers were generally unable to obtain catastrophic reinsurance, especially for terrorist events. While such reinsurance has become slightly more available since, it comes with higher deductibles, various exclusions, and most importantly, with overall coverage limits that are substantially lower than were available prior to 9/11. Reinsurance is a fundamental risk spreading mechanism underpinning the insurance industry. Without adequate catastrophic reinsurance, many group life insurers risk financial ruin from a significant terrorist attack.

Group Life Should be Included in any TRIA Extension

While group life has been readily available to consumers, mainly for competitive reasons, if a major terrorist attack were to occur, it is very likely that some group insurers would be unable to fully pay their death claims. We also believe that group life insurance would not be widely available after such an event since many or most insurers would likely decide to exit the marketplace. It is for these reasons that we strongly urge Congress to include group life insurance in any TRIA extension.

Group life is very similar to workers compensation and most workers across the country are covered by both. The latter was included in the original TRIA legislation, as well as in its extension, and as a result, experienced a significant increase in the availability of related reinsurance. As with workers compensation, we believe that catastrophic reinsurance would become more available and less expensive for group life if it were included in a TRIA extension.

This additional reinsurance capacity would significantly reduce the risk of insolvency that many group insurers would face if a large-scale terrorist attack(s) were to occur.

Separate Recoupment Mechanisms Should be Created

If TRIA is extended again and group life insurance is included, we urge that separate recoupment mechanisms be created for P&C and group life insurers. Recoupment of amounts paid by the Treasury for losses relating to P&C insurance should only be made from P&C insurers. Similarly, recoupment for losses relating to group life insurance should only be made by group life insurers.

Group life insurers take on different types of risks than P&C insurers and the premium structures of the two industries are very different. Without separate recoupment mechanisms, in the event of a catastrophic terrorist attack that primarily results in P&C losses, group life insurers would have to reimburse the federal government for millions or billions of dollars for claims unrelated to their line of business and for which they received no prior premiums. The converse would also be true in the event of an event that killed thousands of people but spared properties.

Conclusion

We look forward to working with your Committee and others in Congress, at Treasury and in the Administration. Thank you for allowing me the opportunity to express our views on this very important matter. I will be glad to answer any questions that you may have.

RAA
REINSURANCE
ASSOCIATION
OF AMERICA

STATEMENT

TESTIMONY

OF

JAMES H. VEGHTE
EXECUTIVE VICE PRESIDENT/CHIEF EXECUTIVE OFFICER
OF
REINSURANCE GENERAL OPERATIONS
&
CHIEF EXECUTIVE OFFICER
OF
XL REINSURANCE AMERICA INC.

EXAMINING THE TERRORISM RISK
INSURANCE PROGRAM

BEFORE

SENATE BANKING, HOUSING AND URBAN AFFAIRS
COMMITTEE

FEBRUARY 28, 2007

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My name is Jamie Veghte and I am Executive Vice President and Chief Executive Officer of Reinsurance General Operations and Chief Executive Officer of XL Reinsurance America. I am testifying on behalf of the Reinsurance Association of America (RAA), which represents the U.S. property and casualty reinsurance industry. XL Re is a global reinsurance company that unites XL Capital Ltd.'s global reinsurance companies under a single banner, including XL Re America, based in Stamford Connecticut, XL Re Ltd, XL Re Europe Limited, and XL Re Latin America Ltd. XL Re is ranked among the 10 largest reinsurers worldwide. Our clients include most of the world's 500 leading insurance companies. XL Re is proud to have provided reinsurance protection to our clients in response to many of the catastrophic events that have occurred in the United States and around the world.

Before I begin my testimony, I want to thank Chairman Dodd and the members of this Committee for the leadership shown on the terrorism insurance issue. Your leadership has been instrumental to the adoption and continuation of the successful, and necessary, TRIEA program. The reinsurance industry commends you for the hard work and tremendous support you have provided on this most important issue.

Reinsurance is commonly referred to as insurance for insurance companies. Reinsurance plays a critical role in maintaining the financial health of the insurance marketplace and ensuring the availability of property and casualty insurance for U.S. citizens. Reinsurance can be used by insurers for several reasons. One of the most important purposes is to protect insurers from catastrophic losses from various perils, including hurricanes, earthquakes, fire and floods. To that end, reinsurers have financially responded to every major U.S. catastrophe for more than a century. In this context, it is important to note that two-thirds of the insured losses from the September 11 terrorist attack were absorbed by the reinsurance industry.

XL Re and the RAA strongly supported the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the Extension Act (TRIEA) in 2005. We believe the program is necessary and working well to: 1) fill a vacuum in reinsurance capacity for acts of terrorism; 2) keep premiums paid by policyholders at affordable levels; 3) provide insurance coverage to support economic activity; and 4) minimize the need for disaster assistance should there be future terrorist acts in the U.S. Today, my comments are intended to provide the Committee with a better understanding of the status of the current private reinsurance market for terrorism risk and explain why the reinsurance industry strongly believes that a public-private partnership is necessary to help stabilize the commercial insurance markets that fortify our free-market economy.

The Need for a TRIA/TRIEA Program

As you are very well aware, TRIA was enacted in response to the tragic events of September 11, 2001. In the history of our nation, no hurricane, earthquake or other catastrophic event so fundamentally changed the American landscape and the insurance and reinsurance industries.

These attacks forced all Americans to confront the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil. Although the insurance and reinsurance industry responded unwaveringly to the catastrophic losses of September 11, the events shook the financial foundation of the industry and forever changed the way it views this risk. The simple fact is that the U.S. insurance and reinsurance industry cannot underwrite or model the scale, size or frequency of future terrorist attacks in our nation. The insurance and reinsurance industry cannot provide significant terrorism coverage, especially nuclear, radiological, biological and chemical (NRBC) risks, without TRIEA's public-private partnership.

Will this change in the future? If terrorism risk lessens in the world, the need for a public-private backstop should also moderate. But absent the lessening of the risk of terrorism, the RAA does not see a time in the foreseeable future when the frequency or severity of terrorism risk can be successfully modeled and underwritten.

TRIA was created to provide a federal backstop which was essential to allowing the primary insurance industry to provide terrorism coverage to our nation's businesses. XL Re and the RAA believe that TRIA/TRIEA has fulfilled its purpose of allowing primary insurers to provide terrorism insurance coverage to commercial policyholders in both urban and rural areas. By limiting insurers' exposure to catastrophic terrorism losses, TRIEA has improved the market for such coverage and has had a stabilizing influence on the economy.

Private Reinsurers Still Face Significant Hurdles in Underwriting Terrorism Risk

Following the terrorist acts of 2001, insurers and reinsurers have worked hard to develop a better understanding of terrorism risk. Companies have consulted military and intelligence experts, hired specialty risk modeling firms, and invested in new research and development.

Despite these considerable efforts, the basic facts have not changed: terrorism risk poses great challenges as an insurable risk. A key struggle in the development of a private market is that terrorism risk is not conventional. The Federal government, in fact, is telling us that we are at war on terrorism. War, by its nature, is not insurable.

Terrorism risk also has characteristics regarding frequency, severity and correlation that make it unlike any other insured peril or risk:

Frequency

1. The frequency of loss is unpredictable, with little historical track record to project future loss experience. In addition, the insurance industry does not have access to all existing information about terrorism, targets and potential attacks due to national security interests.
2. Terrorists learn from their attacks and thus will attempt to defeat loss prevention and mitigation methods used by policyholders, insurers and reinsurers. This also suggests that history will never be a reliable predictor of future terrorism losses.

Severity

1. Terrorist acts are willful and intended to inflict maximum damage. They are not random or fortuitous acts.
2. The potential size of loss is enormous, with total destruction of multiple insured properties likely. The introduction of nuclear, biological, chemical and radiological weapons can greatly magnify losses to property and life. As an example, the American Academy of Actuaries has modeled potential insured losses totaling $778 billion stemming from an NRBC event in New York City. These extreme loss scenarios would cause losses that far outstrip insurer financial resources and therefore are uninsurable.

Correlation

1. The potential size of loss is compounded by the aggregation of losses arising from multiple clients and multiple insurance products implicated in the same occurrence.

2. Unlike natural disaster risk, reinsurers achieve virtually no spread of risk with terrorism coverage. Hurricanes in Japan and Florida and earthquakes in the far west are not correlated. Premiums can be collected from each risk knowing that one loss will not lead to another. Terrorism risk in Europe and North America, however, may be highly correlated and thus minimize any benefit of risk spreading geographically.
3. At the same time, terrorism events can lead to major disruptions in the financial markets. In the event of a large loss, reinsurers may be liquidating assets to pay claims. The asset values themselves may be under market pressure due to investors' concerns over the terrorist attack.

Reinsurance company underwriters must consider all of these factors and more when deciding whether to assume terrorism risk. The result has been the development of a very limited market for terrorism reinsurance.

Private Reinsurers' Function under the TRIEA Program

In the event of a certified terrorist attack, TRIEA will provide reinsurance-like protection for primary commercial insurance exposures. For 2007, 90 percent of the commercial terror loss for primary insurance companies is covered up to an industry total of $100 billion. This coverage is subject to an individual company retention of 20 percent of 2006 direct earned premium on commercial lines. These individual company retentions, and the 10 percent co-pay for losses above the retention, require commercial insurance companies to absorb significant losses before TRIEA funding is available. The primary industry is under increasing financial risk and exposure to acts of terrorism because of: (1) the significant and rising retentions under TRIEA; (2) the mandatory offer of coverage required of insurers under the program; (3) state regulatory action or refusal to act on rates and exclusions; and (4) the scrutiny of independent rating agencies. In certain instances under TRIEA, some insurance companies will have to absorb losses greater than those losses sustained during the terrorist attacks of 2001 before federal funding is provided.

Primary insurers seek private reinsurance to help reduce the large gap in terror exposure they face from the company retention and the loss-sharing provisions under TRIEA. Private reinsurance is sought to "buy down" the primary company retentions under the Act. The industry retention under TRIEA, estimated at $35 billion, leaves plenty of room for the private reinsurance market to provide capacity. Yet, five years into the program the reinsurance market has provided only $6 - $8 billion of this retention. Observations by some that TRIEA may be infringing on the development of a private reinsurance marketplace are without basis. In fact, the opposite is true. TRIEA has established definitive loss parameters that provide reinsurers with a defined layer in which to share the retained risk of loss that primary companies face under the program.

Market Observations on Reinsurance Terrorism Capacity

Working with client companies to manage their substantial retained exposure under TRIEA, reinsurers have been willing to put limited capital at risk to manage terrorism-related losses. Reinsurers typically seek to offer terrorism coverage in a stand-alone contract, rather than within a traditional all perils catastrophe contract, especially for insurer clients writing a national portfolio. Some regional carriers, with exposures limited to rural or suburban areas, have secured terrorism coverage within their standard reinsurance programs, usually with some limitations as to the nature of the subject risk or size of subject event.

The RAA surveyed reinsurance brokers and reinsurance underwriters to estimate how much terrorism reinsurance capacity is written in the private reinsurance market. This coverage generally includes TRIEA "covered acts" as well as domestic terrorism and personal lines exposure where requested. The most recent RAA survey of market participants estimates the global reinsurance capacity available in 2007 for risks located in the United States is about $6 to $8 billion for TRIEA certified, stand-alone and treaty reinsurance. Favorable loss experience and surplus growth may moderately increase the supply of private terrorism reinsurance but not to the extent that it would fill current capacity needs of the primary industry to meet its retentions under TRIEA.

Regarding losses from nuclear, radiological, biological, and chemical events (NRBC) generally, there is very little reinsurance appetite for this risk. According to the RAA, knowledgeable market participants believe NRBC capacity to be 15 to 20 percent of non-NRBC capacity for terrorism risk. And when it is available, pricing for coverage that includes NRBC is at a significant premium and coverage amounts are restricted. With regard to workers' compensation, some insurers have been able to add the terrorism peril to their reinsurance programs, but this coverage typically excludes NRBC events.

XL Re and the RAA believe that in the foreseeable future, reinsurers will be unable to provide enough capacity to replace TRIEA coverage. Although progress has been made in modeling terrorism loss scenarios, forecasts of the frequency and the severity of terrorism losses are extremely problematic. Reinsurers can provide only limited capacity for terrorism because the magnitude of these potential losses would otherwise put these companies at risk of insolvency. Reinsurers' capital is necessary to support many other outstanding underwriting commitments made by reinsurers, including natural disasters, workers' compensation and other casualty coverages.

Capital Markets' Limited Impact On Terrorism Risk Capacity

A key question asked by many policymakers is what role the capital markets can play in assuming terrorism insurance risk through the use of catastrophe bonds. Catastrophe bonds have been used by the financial markets to absorb and spread natural hazards risk. Indeed, reinsurance companies are one of the most frequent users and facilitators of catastrophe bonds. Hurricane and other natural disaster "cat" bonds have grown in use. According to the data from Benfield Group Ltd., natural catastrophe bond issuance in 2005 included more than 10 transactions totaling $2.4 billion in capacity. Since Hurricane Katrina, another $4.5 billion in capital has been dedicated to natural catastrophe bonds. Since the Fall of 2005 the total amount of additional capital raised for new reinsurance startups and capital replenishment of existing reinsurance is more than $32 billion. Yet, none of this new capital has been dedicated to terrorism risk. The capital markets lack any real appetite for terrorism risk. Although a few new companies have expressed an interest in providing terrorism insurance, their capacity is limited and market presence untested.

Acts of terrorism present much greater underwriting and pricing challenges than natural catastrophe risk to the insurance and reinsurance industry and, of course, to those issuing and investing in catastrophe bonds. There is no reason to believe terrorism bonds are likely to be a significant provider of terrorism coverage in the foreseeable future. The capital markets face the same problems as insurers: inability to assess frequency of attack; a lack of predictive experience; correlation of loss to other exposures such as a stock market decline; and potentially devastating financial loss. In addition, rating agencies have to-date been unwilling to rate terrorism-only bonds.

A Continued Public-Private Partnership Is Necessary to Address Terrorism Risk

Due to the nature of the terrorism peril, the RAA believes that private market mechanisms alone are insufficient at this time to spread the risk of catastrophic terrorism loss in a meaningful way. Without some form of a federal role we would expect less coverage available at the policyholder level, rising prices for terrorism cover and even more limited private reinsurance capacity.

XL Re and the RAA continue to work with industry and policymakers to determine the most effective federal program. Key to these ongoing discussions is the participation and consensus from the policyholder community. XL Re will continue to work with our clients on the most effective and efficient program design. We welcome the opportunity to work with this Committee, the Congress at large, the Administration and all private sector stakeholders to craft a public-private partnership to address this most important national issue.

Thank you for the opportunity to provide testimony on this important issue.

Testimony of the
National Association of Insurance Commissioners

Before the
Committee on Banking, Housing and Urban Affairs
United States Senate

Regarding:
Extension of a Terrorism Risk Insurance Program

February 28, 2007

Michael McRaith
Director
Illinois Division of Insurance

Introduction

Chairman Dodd, Ranking Member Shelby, Members of the Committee, thank you for inviting me to testify today before this Committee, and thank you for addressing this important issue so early in the new session of Congress. My name is Michael McRaith. I am the Director of the Division of Insurance for the state of Illinois, and I am here to today on behalf of the National Association of Insurance Commissioners (NAIC) to provide our views on the role of the federal government in a terrorism risk insurance program.

While the risk of terrorism has become permanent, we have not yet devised a permanent solution to address this risk. Given the vital role that the Terrorism Risk Insurance Act (TRIA) and the Terrorism Risk Insurance Extension Act (TRIEA) have played in ensuring the affordability and availability of terrorism insurance, we should not allow TRIEA to expire without an appropriate federal backstop being in place on January 1, 2008.

Today, I would like to make three basic points:

- First, the availability of terrorism insurance has become crucial to a stable economy, but given the difficulty in accurately determining the frequency, severity, and loss costs for acts of terrorism, the private insurance market has shown little appetite to provide terrorism insurance coverage absent a federal backstop.

- Second, in the absence of private market innovations and solutions, Congress should act to sustain a viable private market for terrorism insurance by supporting a federal backstop that includes domestic and foreign acts of terror, group life insurance coverage, and a mechanism to address nuclear, biological, chemical, and radiological (NBCR) risks.

- Third, state insurance regulators are committed to working with Congress to consider changes to the current program that would better stabilize the terrorism insurance market and better protect the economy and consumers.

The Economy Depends on Terrorism Insurance

Today TRIEA is quickly approaching its expiration date, but the NAIC's commitment to the need for a federal backstop as an essential underpinning of our national economy has not changed. My fellow commissioners and I continue to believe the United States economy remains vulnerable to terrorist attack and requires insurance to help manage exposure to that very real, unpredictable, and volatile risk. Without a federal backstop, such insurance may become unavailable and unaffordable and we may revisit some of the same market disruptions and economic uncertainties we faced in the aftermath of the September 11 terrorism attacks. The uncertainty surrounding the expiration of TRIEA also affects our competitive position internationally. Other nations with serious terrorism problems, such as the United Kingdom, have permanent programs in place to ensure terrorism insurance is available. A long-term solution to the terrorism exposure here in the U.S. is necessary, and overdue.

TRIA and TRIEA have worked exactly as intended by making terrorism coverage available to those who need it. More businesses are insured for terrorism now than ever before, as evidenced by an increased "take-up" rate (that is, the rate at which companies have purchased terrorism insurance coverage) for terrorism coverage since the passage of TRIA. As mentioned in the President's Working Group on Financial Markets (PWG) report on terrorism insurance, the take-up rate has increased from 27 percent in 2003 to nearly 60 percent in 2005, while the cost for that coverage represents about 3 to 5 percent of the total cost of property coverage. Indeed, in areas of perceived high risk, the commercial real estate, construction, and financing markets depend on the availability of terrorism insurance coverage that likely would not exist without a federal backstop.

Terrorism Insurance Depends on Private Market Partnership with the Federal Government

Insurance depends on an estimation of future loss costs which, in turn, depend on an understanding of frequency and severity for a particular event. While insurers, reinsurers, risk modelers and others have made strides in improving their tools for deriving this information, it remains exceedingly difficult to accurately apply insurance principles to the risk of catastrophic terrorism. The notion of frequency, in particular, is especially difficult to estimate because acts of terror are not random. Terrorists can change tactics and actively work to disrupt our understanding of their actions and the frequency with which they choose to act. The events of September 11, 2001, dramatically illustrate this challenge. Even if an insurer could anticipate all the variables that contributed to that chain of horrific events, it still would have no way of knowing with what frequency it may or may not happen again. The events of September 11, 2001, also illustrate the severity of terrorism. The direct actions of just a small group of men resulted in nearly $21 billion in losses—the third costliest insurance event on record. When considering these events in the context of a nuclear, biological, chemical, or radiological (NBCR) event, the severity becomes even more troubling. The NAIC held a public hearing on terrorism insurance matters in March 2006 at which the American Academy of Actuaries provided a statement estimating that a large NBCR event in downtown Manhattan could cause insured losses (property/casualty and group life insurance) of $778 billion dollars.

As Congress considers the ramifications of what a $778 billion dollar event would do to the insurance industry, it is important to have an understanding of the market's capacity. As the PWG report also noted, the capacity of the market has increased since 2001. Insurance capacity is generally measured by determining the amount of capital and surplus available to insurers to support their policy writings. Using that measure, NAIC data shows that in 2005 the total capacity for property and casualty insurers was $427 billion. It should be noted, however, that that number is the total capacity for the market for all property/casualty lines. Less than half of those funds are used to support commercial products in all lines of insurance, and the capacity of any one company is far less. Unknown frequency, coupled with the potential for severe losses, make it difficult for insurers to provide coverage for acts of terrorism.

Congress Should Continue A Terrorism Risk Insurance Program

TRIA and TRIEA are examples of a partnership between the private and public sectors to solve a problem that neither currently can handle alone. Given our economic dependence on terrorism insurance, and in the absence of a private market innovation to make managing this risk practical, the NAIC urges immediate action by Congress on a federal measure to ensure continued marketplace stability before TRIEA expires at the end of 2007. We believe the presence of the federal backstop has provided an appropriate mechanism for the insurance industry to make vital terrorism coverage widely available to American businesses. By requiring insurers through the "make available" mechanism to offer coverage for acts of terrorism they otherwise might not have offered, the federal backstop has been successful in bringing confidence to the insurance marketplace. Because some terrorism risks are largely uninsurable without a financial backstop, state regulators are very concerned that significant market disruptions will develop before the program's expiration, due in part to the timing of the business cycle for insurance renewals. With that in mind, we again applaud this Committee for holding today's hearing and addressing this important issue early in the legislative session.

As was the case when the initial program was set to expire in 2005, insurance companies and insurance contracts are affected already by the possible expiration of the current program. Terrorism insurance coverage, as companies offer it today, is typically contingent on a federal backstop, and companies will again place limitations on commercial policies to exclude terrorism coverage if a federal backstop no longer exists. These limitations will greatly reduce terrorism coverage in the states that have approved them. The few states that have not allowed insurers to file coverage limitations fear that, without a federal backstop, insurers will be unwilling to underwrite many businesses that want appropriate and reasonably priced terrorism insurance coverage. This could lead to availability and affordability problems down the road.

To address this situation, Congress should act to ensure the existence of a federal backstop program, and we believe it should not make a distinction between so-called domestic or foreign acts. Based on the feedback of insurers, reinsurers, and other stakeholders that we have gathered during the NAIC's many meetings and forums on the subject, there seems to be broad consensus that such a partnership between the private market and the federal government is necessary. As the private market continues to improve its tools and resources to understand and manage terrorism risk, there may be an opportunity for the private market to assume more risk, but given the potential for such enormous losses, a federal backstop at the extreme catastrophic level likely would still be necessary. However, we also recognize that the federal government may be reluctant to establish a permanent program; therefore, if Congress chooses to develop a temporary backstop, its duration at a minimum should be long enough to provide sustained stability to the commercial insurance cycle.

The NAIC Continues to Work on Terrorism Insurance Solutions

Following enactment of the Terrorism Risk Insurance Act (TRIA), the NAIC established a Terrorism Insurance Implementation Working Group of state regulators that has worked closely with the Treasury Department and insurance companies to successfully implement TRIA's provisions, as well as to monitor the impact it has had on the insurance marketplace. The Working Group continued that involvement in 2005 when the program was set to expire and supported its extension through the Terrorism Risk Insurance Extension Act (TRIEA).

Once again, the NAIC stands ready to assist Congress in developing an appropriate method for continuing a federal terrorism insurance backstop. The NAIC continues to discuss the challenges of terrorism insurance at its national meetings and in public hearings, and we are committed to maximizing the participation of the private market in this obligation. As Congress contemplates the expiration of the current program, there are a few issues and concepts that should be considered in the debate over a federal terrorism insurance backstop:

Length of Program

The duration of any successor program to TRIEA should be long enough to provide sustained stability that reflects the commercial insurance cycle as well as sufficient time and means for the private sector to build the appropriate capacity.

Domestic Terrorism

Any successor program to TRIEA should not make a distinction between domestic and foreign acts of terrorism. Both types should be covered. The effects of a terrorist act could be potentially devastating regardless of whether it is perpetrated by an American citizen or foreign national.

Tax-Deferred Catastrophe Reserves

Modifying the U.S. tax code to allow property/casualty insurers to set aside catastrophic reserves on a tax-deferred basis is one concept that potentially could allow for more private market terrorism insurance capacity. If companies are encouraged or required to retain more of the premiums they collect for catastrophic scenarios, the government's role could be lessened over time. Currently, when a policyholder pays a premium for terrorism insurance, in the absence of terrorism losses, that money is subject to the normal market mechanisms where some is retained, but much of it is paid out in the form of taxes and shareholder dividends. By establishing tax-deferred reserves that could be used only for catastrophic losses of a certain magnitude, companies could be encouraged or required to hold a portion of that money and let it grow over time. Tax-deferred reserves would put more of the responsibility for covering the cost of insured terrorism losses on policyholder dollars, which are correlated with risk, rather than taxpayer dollars, which are not correlated with risk. Although challenges exist in how these reserves are structured and monitored, they are common throughout the world for various catastrophic policies.

Workers' Compensation and Group Life Insurance

There are two major types of insurance that cause insurers special concern about whether they can continue to underwrite them without some form of partnership with the federal government. The concentration of risk involved in both lines is significant and can not be addressed solely by the private market. The first such line is workers' compensation, which is a property/casualty product that provides coverage for work-related injuries, illness, and death. It covers lost wages, provides unlimited medical benefits and, in most states, provides rehabilitation benefits to get injured workers back on the job. In the event of death on the job, workers' compensation provides monetary death benefits to the surviving spouse and children. It also provides employers with liability coverage if an employee pursues legal action against an employer. Workers' compensation currently is included under TRIEA.

State laws do not allow an insurer to exclude or limit workers' compensation coverage, except as permitted by state law, so acts of terrorism are required to be covered regardless of the presence of a federal backstop. As a result, an insurer underwriting this risk without adequate reinsurance is subject to a large potential loss if there are a significant number of employees at a single location. The American Academy of Actuaries estimates that "a modest-sized insured with 200 employees could easily generate a terrorism related event of $50 million. This presumes death of all employees and typical death benefit of $250,000 per employee.[1] The absence of a federal backstop program could cause significant instability to the workers' compensation market with respect to terrorism losses.

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[1] American Academy of Actuaries, P/C Extreme Events Committee May 4, 2004 Report, P/C Terrorism Coverage: Where Do We Go Post-Terrorism Risk Insurance Act?, Page 14.

The second type of coverage causing insurers special concern is group life insurance, which is not currently included in the federal backstop. Like workers' compensation, this insurance coverage is vulnerable to risk concentration problems. For example, if a business has 1,000 employees at a given location, the pricing employed by life insurers for group products probably assumes that three or four employees might die in a given year. If instead, a location with 1,000 employees is hit by a terror attack and all of them die, the insurer has an enormous financial exposure from a single occurrence.

Unlike workers' compensation, there is no statutory requirement for group life that prohibits an insurer from limiting available coverage for acts of terrorism in some fashion. However, insurance regulators are not inclined to approve exclusionary or limiting language in those states that have approval authority over the wording in group life insurance contracts. Further, employers are reluctant to purchase coverage for their employees that contains such exclusionary language. Although there is some level of private reinsurance available for group life coverage, it is not sufficient to cover catastrophic terrorism losses. Given the potential solvency threat that a major act of terrorism could present to group life insurers, the NAIC adopted a resolution in June 2005 urging Congress to include group life coverage in any federal backstop program.

Insuring Nuclear, Biological, Chemical, and Radiological (NBCR) Events

In 1995, domestic terrorists in Japan orchestrated a sarin nerve gas attack in the Tokyo subway system that killed twelve people, injured nearly one thousand, and caused massive disruptions. This was the work of just ten men with only a few liters of sarin gas. Our country has thankfully avoided a massive NBCR terrorism event, but we would be naïve to assume that such an event is beyond the realm of possibility. Indeed, this body knows all too well the reality of biological attacks. Just weeks after the events of September 11, two Senate offices and several media outlets were contaminated by anthrax-laced letters that resulted in five fatalities and seventeen people becoming ill. These events were relatively small in scale and complexity, and as noted previously in this testimony, a large-scale NBCR event in a densely populated urban area like Manhattan could result in insured losses of $778 billion.

In September 2006, the U.S. Government Accountability Office (GAO) released a report concluding that NBCR risk does not match the principles of insurability, and there is little appetite in the private market to insure it even with the presence of a federal backstop. Private insurers currently structure their policies to exclude NBCR events, except where coverage is expressly required under state law, such as with workers' compensation coverage. However, the potentially catastrophic nature of NBCR risk poses a serious threat to policyholders and the economy and we must consider how to finance the losses from such events. We encourage you to consider inclusion of NBCR events resulting from acts of terror in any federal backstop. The inclusion of NBCR should be structured in such a way to leverage the private market's ability to issue policies and settle claims while recognizing their difficulty in overcoming the challenge of insurability. The threshold of retention for NBCR risk should be much lower than for other risks but set at such a level to create a financial responsibility on the part of the private market so that they have a vested interest in that aspect of coverage.

Responsibility of Policyholders and Insurers

Some have argued that federal involvement in terrorism insurance has stymied the development of private market solutions and personal responsibility on the part of commercial policyholders. State insurance officials see little evidence to support this conclusion. To the contrary, the evidence demonstrates that policyholders have invested heavily in strengthening their disaster preparedness and response efforts in the wake of the September 11 terrorist attacks notwithstanding the existence of a federal backstop.

For example, since September 11, many large commercial and many multi-family residential buildings in urban cities and elsewhere regularly subject entrants to security checks before permitting entry. Sensitive locations may even require visitors to submit to background checks prior to entry. Structural design also has changed substantially in response to the terrorist threat not the least of which is the ubiquitous use of barriers to thwart vehicle-borne explosive devices.

Although risk mitigation and loss control efforts are important tools to reduce exposure, the sad fact is that such measures can do little to avoid the catastrophic consequences of a successful large-scale terrorist attack. Policyholders can take steps to reduce their exposure and potentially minimize individual losses, but the insurance industry so far has been at a loss to develop an effective mechanism to apply the principles of insurance to the truly catastrophic nature of a potential terrorist attack. The country has taken such steps to improve airport and aircraft security and to harden many of our commercial enterprises and government facilities, but we still remain vulnerable to a terrorist attack with a potential magnitude that dwarfs the insurance industry's capacity to respond. The steps taken to mitigate losses also may result in counter measures by terrorists that could lead to attacks on buildings or infrastructure that we might not have previously considered targets. This inescapable reality demonstrates the need for a federal backstop to help deal with potential losses of this magnitude. Clearly, loss control must be a part of any long-term solution in the private sector to manage terrorism exposures, but such mitigation techniques do not address the issue of financing the catastrophic losses should they occur. No amount of mitigation can result in foolproof guarantees that losses will not occur. Terrorism coverage in today's world is an integral part of any businesses' risk management efforts. Without a federal backstop we could face market disruptions, and terrorism insurance likely will become less affordable or even unavailable to consumers.

Conclusion

State insurance officials strongly urge Congressional action to ensure a sustained and stable marketplace for terrorism insurance by providing a federal backstop program. Such a program should cover foreign and domestic events, expand coverage to group life insurance, and provide a mechanism to leverage the private market strengths in covering NBCR risks. Terrorism insurance is crucial to a healthy American economy, and in the absence of private market capacity, federal involvement is essential.

The NAIC stands ready to assist Congress in developing an appropriate federal terrorism insurance program. Thank you for inviting me to testify and for considering the views of state insurance regulators as you move forward on this crucial issue.

Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

TESTIMONY OF

TRAVIS B. PLUNKETT,
LEGISLATIVE DIRECTOR
AND
J. ROBERT HUNTER,
DIRECTOR OF INSURANCE,
CONSUMER FEDERATION OF AMERICA

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE

REGARDING

EXAMINING THE TERRORISM RISK INSURANCE PROGRAM

FEBRUARY 28, 2007

Chairman Dodd, Ranking Member Shelby and members of the Committee, my name is Travis Plunkett. I am the Legislative Director of the Consumer Federation of America. On behalf of myself and our Director of Insurance, J. Robert Hunter,[1] I appreciate the invitation to appear before you today to examine the temporary Terrorism Risk Insurance Act (TRIA.) CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education.

In this testimony, I will offer a detailed explanation of why it would be best for consumers and taxpayers if TRIA were significantly scaled back and reconfigured when it expires at the end of this year, rather than being enlarged and made permanent. There is strong evidence that insurers no longer need TRIA subsidies to provide adequate terrorism capacity in most cases. Property-casualty insurers have experienced unprecedented profits in the last three years, despite significant hurricane losses, and currently have over $600 billion in policyholder surplus. As the Department of the Treasury has reported, terrorism risk insurance is much more available and affordable since the attacks of September 11th, even though insurer retentions have increased and federal assistance has declined. As a result, the "take up" rate by policyholders purchasing terror insurance coverage has increased to over 50 percent.

CFA believes that the TRIA program as currently structured is standing in the way of the development of a more vibrant private market for terrorism coverage that would have the capacity to handle all but the most catastrophic attacks. The Department of the Treasury, for instance, has reported that although the amount of reinsurance available for terrorism has increased since September 11th, federally subsidized reinsurance has depressed the demand for private reinsurance.

As there still is very little coverage available for chemical, nuclear, biological and radiation (CNBR) attacks, or large-scale attacks that result in over $100 billion in losses, we urge Congress to restructure TRIA to address these real needs and leave it to the private market to cover terrorism losses of less than $100 billion. We strongly recommend that Congress <u>not</u> expand the program to cover group life or other new lines of insurance that have failed to offer any meaningful evidence to justify such an expansion. In fact, we urge you to consider reducing the lines of coverage that receive TRIA back-up right now, but could function well without government assistance. We also recommend that Congress end the provision of free reinsurance to a very affluent industry by requiring insurers to pay an actuarially based premium for whatever back-up they receive. Finally, we strongly recommend that, if TRIA is reauthorized, it should remain a program that is truly temporary. Extending TRIA permanently or for more than five years would freeze the program in time, inhibiting the further ability of the private market to expand and preventing Congress from adjusting the program as market conditions change.

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[1] Hunter is a former Federal Insurance Administrator under Presidents Ford and Carter and former Insurance Commissioner in Texas. As Administrator, Hunter directed a program similar to TRIA in many respects, the Riot Reinsurance Program.

I. Background

As a result of the dreadful terrorist attacks of September 11, 2001, the property/casualty insurance industry suffered losses of $12.2 billion after taxes ($18.8 billion before taxes). On an inflation-adjusted basis, that was the second largest insured loss in history, after Hurricane Andrew (Hurricane Katrina has now become the largest insured event in history). Although the tax write-off of 35 percent was a significant financial benefit to insurers, Congress enacted the Terrorism Risk Insurance Act (TRIA) in 2002 to ensure that terrorism coverage was affordable and available in the aftermath of this unprecedented event. Congress also wanted to assure that a lack of affordable terrorism insurance did not set off a chain reaction that would prevent large construction projects from going forward, thus harming the overall economy. In 2005, Congress extended the Act for two additional years (through December 31, 2007) but sharply increased insurer financial responsibility and reduced taxpayer exposure.

The law mandates that insurers write terrorism coverage, which is then backed by the federal reinsurance program. In this the final year of the program, at least $100 million in aggregate losses would have to occur for the Secretary of the Treasury to certify the loss as reimbursable. Someone acting on behalf of a foreign interest would have to commit the attack. If an incident meets these criteria, taxpayers pay for insurance industry losses in accordance with a schedule that varies over time. The Act expires on December 31, 2007, unless renewed by Congress.

In 2007, insurers will be responsible for losses below a deductible of 20 percent of their direct earned premium (DEP) for eligible commercial lines in the 2006 calendar year. Above the deductible amount, the federal payments have been reduced from 90 percent of a company's insured terrorism losses in 2006 to 85 percent in 2007, capped at an overall industry level of $100 billion. If an event triggers federal involvement, insurers are required to pay back a very small layer of taxpayer assistance, which could be passed on to insurance consumers in the form of a surcharge.

It is important to note that TRIA is a program of federal reinsurance that does not charge a premium to insurers. CFA's calculations indicate that the value of the Federal reinsurance offered to insurers under TRIA (through 2007) is approximately $7.3 billion, had full "take up" of coverage by policyholders occurred. As the take-up rate has been about 50 percent of those who could purchase terror coverage, we estimate that property-casualty insurers have received a subsidy of at least $3.7 billion.[2] Had insurers been required to pay premiums for this coverage, this money would now be available to the Treasury Department to pay for any attacks that might occur.

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[2] Given that the policyholders with the highest risks as more likely to purchase terrorism coverage, it is likely that the actual subsidy has been more than $3.7 billion.

II. Market Conditions are Ideal for Cutting Back and Reconfiguring TRIA

A. The Insurance Industry is Flush with Profits and Retained Earnings

Since the attacks of September 11th, the property/casualty insurance industry has experienced a significant period of growth and earned profits that are virtually unprecedented, and expected to increase further. In fact, the industry is clearly overcapitalized. Earlier this year, CFA released an extensive study that concluded that this dramatic increase in profits and surplus has occurred in part because insurers have systematically overcharged for insurance and shifted costs to consumers and taxpayers. A summary of the study findings follow. The full report is attached.

Record High Profits/ Low Losses

After-tax returns for 2006 were $68 billion. Profits for the record years of 2004, 2005, and 2006 are estimated to be $157.4 billion. The loss and loss adjustment expense (LAE) ratio for 2006 is estimated to be 68.3 percent, the lowest in 27 years studied. The years 2003 through 2006 represent four of the six lowest loss and LAE ratios in the last 27 years.

YEAR	INDUSTRY NET INCOME (post-tax)	LOSS & LAE RATIO	POLICYHOLDERS SURPLUS	PRETAX OPERATING INCOME
1997	$36.8	72.8%	$384.1	$35.5
1998	$30.8	76.5%	$423.4	$23.4
1999	$22.0	78.9%	$428.1	$15.3
2000	$20.5	81.4%	$400.2	$10.5
2001	-$6.7	88.4%	$374.4	-$12.8
2002	$9.1	81.6%	$376.0	$8.4
2003	$31.2	75.1%	$353.8	$35.5
2004	$40.5	73.1%	$508.7	$45.4
2005	$48.8	74.8%	$551.0	$47.3
2006	$68.1	68.3%	$606.7	$82.8

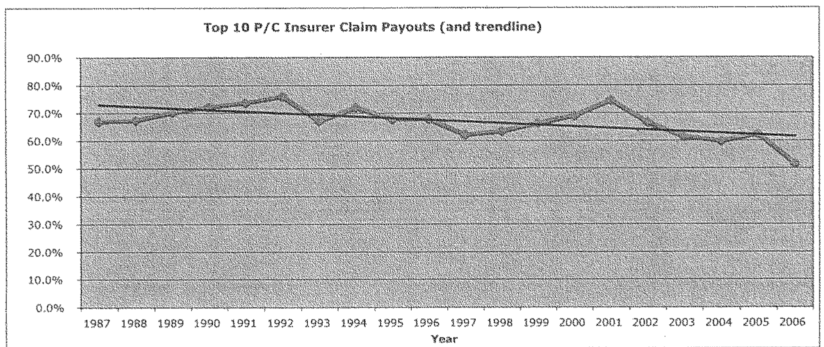
Source: A.M. Best Aggregates and Averages. (2006 data estimated by CFA based on reported industry results for first nine months.)

Surplus is Unprecedented: Insurers are Overcapitalized

Retained earnings, or surplus, for the entire industry is $600 billion as of the end of 2006. An adequate surplus guarantees a solid and safe insurance industry but this amount is, by any measure, unprecedented. To assess the financial solidity of an insurance company, regulators examine the ratio of net premium written to surplus, which, at .73 to 1 (73 cents of premium written for every dollar of surplus) is less than half of the extremely safe 1.5 to 1 ratio that is recommended by many observers and far less than the famous "Kenny" rule of 2 to 1 as an efficient surplus level. The largest loss ever suffered by the insurance industry, Hurricane Katrina, represented an after-tax loss of $26.3 billion, or 4.4 percent of current surplus. The $12.2 billion in after-tax losses experienced by insurers after the September 11th terrorist attacks amounts to about 2 percent of surplus. Many insurers are engaged in massive stock buy-back programs because of this excess capital situation.

Claim Payouts Continue to Drop

For the top ten insurers, losses paid as benefits to consumers are an estimated 52 percent of premium in 2006. The amount of premium paid in benefits by the largest insurers has experienced a startling drop from 75 percent in the late 1980s to only 60 percent today when plotted on a straight-line trend over the period. This signals a great loss in insurer efficiency in delivering benefits to Americans. Allstate, for example, appears to be paying much less than half of the premium it collects in benefits to consumers.



Insurance is a Low Risk Investment

Representatives of the insurance industry often claim that high premiums and profits are necessary to compensate for the high risks they must bear. In fact, insurance is a low-risk investment. Using standard measures of stock market performance that assess financial safety and stock price stability, the property/casualty insurance industry represents a below-average risk compared to all stocks in the market, safer than investing in a diversified mutual fund.

In 2006, the study estimates that stock insurers will earn a return on equity (ROE) of about 20 percent, well in excess of what is required by investors. The lower industry-wide ROE that insurers report underestimates the industry's actual ROE. The industry-wide ROE includes returns from mutual insurers, who tend to carry excess capital on their books. Insurers calculate their ROE using a method that understates returns, using mid-year capital rather than beginning-of-year capital. Moreover, since insurers are significantly overcapitalized by all historic measures, the income earned on swollen surpluses is lower than it would be if efficient capital levels were maintained.

B. Policyholders are Enjoying Deep Premium Cuts in All Insurance Lines

A significant shift in the insurance market since September 11th has also meant major benefits for insurance policyholders. The property/casualty insurance market has moved from the "hard" part of the business cycle, when prices increased sharply and coverage cutbacks were widespread, to a soft market, where abundant capital has caused prices to drop precipitously.

Commercial insurance price increases were severe as Congress was considering enactment of TRIA in 2001 and 2002. Year-to-year price increases approached 50 percent in some lines. That situation has changed dramatically over the course of the normal economic cycle. Consider the data from 2005 and 2006:

	1Q 2005	3Q 2005	1Q 2006	3Q2006
Small Comm. Accounts	-5%	-5%	-2%	-3%
Mid-size Comm. Accounts	-9%	-8%	-3%	-5%
Large Comm. Accounts	-10%	-9%	-3%	-7%
Business Interruption	-7%	-5%	1%	-1%
Construction	-3%	-3%	2%	-3%
Commercial Cars	-6%	-6%	-4%	-6%
Property	-12%	-9%	2%	1%
General Liability	-8%	-7%	-6%	-6%
Umbrella Liability	-6%	-6%	-5%	-5%
Workers' Compensation	-5%	-3%	-7%	-6%
D&O	-4%	-4%	-3%	-3%
Employment Practices	-4%	-4%	-3%	-3%
Medical Malpractice	2%	0%	-1%	-1%
Surety Bonds	0%	0%	0%	-1%
Terrorism	-1%	-1%	-1%	-1%

Source: Counsel of Insurance Agents and Brokers

As the Department of the Treasury assessment of TRIA determined, the average percentage of overall premium paid out by commercial policyholders for their terrorism coverage was 1.8 percent in 2004 (1.7 percent according to the policyholder survey).[3] Thus, if terrorism charges doubled as a result of TRIA's termination, overall insurance premiums paid by all sizes of businesses would still be flat or even decline if TRIA expires at the start of 2008. At the

[3] U.S. Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002," page 4.

current time, terrorism prices could more than quintuple for large commercial accounts with no resulting premium increase overall.

C. Another Marketplace Improvement: the Risk of Terrorism Is Being Modeled and Insurance Companies Are Using These Models

The insurance industry often argues that predicting the frequency and severity of terrorism attacks for insurance purposes is virtually impossible. The truth is, insurers are doing it already. Modeling terrorism risk is an imperfect science, but it is improving fast. A huge amount of research has been done in this area since TRIA was enacted, and several private companies have produced and are selling models to measure the actuarial and underwriting implications of the terrorism risk. The fact that insurers use these models is proof that they are of at least some value. Insurance companies pay significant sums for the licenses to use these models. Businesses would not do that if they did not think the models were valuable. For instance, many insurers use the Insurance Services Office (ISO) model for setting terrorism rates. ISO's research shows that the terrorism insurance risk is limited to a fairly small number of cities and that for the vast majority of the nation, the risk is low and the cost can be fully borne privately.[4]

D. Securitization Offers Great Potential to Cover Large Disasters, Including Terrorism

The market capitalization of the U.S. exchanges is about $50 trillion. Every day, the markets observe capital losses and/or gains that exceed the September 11th attacks or any natural disaster. There is significant advantage for investors, if the price is right, to get involved with high-level risk over large insurer retentions. For example, *National Underwriter* online reported last year that since 1997, 69 catastrophe bonds had been issued with a total of $10.65 billion in risk limits, while about $1.9 billion worth of bonds were issued in 2005 in ten separate transactions by nine issuers.[5]

II. Federal Reports Have Supported Ending TRIA or Sharply Reducing Coverage in Any TRIA Extension

A series of reports in the last two years by the Congressional Budget Office and Department of the Treasury have offered valuable information about the true state of the terror insurance marketplace and evaluated the possible effects on insured parties and the economy if TRIA expires. Taken together, these reports show a sharply increasing ability of the private market to handle all but the most catastrophic terrorism losses.

[4] For a complete discussion of the implications of ISO's research, see CFA's report, "The Terrorism Risk Insurance Act: Should it be Renewed?" at http://www.consumerfed.org/terrorism_insurance_report.pdf. The report was presented to the Senate Banking Committee at its hearing of May 18, 2004.
[5] "Cat Bond Use on Rise, Says S&P," *National Underwriter* Online, March 20, 2006.

A. 2006 Report of the President's Working Group on Financial Markets

In this report issued in September of 2006, the Department of the Treasury found that insurers have allocated additional capacity to terrorism risk, prices have declined and purchase rates have increased.

- Terrorism risk insurance is much more available and affordable since the attacks of September 11th, even though insurer retentions have increased and federal assistance has been reduced over the life of the TRIA program. Insurer surpluses have increased and prices for terrorism risk have declined. As a result, the number of companies buying terrorism coverage has increased from 27 percent in 2003 to 58 percent in 2005. The primary reasons why a significant number of policyholders are still not choosing to purchase terrorism coverage are higher-than-desired costs and low perception of risk.

- These improvements in the marketplace have occurred because of better risk assessment and management, better risk modeling, an increase in reinsurance capacity and an improvement in the financial health of insurers.

- The amount of reinsurance available has increased since September 11th. Federally subsidized reinsurance has depressed private reinsurance availability "because it dilutes demand for private sector reinsurance."

- Insurers have more available capital to allocate and are choosing to use some of this additional capacity to terrorism risk.

- Group life coverage has remained available and prices have declined, even though it is not covered under TRIA. There is no reason to expect problems with the group life market if it is not included in TRIA in the future. The availability of catastrophic life reinsurance has increased and will likely improve further. Unlike property casualty insurers, group life companies appear not to have taken steps to improve their risk modeling techniques.

- Insurers have not generally provided terrorism coverage for chemical, nuclear, biological or radiation (CNBR) attacks, with the exception of state mandates for such coverage as worker's compensation, and are not likely to do so in the future. Although some insurance consumers have expressed interest in purchasing CNBR coverage but do not do so because of concerns about affordability and availability. CNBR reinsurance is mostly not available.

Although Congress did not ask the Department to make policy recommendations about the future of TRIA in this report, the unavoidable conclusion of this study is that expanding the program (to cover group life, for example) is not justified, renewing TRIA in its current form is unnecessary to meet the goals of the law and that only a sharp cutback in or the expiration of the program will allow private capacity for terrorism insurance to continue to significantly increase.

B. 2005 Department of the Treasury Assessment

On June 30, 2005, the Treasury Department issued their market assessment, as required in TRIA. The report found that TRIA had served its purpose and should not be extended "as-is." If TRIA were to be extended at all, the Department recommended that it should be sharply cut back. In delivering the report, Treasury Secretary Snow stated:

> "While TRIA has been effective in achieving its temporary objectives, the economy is more robust today than when TRIA was enacted. GDP growth is up from 2.3 percent in 2002 to 3.9 percent in 2004 (fourth quarter over fourth quarter). Unemployment, which reached 6.0 percent in December 2002, is down to 5.1 percent in May 2005. Construction jobs, taking residential and nonresidential together, now stand at a record high 7.2 million. Extending TRIA would have little impact on the economy given its current strength.
>
> "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 its 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 opposes extension of TRIA in its current form.
>
> "Any extension of the program should recognize several key principles, including 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."

The study made it very clear that the financially well-off insurance industry was receiving an overly generous and unnecessary taxpayer subsidy and that the law must be eliminated or reduced in order to foster the growth of the private market for terrorism insurance. The report also debunked the myth that the potential lack of terrorism coverage in 2001 and 2002 led to a slowdown in non-residential construction or that TRIA had been effective in increasing this construction since it took effect.[6]

[6] "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. In any case, nonresidential building is only 2.2 percent of GDP, and commercial office construction only 12.2 percent of the nonresidential building total. When the economy is fragile, concerns over weakness in even very small sectors of the economy (nonresidential construction) can loom large...such concerns recede as the economy strengthens. Given the small size of nonresidential and commercial office construction, stimulating this sector (whether through TRIA or otherwise) would be neither effective nor warranted." U.S. Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002," page 135.

C. 2005 Congressional Budget Office Study

The well-balanced Congressional Budget Office report of January 2005 analyzed how the market would be affected if TRIA expired:

- Terrorism premiums would likely rise for those buying insurance in high-risk situations.

- The number of businesses buying insurance would probably decrease. (Just over half of all businesses are currently purchasing terrorism coverage.) Such a decrease would mean more taxpayer involvement in a post-terrorism attack situation.

- Mitigation efforts would increase. Efforts to lower the risk of terrorism attacks or reduce their effects would be encouraged by the market charging actuarial rather than taxpayer-subsidized rates for terrorism insurance. Steps such as hiring guards and placing metal or explosives detectors at entrances to higher risk buildings would be encouraged by the expiration of TRIA.

- Private sector alternatives to TRIA would be encouraged if TRIA expired, such as reinsurance to replace the free TRIA coverage or the development of securitized responses, such as bonds similar to catastrophe bonds.

- The economy might be affected somewhat, but not as much as the insurers contend. CBO indicates that the analysis presented to the public through press releases sent out by the insurance industry overstates the potential costs to the economy if TRIA expired.

- The cost of insuring against terrorism would not change much for the nation. TRIA does not change the anticipated terrorism costs except, CBO states, to the extent it increases national costs because it undermines the incentives of insurers to insist on mitigation measures and insured parties to implement these measures in order to get lower premium charges. Not extending TRIA would merely shift roughly the same costs from taxpayers to private firms and insurers.

- There could be insurance market disruption if another large terrorism event occurs. CFA believes that Congress knows how to handle this sort of situation, given the success it had in stabilizing the insurance market after September 11, 2001 and during the riots in the nation's cities in the 1960s, for example.

CBO also listed the pros and cons of altering TRIA by requiring that insurers be charged actuarial (or above actuarial) premiums for the coverage that is provided:

- Charging premiums would result in more mitigation by insurance purchasers because increased premiums would encourage the development of discount plans for safety precautions taken by insured businesses.

- Charging premiums would encourage the private sector to grow, since the private sector cannot compete with the free reinsurance provided by the taxpayers under TRIA.

- Charging premiums might result in less terrorism coverage being purchased. This would mean more taxpayer involvement in a post-terrorism attack situation.

CBO summarizes their conclusions as follows:

"In sum, as the Congress considers whether to extend TRIA (and in what form), it is useful to consider what has changed in the two years since the law was enacted. The most significant development seems to be a growing sense that the terrorism threat to the United States will continue for the foreseeable future. That development suggests that the economy, especially the stock of physical capital, needs to be responsive to the prospective losses from terrorist attacks. For example, new construction might be designed, located, and built to withstand such attacks. Existing structures might need to be retrofitted with safety features. Those needs argue against extending the TRIA program in its current form, which subsidizes insurance and dampens incentives for mitigation activities.

"The macroeconomic costs of scaling back the federal subsidy for terrorism insurance are likely to be small. One reason is that the capacity of insurance companies to provide terrorism coverage has improved recently. Another reason is that TRIA does not lower the costs of terrorist attacks but rather partially shifts those costs from property owners to taxpayers. As noted above, total costs might be lower without TRIA. However, the gains in economic efficiency from allowing TRIA to expire could require a significant trade-off: without the TRIA program, an especially large loss from a terrorist attack would be likely to produce another episode of scarce coverage, rising prices, and uninsured assets." (Emphasis added.)

III. Industry Claims of Economic Disaster if TRIA Expires Are Invalid

A. <u>The Terrorism Market in 2001 and 2002</u>

The claims made by insurers and the real estate industry in 2001 as Congress was considering what to do about terrorism insurance after the September 11th attacks were extreme. In late 2001, insurers and some policyholders warned that a national crisis would ensue in early 2002 if no terrorism back up was put in place by Congress. Insurers claimed that the crisis would hit suddenly in 2002, since most reinsurance contracts would expire January 1, 2002.

The Consumer Federation of America initially supported legislation to provide a federal terror insurance back up, as long as insurers were required to pay back the taxpayer-supported reinsurance that was provided. However, Congress adjourned in late December 2001 without enacting terror insurance legislation. CFA took this position of support in part because the insurers were making a strong argument that if no program was in place by January 1, 2002, there would be significant problems in the insurance market leading to unavailability of insurance, banks calling loans, damage to the nation's economy and other dire consequences. Congress failed to act in 2001.

B. CFA Study of January 2002

Fearing that a crisis would develop immediately after reinsurance contracts expired on December 31, 2001 and new contracts took effect on January 1, 2002 without terrorism reinsurance back up for primary insurers, CFA undertook a major study of market conditions in late January 2002. To our surprise, CFA found that, contrary to the grim scenarios feared by many and predicted by the insurance industry, the failure of Congress to enact a terrorism insurance back up program had not caused major gaps in coverage or economic disruption in the nation. As a result, CFA changed its position and called upon Congress to enact narrower, targeted measures to provide terror back up only to the "target risks" and parts of the country (like New York City) that were still having trouble procuring terrorism insurance.[7]

The study CFA released in late January 2002 had five major conclusions:

1. The insurance industry was wealthy and overcapitalized.
2. High rates were a problem for mid-sized and larger firms.
3. The rate problem was caused by the classic turn in the economic cycle of the industry, sped up--but not caused by--terrorist attacks.
4. Banks were freely loaning money to the vast majority of businesses--if not all of them---regardless of the terrorism insurance situation in the nation.
5. There were no widespread economic problems related to the terrorism insurance situation.

C. CFA Study of August 2002

Insurers responded to CFA's report by saying that it would soon be apparent that the lack of terrorism reinsurance was having negative consequences as policy renewals took place throughout the year. This was a change from their earlier prediction so we waited to study the situation until well after at least half of the policies in the nation had been renewed (i.e., after July 1, 2002). By August, at least 80 percent of the policies in the nation had been renewed without terrorism reinsurance coverage. CFA's August report on the terrorism insurance marketplace had three significant findings. We report these findings here in great detail since we anticipate that insurers will make identical claims of dire consequences if TRIA is not renewed at the end of 2007.[8]

1. No General Terrorism Insurance Crisis Existed in 2002

CFA found that a broad-based terrorism insurance crisis did not exist as of August 2002. There were reports of problems in some areas of the nation (New York City and Chicago were mentioned as problem spots by some reinsurers), but most of the nation had not had significant difficulty finding coverage. Moreover, the price had dropped for stand-alone terrorism insurance, although it was still expensive.

[7] "How the Lack of Federal Back Up for Terrorism Insurance Has Affected Insurers and Consumers: An Analysis of Market Conditions and Policy Implications," Consumer Federation of America, January 23, 2002.
[8] "How the Lack of Federal Back Up for Terrorism Insurance Has Affected Insurers and Consumers: An Update," Consumer Federation of America, August 22, 2002, http://www.consumerfed.org/pdfs/terror_insurance_report.pdf.

Below is a sampling of contemporaneous news stories that demonstrate that coverage was often available and prices were coming down:

> Terrorism coverage, which was unobtainable immediately after the September attacks, is becoming more widely available and in larger amounts. Premiums are falling as more insurers enter the market. So what of the dire predictions?
>
> New York Times, February 27, 2002

> A growing number of insurers are beginning to offer terrorism insurance to U.S. businesses, a development that has begun to lower the cost of such coverage while at the same time casting doubts on the need for a government-sponsored terrorism-insurance solution...
>
> Wall Street Journal, April 15, 2002

> Terrorism insurance isn't only available, the price of it has fallen in the last six months, according to an executive with American International Group's new Lloyd's syndicate.
>
> BestWire, April 16, 2002

> Last fall, insurers were offering dire predictions that unless Congress stepped in quickly, the construction industry would all but come to a halt because builders and owners wouldn't have insurance against terrorist attacks. For thousands of companies, protection against terrorism was going to expire on January 1, and the industry wasn't rushing to renew. Well, it's May. The sky hasn't fallen.
>
> Chicago Tribune, May 1, 2002

> In the seven months following Sept. 11, the market has stabilized, more capacity has become available, and prices have dropped, sources agree. "The market has settled down and is obviously more comfortable with the type of risk that it's seeing, the cover that's being offered, and the pricing," said Simon Low, divisional underwriter for the war and political risk department at Wellington Underwriting, a Lloyd's managing agency.
>
> National Underwriter, May 6, 2002

> The world's largest commercial lines insurer, AIG, asked the federal government not to offer airlines war and terrorism insurance any more since, as the CEO Mr. Greenburg put it, "We, as taxpayers, don't want to compete with our own government for business that the commercial sector can underwrite."
>
> New York Times, February 26, 2002

> Hard markets are extremely rare. But the moment that terrorism brought down the World Trade Center towers, it was obvious that insurance prices would jump. Capitalists react at such moments...At first, after Sept. 11, it looked as if both primary insurers and their reinsurers would, to the extent possible, flee from covering any losses terrorism might cause in the future. But that hasn't happened. Said Donald Kramer, a vice chairman of ACE, in late April: "Is terrorism insurable? Everybody's said no. Yet everybody's coming out with terrorism products." ...It's uncommon for insurers to spell out the details of their terrorism coverage. But in the 2001 Berkshire Hathaway annual report, Warren Buffett gave some facts about four contracts exposing Berkshire to terrorism risks. One new property catastrophe policy that Berkshire has taken on, for example, leaves it providing "significant coverage" on Chicago's Sears Tower once losses there pass a threshold of $500 million. In another instance of terrorism tolerance, Bermuda's RenaissanceRe, a master at using sophisticated simulation models to write natural-

> disaster catastrophe reinsurance, has put the models to use in filling, at prices that have soared, today's demand for workers' comp catastrophe reinsurance. When they can get terrorism out of their minds, P&C insurers are loving the market they're in right now.
>
> Fortune, June 10, 2002

> Discussing the state of reinsurance markets at the annual conference of the Inland Marine Underwriters Assn. earlier this month in Oak Brook, Ill., Vincent D. Liotta, managing director at Guy Carpenter & Co. Inc., said prices are "dramatically dropping" for terrorism reinsurance. Mr. Liotta, who is head of the marine and aviation department at the New York-based reinsurance brokerage, said capacity is readily available for terrorism reinsurance, with coverage available on an excess-of-loss and pro rata basis, as well as on an annual aggregate-of-liability basis. The principal markets for terrorism reinsurance are Bermuda and London, Mr. Liotta said, and available coverage includes reinsurance for biological and chemical attacks.
>
> Business Insurance, June 17, 2002

2. The Capacity to Write Insurance in the Wake of the Terrorist Attacks Had Increased

One of the concerns expressed when the terrorist attacks occurred was that the drain on capital in the insurance industry might adversely impact insurers. CFA found that the insurance industry continued to be overcapitalized. Year-end 2001 data indicates that net premium written in 2001 was $324.0 billion and surplus at year-end was $289.6 billion.[9] This was an ultra-safe premium to surplus ratio of 1.1 to 1.[10] We predicted that: "This continues to be a rich industry which, given the massive cyclical price jump they have enjoyed since late 2000, will be getting even richer."

The below excerpts from various news articles from that time period illustrate this positive trend:

> Bermuda is once again the hub of renewed insurance activity as a second wave of new insurers and reinsurers landed on its shores following the Sept. 11 terrorism, according to the cover story, "Bermuda Bound," in the March issue of Best's Review. Within weeks of Sept. 11, Marsh & McLennan formed Axis Specialty, through its private equity subsidiary MMC Capital, and Bermuda-based RenaissanceRe Holdings Ltd. started DaVinci Reinsurance to address the industry's capacity shortage. In all, nine new insurers have moved into Bermuda since the terrorist attacks. The other seven are Allied World Assurance, Endurance Specialty Insurance, Arch Reinsurance, Montpelier Reinsurance, Goshawk Reinsurance, Olympus Reinsurance and Queens Island Reinsurance.
>
> Best Wire, March 1, 2002

> "My observation would be that, in seven months post 9/11 the insurance market has done pretty well" with regards to providing capacity, said Stephen Ashwell, war, terrorism and political violence underwriter at Syndicate 33, which is managed by Hiscox plc, a Lloyd's managing agency. For a fairly innocuous risk, a buyer could get between $500 million and $1 billion of standalone terrorism coverage placed in the global insurance marketplace, he said, although he emphasized there are clearly aggregation issues. "The

[9] Industry Financial Results, Insurance Services Office, June 28, 2002.

[10] The proper target leverage ratio is 2 to 1, according to the National Association of Insurance Commissioners (NAIC.) A 3 to 1 ratio is considered to be a sign of instability for an insurer.

> worldwide capacity probably now is approaching $1 billion [for one risk]," said Tom Bartleet, executive director in global property/casualty for Willis Ltd. in London. "It's theoretically possible," to put together a program with $1 billion of coverage, although the ability to do so "relies on the industry, the location, the accumulations around it and the price you're prepared to pay." In the seven months following Sept. 11, the market has stabilized, more capacity has become available, and prices have dropped, sources agree. "The market has settled down and is obviously more comfortable with the type of risk that it's seeing, the cover that's being offered, and the pricing," said Simon Low, divisional underwriter for the war and political risk department at Wellington Underwriting, a Lloyd's managing agency.
>
> National Underwriter, May 6, 2002

> Chances for passage of a federal terrorism reinsurance program are hard to judge, but failure to pass it would not have an adverse effect on his brokerage firm, the head of Marsh [Marsh and McLennan, the world's largest insurance broker] said today during an insurance conference in New York...he said failure to pass such a plan would not have great implication for his company. Terrorism coverage is available on a limited basis. Mr. Sinnott said the firm can write coverage of up to $300-to-$400 million. But for clients who are considered targets of terrorism, such as high-rise buildings, it can "price itself out of most client's view," Mr. Sinnott observed.
>
> National Underwriter, June 5, 2002

> Fortunately for buyers, the immediate post-Sept. 11 situation for terrorism coverage appears to be easing somewhat as new players enter the field.
>
> Business Insurance, July 8, 2002

> Terrorism coverage, a huge concern for ceding insurers since its exclusion from most contracts last year, is now reappearing in limited forms, but with continuing exclusion of nuclear, chemical and biological terror risks, reinsurers and brokers say. On the plus side, the post-Sept. 11 chaos that characterized the Jan. 1 renewal market has ended and renewals are being completed smoothly. In most cases, capacity is available to complete programs where reinsurers are satisfied with pricing, observers report.
>
> Business Insurance, July 8, 2002

3. Terrorism Coverage Was Available in Most Cases. Even Hard to Place Policies Were Being Written.

The key problem CFA found at the time was limited to very large properties (in excess of the available $500 million to $1 billion stand alone coverage), particularly in very large cities (New York, Washington and Chicago). This problem seemed to be restricted to the areas with the heaviest concentration of risk and therefore the most reluctance by underwriters to fully cover all risks that applied.

But even very hard-to-place risks were finding coverage, as these contemporaneous articles indicated:

> Construction contractors for years have turned to the surplus lines market for liability coverage.... Now, even very large commercial construction project accounts are seeking coverage through wholesalers, noted Swett and Crawford's Mr. Hartoch. "We are doing some huge ones," he said.
>
> Business Insurance, August 19, 2002

The ground zero cleanup and construction project at the World Trade Center site is covered in a "wrap up" policy issued by Liberty Mutual.

BestWire, January 24, 2002

Captive insurance companies are forming to cover terrorism, for instance for construction trades.

National Underwriter, January 31, 2002

U.S. airlines are planning to set up their own insurance company as a way of covering their big-ticket liability exposures in the wake of Sept. 11, sources said Monday.

Reuters, February 11, 2002

Simon Property Group, Inc. announced today that it has purchased two stand-alone policies of terrorism insurance, each with $100,000,000 aggregate limits. The first policy will insure Mall of America in Bloomington, Minnesota against damage incurred from acts of terrorism. The second policy will insure the remainder of Simon's shopping center portfolio against similar perils. The policies were purchased from Lexington Insurance Company, a subsidiary of American International Group..."We are pleased that we were able to successfully negotiate an acceptable premium for terrorism insurance with Lexington Insurance Company," said David Simon, the company's chief executive officer.

First Call Newswire, March 27, 2002

"Even with insurance expenses increasing on average 30%, it still, in most cases, represents only about 1% to 3% of a property's expenses. This addition to overall expenses, by itself, will not in most cases make a dramatic difference in debt-service coverage," said Roy Chun, a managing director in Standard & Poor's surveillance group. "Standard & Poor's has not yet had to downgrade a transaction due to rising property and casualty insurance premiums," he said. "Rated REITs have also reported material increases in property and casualty insurance costs," added Lisa Sarajian, managing director of Standard & Poor's REIT group. "But these costs have risen during a time when other operating costs have fallen, which has helped to cushion the impact," said Ms. Sarajian. Thus, there has not yet been any significant impact to the operating cash flow of REITs due to rising insurance premiums.

National Underwriter, May 16, 2002

Even in New York, the picture has improved sharply from the immediate aftermath of Sept. 11, when insurers simply refused to provide coverage for terrorist attacks. "It is available, for the most part, at a price," said Walter L. Harris, the president of Tanenbaum-Harber, a brokerage firm providing coverage for big New York City buildings."

New York Times, June 11, 2002

Fitch Ratings has affirmed and removed from Rating Watch Negative GS Mortgage Securities Corp II, series 2001-LIB, classes A-1 ($58.4 million) and A-2 ($186.9 million) and X (interest only), rated 'AAA'. Fitch also affirms and removes from Rating Watch Negative the class B certificates ($50.8 million), rated 'A'. The four classes were placed on Rating Watch Negative on June 3, 2002 in connection with 12 other CMBS deals. Fitch has been in contact with ORIX Real Estate Capital Markets, LLC, the master and special servicer of this transaction, and the sponsor of the loan, Brookfield Properties, with regard to the terrorism insurance policies specific to One Liberty Plaza and other properties covered under Brookfield's terrorism insurance policies...After this review, Fitch believes the current insurance policies provide sufficient coverage for these certificates.

Businesswire, June 12, 2002

Fitch Ratings has affirmed and removed from Rating Watch Negative 1345 Avenue of the Americas Trust, classes A-1 ($40.8 million), A-2 ($233.3 million), and X (interest only), all currently rated 'AAA'...The three classes were placed on Rating Watch Negative alert on June 3, 2002 in connection with 12 other CMBS deals. Fitch has been in contact with Wells Fargo Bank, N.A., the master and special servicer for this transaction, with regard to the terrorism insurance policies specific to 1345 Avenue of the Americas and other properties covered under the borrower's terrorism insurance policies...After this review, Fitch believes the current insurance policies provide sufficient coverage for these certificates.

Businesswire, June 13, 2002

D. Claims that Cutting TRIA Back Sharply to Protect Taxpayers Will Result in Economic Chaos Are Not Justified

As the statements below illustrate, insurers predicted dire economic consequences if TRIA was not renewed by Congress in 2005:

"The American economy is already being adversely affected by the anticipated year-end expiration of TRIA. If we want to avoid a repeat of the near-paralysis of major construction and interruption of other business activity which we experienced in 2001-2002 before TRIA was in place, then Congress needs to act well in advance of year-end."[11]

The end of TRIA "... will, in turn, have a severe, negative effect on the national economy, including job loss, stalled commercial transactions and delayed construction project."[12]

"U.S. gross domestic product may be $53 billion (0.4 percent) lower, household net worth may fall $512 billion (0.9 percent) and roughly 326,000 (0.2 percent) fewer jobs may be created because of the economic drag produced by the lack of a federal terrorism insurance backstop."[13]

Despite the Department of the Treasury's unequivocal rejection of the contention that the lack of Federal terrorism insurance did or would in the future adversely affect building

[11] Statement of Robert J. Lowe on behalf of the Coalition to Insure Against Terrorism, the Real Estate Round Table and the United States Chamber of Commerce, United States Senate Committee on Banking, Housing and Urban Affairs, April 14, 2005.

[12] Statement by Brian Duperreault, Chairman, ACE Limited on behalf of the American Insurance Association, United States Senate Committee on Banking, Housing and Urban Affairs, Hearing on "Oversight of the Terrorism Risk Insurance Program" April 14, 2005.

[13] "The Economic Effects of Federal Participation in Terrorism Risk," a report commissioned by the American Insurance Association, Financial Services Roundtable, National Association of Mutual Insurance Companies, National Council on Compensation Insurance, Property Casualty Insurers Association of America and the Reinsurance Association of America, as reported in the *National Underwriter*, September 16, 2004.

construction and the overall economy (see footnote 7,) insurers continue to make such claims.[14] But if the terrorism reinsurance "gap" in 2002 taught us anything, it was that the nation quickly adjusted to the terrorism insurance shortage and the private market found ways to provide most of the needed coverage. In 2002, the insurance industry was in the early stages of steep price increases and general insurance shortages, which are typical of the hard market phase of the insurance cycle that had begun in early 2001 and was exacerbated by the September 11th attacks. In 2007, the industry is in a much better financial position. It has record reserves, as well as virtually unprecedented profits and retained earnings. If this industry could adjust to a lack of terrorism reinsurance in 2002, it certainly can handle a cutback in 2008. If terrorism insurance premium charges increase in the wake of TRIA's limitation, policyholders are in a good position to handle these increases because overall insurance rates have fallen consistently for two years.

IV. Recommendations

A. Convert TRIA to Cover only Catastrophic Terrorism Insurance Events. As the studies cited above demonstrate, property casualty insurers have the financial resources to cover terrorism losses of a far greater magnitude than they must bear under the current TRIA program. Moreover, market capacity to offer terror coverage is growing and rates are declining, despite the fact that insurer retentions under TRIA have been increasing. However, very little coverage yet exists for CNBR attacks. CFA recommends that Congress convert TRIA to a program that would cover truly catastrophic terrorism attacks of all types, including CNBR events. Such a program should cover all losses of between $100 and $200 billion and mandate coverage for all events, including CNBR losses. If losses exceed $200 billion, Congress would have to mandate additional measures, as it must do under the current program if losses exceed $100 billion. Above $100 billion in losses, the federal government should pay for 90 percent of losses. For losses of less than $100 billion,[15] normal tax considerations apply, which means that insurers can write off 35 percent of losses. This means that insurers would pay $65 billion for $100 billion in losses, while taxpayers would pay $35 billion. Congress should also authorize insurers to create a national insurance pool under the regulatory oversight of the National Association of Insurance Commissioners (NAIC). All property-casualty insurers who underwrite covered lines of insurance would be required to participate in the pool, in order to spread the costs of terror losses across the industry. Such a pool would help protect smaller insurers from overexposure because of geographic concentration of risk, for example. Insurers would be required to make terror coverage available. Congress should require NAIC to establish standards for the creation and maintenance of the pool to assure that the pool functions in a manner that is transparent to the

[14] "Allowing TRIA to expire would leave many … businesses without proper insurance coverage. This uncertainty would undermine economic expansion and job growth from the Heartland to the nation's urban centers." June Traina Holmes, Interim CEO, Property Casualty Insurers Association of America, Letter to the Editor, Wall Street Journal, October 30, 2006, www.pciaa.net.

[15] It is clearly within the financial grasp of property casualty insurers to cover an initial $100 billion in losses, or $65 after taxes. Insurer retentions under TRIA right now are about $30 billion, plus an additional 15 percent of losses. The President's Working Group on Financial Markets estimates in their report (page 26) that there is presently about $6-$8 billion in terrorism reinsurance capacity and $3-$4 billion in private capital from sources like hedge funds. As this demand for reinsurance and private capital will undoubtedly increase if TRIA coverage is reduced, it is quite conservative to assume that at least $10 billion in reinsurance and $5 billion in private or securitized capital would be available. Thus, property casualty insurers would only have to fill a "gap" of about $20 billion under this program, which is just over 3 percent of the industry's current $600 billion surplus.

public and fair to all insurers, particularly small insurers. For example, NAIC would have to ensure that retentions are set that are reasonable for both small and large insurance companies and that the public has the opportunity to have input in the rules that govern the pool.

B. Require Insurers to Pay a Premium for Coverage. As mentioned above, the current subsidy that taxpayers have provide under the TRIA program is at least $3.7 billion dollars. There is no reason why taxpayers should not be reimbursed for the value of the reinsurance they are providing to this affluent industry. The Department of Treasury should require insurers to pay premiums that are actuarially sound, if not a little higher. Requiring insurers to pay rates that are slightly higher than estimated, will, as CBO noted, encourage private insurance mechanisms to quickly compete by offering lower rates. It will also encourage mitigation efforts by insurers and policyholders.

C. Do Not Add Group Life Coverage to TRIA. There is no meaningful evidence that justifies expanding TRIA to cover group life insurance. The Treasury Department has twice rejected expanding TRIA to include group life. As the Treasury Department reported in the report of the President's Working Group on Financial Markets, group life coverage has been and is expected to continue to be widely available at rates that have been declining, despite the lack of TRIA coverage. This is because the group life market is so competitive.[16] Even the National Association of Insurance Commissioners, a group well known to be very industry-friendly and particularly concerned about solvency and any possibility of undue risk, has refused to allow group life exclusions. A major reason that both the Treasury Department and NAIC have rejected the appeals of life insurers for relief is that these insurers have not attempted all meaningful measures to spread their risk privately. CFA has not received a single complaint from a consumer or business indicating that there is a problem in the life insurance market. Since there are no exclusions allowed by the NAIC, we would likely be hearing about rising costs if they were occurring.

D. Carefully Consider Further Reducing Lines of Insurance Covered by TRIA for Which There would Likely be Few Terrorism Losses. Lines of insurance such as fidelity, boiler and machinery, and general liability, for example, generally have risks with low exposure to terrorism threat that spread throughout the nation.

E. If TRIA is Renewed, Keep it Truly Temporary. Extending TRIA permanently, or for more than five years, would freeze the program in time, inhibiting the further ability of the private market to expand and preventing Congress from adjusting the program as market conditions change. This would be a major error. If we have learned anything about the terrorism insurance marketplace since September 11th, it is that developments that were once thought to be highly unlikely can occur with startling speed. For example, in a few short years, the property-casualty insurance industry has developed into a financial tiger with record profits and surpluses and virtually unparalleled financial capacity to handle terrorism losses.

[16] Terrorism Risk Insurance: Report of the President's Working Group on Financial Markets, September 2006, pages 65-66.

Americans for Insurance Reform
Center for Insurance Research
Center for Economic Justice
Center for Justice and Democracy
Consumer Federation of America
Consumers Union
Foundation for Taxpayer and Consumer Rights
United Policyholders

Property/Casualty Insurance in 2007: Overpriced Insurance, Underpaid Claims, Declining Losses and Unjustified Profits

January 8, 2007

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202-387-6121

Americans for Insurance Reform *is a coalition of over 100 public interest groups from around the country working to increase accountability and oversight of insurance industry practices.*

The Center for Economic Justice *(CEJ) is a 501(c)(3) advocacy and education center dedicated to representing the interests of low-income and minority consumers as a class on economic justice issues. CEJ's work focuses on administrative advocacy on insurance, utilities, and credit; the tools necessary for the poor to pull themselves out of poverty.*

The Center for Insurance Research, *based in Cambridge, Massachusetts, provides an independent voice for reform in debates about insurance, banks, financial services companies and related public policy issues around the nation. CIR focuses on national and state issues of insurance and financial services regulation in a range of areas including: mutual conversions, health care, illegal discrimination, insurance accessibility, cost reduction, quality assurance, disclosure, corporate and regulatory accountability.*

Center for Justice & Democracy *is a national consumer organization working to educate the public about the importance of the civil justice system.*

Consumer Federation of America *(CFA) is a non-profit association of 300 consumer groups, with a combined membership of more than 50 million people. CFA was founded in 1968 to advance the consumer's interest through advocacy and education.*

Consumers Union *is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived form the sale of Consumer Reports, its other publications and services, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, Consumer Reports with approximately 5 million paid circulation, regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications and services carry no outside advertising and receive no commercial support.*

The Foundation for Taxpayer and Consumer Rights *is a national leader on issues related to insurance, healthcare, energy and political reform. The nonprofit, nonpartisan organization is based in Santa Monica, California.*

United Policyholders *("UP") is a not-for-profit corporation founded in 1991 as an educational resource for the public on insurance issues and insurance consumer rights. UP monitors the insurance sector, works with public officials, has a nationwide network of volunteers and affiliate organizations, publishes written materials, files amicus briefs in cases involving coverage and claim disputes and is a general information clearinghouse on consumer issues related to commercial and personal lines insurance products. UP provides disaster aid to property owners across the U.S. via educational activities designed to illuminate and demystify the claim process.*

THE PERCEPTION CULTIVATED BY INSURERS: PROPERTY CASUALTY INSURANCE IS A HIGH-RISK BUSINESS THAT IS FINANCIALLY THREATENED BY CATASTROPHIC WEATHER AND TERRORIST EVENTS

For policymakers and Americans who do not pay close attention to insurance markets, it would be easy to assume that the property/casualty insurance industry is in financial peril because of the risk inherent in offering insurance in a world where weather events and terrorism attacks seem to be more frequent and more catastrophic. After all, in recent years, insurers have had to pay claims for the losses associated with the September 11th terrorist attacks and several of the most destructive hurricanes in U.S. history.

It is not surprising therefore, that when insurance companies petition Congress for federal assistance in covering terrorism or natural catastrophe losses, Senators and Representatives are often inclined to believe that such assistance may be necessary. When coastal states (including California, in the case of earthquakes) are asked to create risk pools so that insurers have a place to steer higher risk consumers, state regulators and legislators often agree that the industry is not in a financial position to cover such risk. When insurers sharply boost premiums on the coasts, increase deductibles, refuse to renew policies or otherwise cut back coverage, policymakers often accept these steps as necessary to help the property/casualty insurance business meet the huge challenges it faces in a risky world filled with dangers that it cannot adequately measure. Many states have also been compliant when asked by insurers to reduce consumer protections in response to higher risks that insurers claim to face, such as a supposed rush by Americans to settle in coastal areas that are more dangerous. [17]

The perception, then, is that insurance has become an inherently unstable business that generates profits insufficient to compensate for the extraordinarily high risk that insurers face.

THE REALITY: LOW RISK AND UNJUSTIFIABLY HIGH PROFITS

The financial reality of the property/casualty insurance industry couldn't be more different than the carefully cultivated perception fostered by insurers. Insurers are paying out lower claims, charging higher premiums, reaping greater profits, and are more financially solid than at almost any time in history. Moreover, insurers are poised to continue to reap hefty profits for years.

<u>Measuring the Financial Strength of the Property/Casualty Insurance Industry</u>

The financial strength of the insurance industry is typically measured by the size of the

[17] "...The risks keep rising because...people continue to flock to places that are exposed to catastrophe," Edward M. Liddy, Chief Executive Officer of Allstate Insurance, in "The New Deal – Insurers Learn to Pinpoint Risks – and Avoid Them," <u>Los Angeles Times</u>, November 28, 2006.

policyholder surplus ("surplus") that it holds. Surplus is the balance sheet difference between the assets the insurers have and the liabilities insurers maintain. The key measure of solidity most analysts evaluate is the ratio of net premiums written ("net" means net of reinsurance) to surplus. "Premiums written" represents the value of premiums that policyholders pay to insurers. Premiums are a measure of the risk that insurers face, since premiums are made by actuaries as an estimate of the financial exposure, or risk, the insurer faces. Deducting the value of reinsurance from this premium amount reflects the fact that reinsurance diminishes an insurer's exposure. If an insurer makes an error in properly setting premium amounts, the surplus is available to cover the error should the error be on the low side of the actual risk observed as time passes. The ratio of net premiums written to surplus shows the riskiness of the venture. The higher the ratio, the greater the risk of experiencing a loss. For instance, if the insurer had $1,000 of premium and only $10 of surplus (a ratio of 10 to 1), a ten percent error in pricing the risk would bankrupt the insurer. If the insurer has $1,000 of surplus (a 1 to 1 ratio), the error in pricing would have to be equal to 100 percent of the premium to bankrupt the insurer. Regulators have historically frowned upon ratios greater than 3 to 1.

Insurer profits are assessed using several methods. First is the pure loss ratio. This is the percentage of the premium dollar that is or will be paid out to policyholders and other claimants as benefits after an insured event occurs. (Some of these losses remain held in reserve by insurers for future pay out.[18]) Another method of evaluating profitability is the loss and loss adjustment expense (LAE) ratio, which adds the cost of adjusting claims to the ratio. A third measure is the combined ratio, which includes all additional expenses (called "underwriting expenses") such as commissions and overhead to the loss and LAE. This figure shows how profitable the insurance venture was compared to the premiums collected, but excludes investment income that insurer's earn, which is very significant in some lines of insurance. Investment income derives from the investment "float" that is earned between the time premiums are paid to the insurer and when the insurer pays out losses. In some lines of insurance, such as fire insurance, this period is relatively brief, so the investment income earned is relatively small. In other lines, such as medical malpractice, the float exists for long periods of time, so the investment income is large. Profit can also be expressed in dollar terms. The final, overall profit, is called "net income" and includes federal taxes incurred.

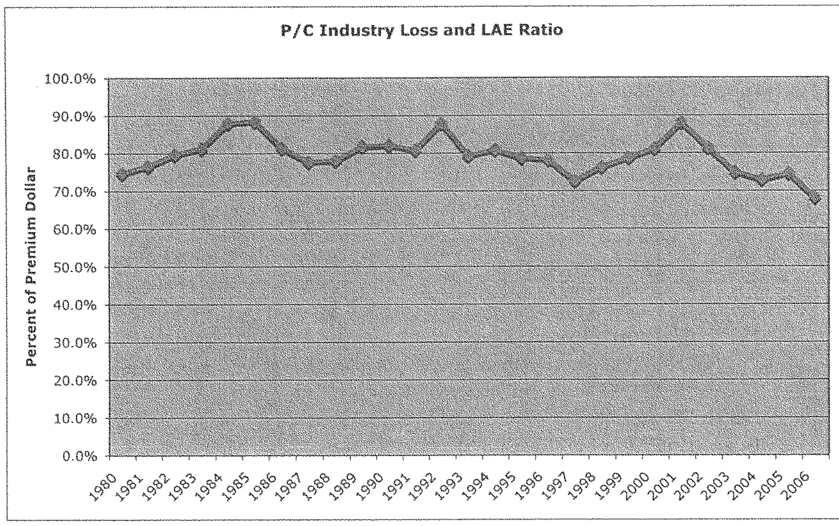
Addendum A details 25 years of key profit, loss and surplus data for the property/casualty insurance industry. It reveals how remarkable recent profits are, despite hurricane and terrorist activity. Addendum B cites 20 years of data for the top ten property/casualty insurer groups, including the top stock company results for the first nine months of 2006. The following findings are apparent from this aggregate data:

- A.M Best's estimate of the full year combined ratio in 2006 is 93.3 percent. The Insurance Information Institute (III) estimates this ratio at 94.3 percent. [19] The higher number will be used for the purposes of this analysis. If underwriting expenses

[18] "Incurred losses" include paid losses plus reserves for known claims and even for unknown claims, called "incurred bur not reported" or IBNR reserves. Paid losses only include what was actually paid out. The profit figures discussed in this report are based upon incurred losses, including all reserves.

[19] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.

(including policyholder dividends) hold at the 2005 level of 26.0 percent, [20] the loss and LAE ratio for 2006 will be 68.3 percent, the lowest ratio recorded since at least 1980. III itself says that the combined ratio is likely to be the lowest recorded in 51 years.[21] Astonishingly, if the 2005 LAE is observed in 2006, (13.1 percent)[22], the incurred losses would be 55.2 percent of premiums. This means that the property/casualty insurance industry is delivering only 55 percent of the premiums to claimants for every premium dollar paid, a very inefficient delivery of benefits to Americans. The loss and LAE ratio for the last 27 years, with its lowest point in 2006, follows:



- Using the operating ratio and reported results for the first nine-month of 2006,[23] pre-tax operating income is an estimated at $82.8 billion; a record high by a wide margin. The previous high was $47.3 billion in 2005, so the new record will shatter the old by $35.5 billion or 75.1 percent.

- Looking at the individual company data:

  (a) American International Group's loss ratio in 2006 for nine months is 50.9 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 68.7 percent. The 2006 loss ratio is almost 20 points below the insurer's long-term average. AIG is barely paying out half of the premiums it receives in benefits.

[20] Aggregates and Averages, A. M. Best and Co., 2006 Edition.
[21] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.
[22] Aggregates and Averages, A. M. Best and Co., 2006 Edition.
[23] 2006 – First Nine Month's Results, Insurance Information Institute, December 27, 2006.

(b) Allstate Insurance Group's loss ratio in 2006 for nine months is 43.5 percent, the lowest since at least 1987. This information is shocking given Allstate's moves to non-renew policies for tens of thousands of consumers in coastal states from Maine to Texas, especially in Florida, Mississippi and Louisiana. Allstate has also made very prominent efforts to convince Congress to provide a federal taxpayer subsidy for catastrophe coverage. The 1987 to 2004 average ratio was 66.8 percent. The 2006 loss ratio is more than 20 points below the long-term average. Paying out such a low percentage of premium (43.5 percent) to Allstate policyholders is simply not justifiable.

(c) St. Paul/Traveler's Group's loss ratio in 2006 for nine months is 46.8 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 65.4 percent. The 2006 loss ratio is almost 20 points below the long-term average.

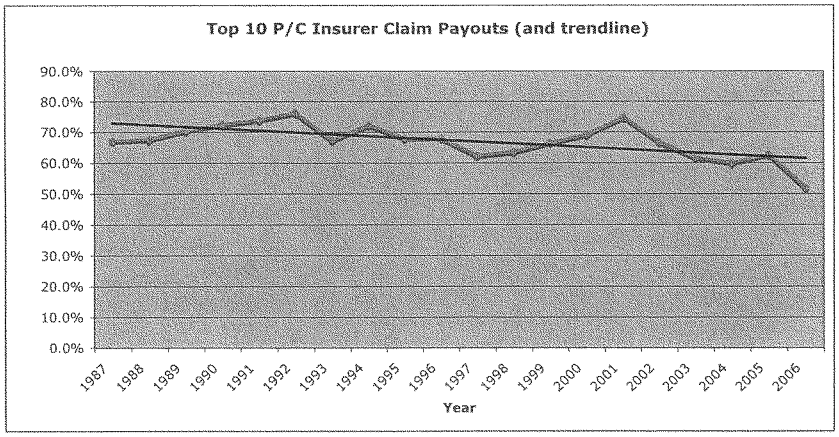
(d) Berkshire Hathaway Insurance Group's loss ratio in 2006 for nine months is 56.1 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 75.6 percent. The 2006 loss ratio is almost 20 points below the long-term average.

(e) Progressive Insurance Group's loss ratio in 2006 for nine months is 53.1 percent. Since 1987, Progressive had a loss ratio lower than this only once, in 2004 (at 51.9 percent.) The 1987 to 2004 average ratio was 55.8 percent, a meager pay out ratio over such a long period of time indicating that policies are significantly overpriced. The 2006 loss ratio is only 3 points below this extremely low long-term payout average.

(f) Hartford Insurance Group's (Hartford) loss ratio in 2006 for nine months is 53.2 percent, the lowest since at least 1987. The 1987 to 2004 average ratio was 65.0 percent. The 2006 loss ratio is more than 10 points below the long-term average.

By any measure, 2006 profits are excessive. The astonishingly low loss ratios reported above mean that consumers are receiving record low payouts for their premium dollars as insurers reap unprecedented profits. The average loss ratio for nine months of 2006 for the top six stock companies in the top ten-company list (mutuals do not supply quarterly info) is 50.6 percent. Moreover, as is obvious in the below graph, the trend in payouts is sharply down over the last twenty years, a period during most state insurance regulators have allowed consumer protections to erode significantly.[24]

[24] CFA tested this drop in benefits related to premiums to see if it could be attributed to a drop in investment income. Over the time frame studied, there was a three percent drop in investment income. Since insurers typically reflect about half of investment income in prices, CFA believes that the drop in investment income accounts for only 1.5 points of the 15 point drop. That is, investment income explains only about one-tenth of the drop in benefit payouts to consumers per dollar expended in insurance premium.



It is truly inappropriate for property/casualty insurers to be delivering only half of their premium back to policyholders as benefits.[25]

Mutual companies, which do not issue quarterly reports and therefore are not included in the data for 2006 tend to report somewhat higher loss data. The overall loss ratio for the mutual companies is likely to be about 5 percent higher than the stock companies, based on the long-term averages shown on the spreadsheet attached as Addendum B. Thus, the overall average payout should be about 53 percent, the figure used for 2006 in the above graph.

INSURANCE RISK DOES NOT JUSTIFY EXCESSIVE RETURNS

The common wisdom perpetuated by the insurance industry is that primary insurers need high profits to cover losses in a very risky sector of the economy. Insurers also claim that their shareholders should receive greater returns given the investment risk they assume. For example, the Insurance Information Institute says that, "considering the tremendous risk assumed by investors who back major insurance and reinsurance companies, the returns in most years are woefully inadequate," complaining that insurers in 2006 will just about match the 15 percent return on equity of the Fortune 500 "for just the second time in many years."[26] It is possible that reinsurance companies assume higher-than-average industry risk but this is certainly not true for the primary market. In fact, primary insurers have succeeded in eliminating or shifting most of their risk.

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[25] Insurers contend that the loss adjustment expense is a benefit to consumers. Obviously, this is a "benefit" that does not go to the consumer or repair cars, doctor bills, etc. But even the loss and LAE ratio itself is at a record low for many decades, at under 70 percent, as shown in the chart in Addendum A.

[26] Earlybird Forecast 2007, Insurance Information Institute, December 21, 2006.

If one owns a property/casualty insurance company stock, one has, with few exceptions, bought into a low-risk business, lower in risk that the market in general. This is shown in ValueLine statistics, which assess the riskiness of particular stocks. One key measure is the stock's Beta, which is the sensitivity of a stock's returns to the returns a particular market index, such as the Standard and Poors 500. A beta between 0 and 1 represents a low-volatility investment, such as most utility stocks. A Beta equal to 1 matches the index, such as the returns yielded by an S&P index fund. A Beta greater than 1 is anything more volatile than average, such as most "small cap" funds.

Another measure of a shareholder's risk is the Financial Safety Index, with a range of 1 to 5, 1 being safest and 5 being least safe; 3 is an average risk.

A third measure is the Stock Price Stability assessment, reported in five percentile intervals with 5 signifying the lowest stability and 100 the highest stability. 50 is average stability.

Consider Allstate. At the same time the company has taken draconian steps to sharply raise premiums and/or cutback coverage for many homeowners in coastal areas , it has presented shareholders with very low risk:[27] Beta = 0.90; Financial Safety = 1, and Stock Price Stability = 95.

ValueLine posts results for 26 property/casualty insurers.[28] The simple averages for these carriers are: Beta = 0.97; Financial Safety = 2.4, and Stock Price Stability = 83.

By all three measures, property/casualty insurance stocks are of below-average risk, safer than buying an S&P 500 index fund. Therefore, long-term below-average returns for insurers should be expected given the low-risk nature of this investment. The low returns demonstrate that the capital market is performing efficiently by awarding below-average returns to a below-average risk industry.

Another measure of how property/casualty insurers have insulated themselves from risk is the extraordinary profits they have earned in recent years. In 2004, insurers posted their largest dollar net (after tax) profit in history ($40.5 billion) despite the fact that four major hurricanes caused significant damage in Florida. Insurers achieved another record of $48.8 billion in 2005, despite the unprecedented losses caused by hurricanes Katrina, Rita, and Wilma. 2006 profits are the highest yet because of low hurricane activity, excessive rates, the use of programs to systematically keep payments to policyholders low and other reasons discussed in this White Paper.

In 2007, the industry is on target for an approximately 20 percent return on policyholder

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[27] ValueLine, December 22, 2006 edition.

[28] The stocks are ACE Ltd., Alleghany Corp., Allstate Corp., American Financial Group, W.R. Berkley Corp., Berkshire Hathaway, Inc., CAN Financial, Chubb Corp., Cincinnati Financial, Everest Re Group, HCC Insurance, Hanover Insurance Group, Markel Corp., Mercury General, Ohio Casualty Corp., Old Republic International Corp., PMI Group, Inc., Partner Re, Ltd., Progressive Corp., PLI Corp., Safeco Corp., St. Paul/Travelers Group, Selective Insurance, Transatlantic Holdings, 21st Century Insurance Group and XL Group, Ltd.

surplus, not the 15 percent predicted by some in the industry. A.M. Best reported three quarters net income of $50.4 billion plus unrealized capital gains of $12.9 billion for a total of $63.3 billion -- which translates to about $84 billion for a full year. Policyholder surplus for 2006 was $423.1 billion at the beginning of the year, a return on equity of 20 percent.[29]

This aggregate data actually understates industry-wide returns on equity for several reasons:

1. Industry aggregate data includes information from mutual companies like State Farm with massive capitalization. As a non-public mutual company, State Farm has no need to achieve a target return on equity as it must only satisfy policyholders, not shareholders. State Farm had 7.6 percent of industry net income, compared to 11.9 percent of industry surplus. In other words, State Farm has much more capital than a typical insurer, dragging down apparent industry-wide earnings because of its massive capital base. If data on State Farm's return on equity is removed, the industry-wide average increases by more than half a percent.

2. Publicly traded insurers have achieved returns on equity in 2005 and 2006 that are much greater than the "Fortune 500" average. For example, Allstate reported a return on equity of 23 percent for the year ending on September 30, 2006. Progressive reported a nine month return on equity of 24.3 percent on mean surplus.

3. The property/casualty insurance industry is tremendously overcapitalized. It is bringing in too much capital to warrant a higher return on equity. The excess capital is evidenced not only by the low industry-wide premium-to-surplus-ratio mentioned below, but also by the premium-to-surplus ratios of the most profitable insurers. For example, Allstate and Progressive not only have premium-to-surplus ratios much greater than the industry average, but are also buying back their own stock because they have too much capital to reasonably or profitably deploy. In October of 2006, Allstate announced a new $3 billion share repurchase plan starting in 2007 that will "compliment" the $12.8 billion program that was completed at the end of 2006.[30] The fact that Allstate still has a stock buyback program in place at the same time it is sharply reducing or eliminating coverage because it says it is financially threatened by the risk of future weather catastrophes is stunning.

   Similarly, Progressive announced that it was buying back 1.1 million shares in April 2006. A representative of the investment firm Bear Sterns stated that the share repurchase was necessary because "both management and the board are working to address the company's significant excess capital position."[31] In August, Safeco announced a $1.4 billion repurchase for almost 20 percent of its outstanding shares.[32]

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[29] A.M. Best Special Report, October 2006.

[30] "Allstate Posts Solid Earnings," National Underwriter Magazine, October 19, 2006.

[31] "Progressive Announces Stock Split, Dividend," National Underwriter Magazine, April 24, 2006.

[32] "Safeco Increases Share Repurchase, Increases Dividend," National Underwriter Magazine, August 24, 2006.

4. The industry method for calculating return on equity, as reported by A.M. Best, underestimates the actual return. Insurer income is divided by the mean (i.e., average) amount of capital that insurers had available throughout the course of the year, rather than the amount of capital on hand at the beginning of the year. As the industry sharply increases its revenue throughout the year, more income flows into surplus. The use of this calculation method increases the amount of capital used to determine return on equity and appears to reduce the estimated return. If the return on equity were calculated using the amount of capital available at the beginning of a year, the return would be much higher.[33] Allstate's return on equity for the year that ended September 30, 2006 would be 25 percent rather that 23 percent if starting capital were used.

5. Proof that the investing in insurance companies represents a below-average risk is also found in the market action of the property casualty insurers stocks. Since June 17, 2002, the date S&P started to track insurance stocks, S&P 500 stocks have increased by 43 percent through year-end 2006, while the S&P Insurance Index[34], weighted down with life insurance stocks, increased only 33 percent. During that time, however, the value of Allstate's stock rose by 65 percent and Progressive's by 62 percent. The simple average increase of the property/casualty insurance company stocks in the S&P Insurance Index was 48 percent over that period, slightly higher than the S&P 500 and more proof that the property/casualty insurance industry overall does just fine with returns on equity less than that of the S&P 500.

INSURERS HAVE REMOVED OR SHIFTED RISK THROUGH LEGITIMATE AND ILLEGITIMATE MEANS

First, insurers have made intelligent use of reinsurance, securitization and other risk spreading techniques. Securitization doubled in 2006. One very innovative development that some insurers have pioneered to spread risk is to issue securities that couple the threat of a catastrophic event with the purchase of construction stocks that would likely increase in value if a catastrophic event occurs and the demand for construction increases. The use of this kind of creative approach to diversify risk is wise.

Second, after Hurricane Andrew, insurers changed ratemaking techniques by using computer models to project either 1,000 or 10,000 years of weather experience. While this caused huge price increases to consumers at the time, consumer leaders supported this change because insurers appeared to be genuinely surprised by the level of damage caused by Hurricane Andrew and promised that the models would bring long-term stability to prices. The model contained projections of periods of intense activity and very large hurricanes, as well as periods of little or no activity, and based rates on these estimates.

[33] For example, if one invested $100 in a one-year certificate of deposit with a 10 percent interest rate, one would earn $10 in interest and have $110 in principal at the end of the year. However, if one calculated return on equity in the manner that the industry does, the same $10 in interest would represent only 9.5 percent interest ($100+$110)/2) or $10/$105.

[34] The index is made up of AFLAC, Allstate, AIG, Hartford, Jefferson Pilot, Lincoln National, Lowes, MBIA, MetaLife, NFIC, Progressive, Safeco, St. Paul/Travelers, Torchmark and UNUM.

However, Risk Management Solutions (RMS) and the other modeling companies have recently stopped using this scientific method to project storms over a 1,000 or 10,000-year period and are now using 1 to 5-year projections. This has caused at least a 40 percent jump in loss projections in Florida and the Gulf Coast and a 25 percent jump in the Northeast. This move reneges on promises made by insurers in the mid-1990s and will lead to rates that are excessive.

In fact, insurance rates on the coasts have soared for property risks, homes and businesses in the last year. At hearings held in Florida last year, home and business owners provided information about rate increases of ten-fold or more that they have been forced to pay, particularly by Citizen's Insurance Company, the state insurer-of-last-resort that has become the largest insurer in Florida.[35] The number of homes insured by Citizen's grew from 407,387 in December 2005 to 854,892 in October 2006.[36] A similar situation exists in Louisiana and other Gulf Coast states.

Third, insurers have sharply hollowed out the catastrophe coverage offered to consumers in recent years by placing a number of new requirements in policies:

- Deductibles of 2 to 5 percent have been imposed with little fanfare or notice. This reduction in coverage was accompanied in many cases by large rate increases.

- Caps on replacement costs. State Farm, for instance, caps payments for increased rebuilding costs at 20 percent. Other insurers allow no increased payments at all. A consumer who buys a $100,000 policy would receive only $100,000 to rebuild, even if the cost of repairs skyrockets after a storm due to increased demand for materials and labor. Costs can also increase when homeowners are required to make special repairs to comply with building codes that were enacted after a home was first constructed. For example, many municipalities require such code upgrades to comply with the National Flood Insurance Program if a home is more than 50 percent damaged by a flood. Given the surge in demand for home building and repair that occurs in the wake of a hurricane, and corresponding increases in prices, these changes significantly shift risk and costs to consumers.

- "Anti-concurrent-causation" clauses. This is the most draconian reduction of all that insurers have attempted to impose in recent years. It removes all coverage for wind damage if another, non-covered event (usually a flood) also occurs, regardless of the timing of the events. Under this anti-consumer measure, if a hurricane of 125-miles-per-hour rips a house apart but hours later a storm surge floods the property, the consumer would receive no reimbursement for wind losses incurred.

Given the cutbacks in coverage that have occurred in coastal areas, there is a serious question as to whether this diminished coverage is worth the even higher price that many

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[35] By law, the rates that Citizen's requires must be at least ten percent above those charged in the "voluntary" market.
[36] "An Overview of Florida's Insurance Market Trends," Florida Office of Insurance Regulation, 2006.

consumers must pay. However, most consumers have no option but to purchase such coverage as it is required by lenders or law or both. Demand for insurance is relatively inelastic.

As cited above, insurers have claimed that they are facing higher risks because of a sharp increase in the number of people and amount of construction in areas of the country vulnerable to earthquake and hurricane disasters. This claim was investigated in 2006 by the Los Angeles Times investigated reporter Perter Gosselin, who wrote that:

> ...Key statistics don't support the argument....Census figures...show that the population of coastal and earthquake counties grew at an annual average rate of 1.56 percent between 1980 and last year. But they show that the U.S population grew at a reasonably close pace of 1.24 percent.

Gosselin interviewd Judith T. Kildow, director of the government-funded National Ocean Economics Program at California State University at Monterey, who said, "You simply cannot make the case from the numbers that America's coastal counties have grown at a disproportionately faster rate than the country as a whole over the last 25 years."[37]

Fourth, insurers have also shifted risk, sometimes onto taxpayers who subsidize state-run insurers-of-last resort, by non-renewing tens of thousands of homeowner and business properties. Allstate, the leading exemplar after Hurricane Andrew, is emerging once again as the company that has been most aggressive in refusing to renew homeowner's policies in the wake of Hurricane Katrina. After Hurricane Andrew, Allstate threatened to non-renew 300,000 South Floridians, leading the State of Florida to place a moratorium on such precipitous actions. Today, Allstate is non-renewing thousands of homeowners even on Long Island, New York and Cape Cod, Massachusetts. It has also announced that it will offer no new homeowner's policies in many states, from Connecticut to Delaware and has refused to write new business in large portions of other states, such as Maryland and Virginia. Other insurers have also cut back coverage on the nation's coasts (See Addendum C, for more information).

Insurers have become quite adept at convincing government to use tax dollars to help them avoid risk. Consider the federal Terrorism Risk Insurance Act (TRIA), the California Earthquake Authority, Citizen's Insurance in Florida, and wind "pools" in a number of other states. As stated above, the state pools have become the largest writers of insurance in some states. Such an arrangement allows insurers to "cherry-pick" these states, keeping the safest risks for themselves and shifting the highest risks onto the taxpayers of the state, thereby socializing high-risk, potentially unprofitable policies and privatizing the low risk, profitable business. This adverse result for policyholders and taxpayers is hardly surprising. It is akin to "solving" the health insurance crisis by requiring states to cover sick or terminally ill consumers, while the private sector writes coverage for young and healthy consumers. Allstate is also leading efforts at the federal level to create a taxpayer-backed program modeled on TRIA to reinsure the private market against the perils of wind and other weather damage.

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[37] "The New Deal – Insurers Learn to Pinpoint Risks – and Avoid Them," Peter Gosselin, Los Angeles Times, November 28, 2006.

INSURERS HAVE EASILY HANDLED RISK AND ARE OVERCAPITALIZED

In determining whether the property/casualty insurance industry is adequately capitalized, one must first examine the losses incurred for major catastrophe or terrorism events. According to the Insurance Information Institute, the top ten insured loss disasters for property were:

EVENT[38]	PRE-TAX DOLLAR LOSS	POST TAX DOLLAR LOSS
1. Hurricane Katrina, August 2005	$40.6 billion	$26.4 billion
2. Hurricane Andrew, August 1992	15.5	10.1
3. World Trade Center, Pentagon terrorist attacks, September 2001	18.8	12.2
4. Northridge, California earthquake, January 1994	12.5	8.1
5. Hurricane Wilma, October 2005	10.3	6.7
6. Hurricane Charley, August 2004	7.5	4.9
7. Hurricane Ivan, September 2004	7.1	4.6
8. Hurricane Hugo, September 1989	4.2	2.7
9. Hurricane Rita, September 2005	5.6	3.6
10. Hurricane Frances, September 2004	4.6	3.0

Source: Insurance Services Office (ISO); Insurance Information Institute. (Ranked on constant dollar cost to insurers)

Considering that property/casualty insurers now have surplus in excess of $600 billion, catastrophes of this size are very easy to manage.

Terrorism risk is an interesting case study. While insurers are rightly concerned about a huge event, such as a nuclear, chemical or biological attack, the actual terrorism events that have occurred so far have been easily managed by private industry. There were hundreds of terrorism events in America in the 20 years leading up to the September 11th attacks. In spite of this fact, insurers did not even bother to charge a separate price for terrorism coverage in their rating structures. September 11th changed this practice, but even that attack was a "small" insured event compared to the industry's mammoth capital and surplus, which has grown significantly since 2001. Yet, insurers convinced the federal government to provide free reinsurance that CFA estimates has represented about a seven-billion taxpayer subsidy to date.

Historically, the prime test for the solidity of the property/casualty insurance industry has been the ratio of net premiums written (NPW) to surplus, discussed above. Regulators became concerned about the financial soundness of an insurer if its ratio exceeded 3 to 1. The so-called "Kenney Rule," named after financial writer Roger Kenney, was that a safe insurer should not exceed about a 2 to 1 ratio. This guideline was introduced in the 1960s and served as the standard that insurers and regulators followed for many decades. More recently, analysts have recommended lowering the acceptable ratio to about 1.5 to 1, in recognition of some more

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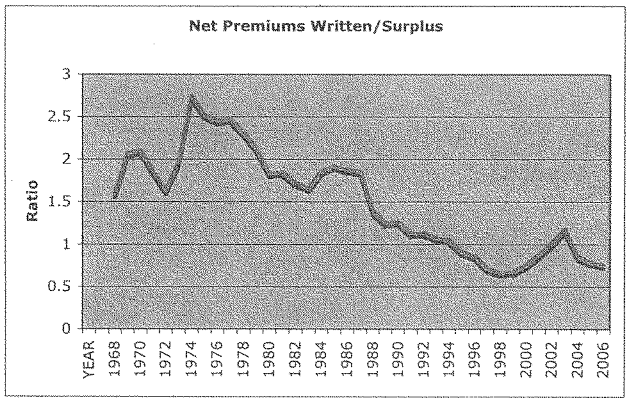
[38] The catastrophes were ranked by III based on size of loss in 2005 dollars, which we do not display here. What is displayed is the actual dollars in the year of the event. We calculate the post-tax figure by deducting the corporate tax rate of 35 percent.

extreme risks that insurers now face, such as catastrophic hurricanes and terrorist attacks. Net premium written to surplus ratios for almost thirty years are as follows:

YEAR	NPW/SURPLUS RATIO
1968	1.59
1969	2.07
1970	2.10
1971	1.85
1972	1.63
1973	1.97
1974	2.74
1975	2.52
1976	2.46
1977	2.47
1978	2.31
1979	2.13
1980	1.83
1981	1.85
1982	1.72
1983	1.66
1984	1.86
1985	1.92
1986	1.88
1987	1.86
1988	1.39
1989	1.25
1990	1.26
1991	1.13
1992	1.14
1993	1.08
1994	1.05
1995	0.91
1996	0.86
1997	0.72
1998	0.67
1999	0.68
2000	0.76
2001	0.88
2002	1.01
2003	1.17
2004	0.86
2005	0.79
2006	0.73

Source: Best's Aggregates and Averages, 1988/2006 Editions, Page 399. 2006 Estimated at 2.8 percent premium growth, Surplus up by estimated profit of $55B.

Property/casualty insurers have not exceeded the recommended 1.5 to 1 ratio of NPW to surplus in almost twenty years. The sharp downward trend in this key leverage ratio is very clear, demonstrating that the industry is now significantly overcapitalized. Here is a graphic display of these data:



MANY INSURERS NOW USE PROGRAMS DESIGNED TO SYSTEMATICALLY UNDERPAY CONSUMER CLAIMS

Insurers have also reduced their payouts and maximized their profits by turning their claims operations into "profit centers" by using computer programs and other techniques designed to routinely underpay policyholder claims. For instance, many insurers are using programs such as "Colossus," sold by Computer Sciences Corporation (CSC.)[39] CSC sales literature touted Colossus as 'the most powerful cost savings tool" and also suggested that the program will immediately reduce the size of bodily injury claims by up to 20 percent. As reported in a recent book, "...any insurer who buys a license to use Colossus is able to calibrate the amount of 'savings' it wants Colossus to generate...If Colossus does not generate sufficient 'savings' to meet the insurer's needs or goals, the insurer simply goes back and 'adjusts' the benchmark values until Colossus produces the desired results."[40] In a settlement of a class-action lawsuit, Farmers Insurance Company has agreed to stop using Colossus on uninsured and underinsured motorist claims where a duty of good faith is required and has agreed to pay class members cash benefits.[41] Other lawsuits have been filed against most of America's leading insurers for the use of these computerized claims settlement products.[42]

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[39] Other programs are also available that promise similar savings to insurers, such as ISO's "Claims Outcome Advisor."

[40] "From Good Hands to Boxing Gloves – How Allstate Changed Casualty Insurance in America," Trial Guides, 2006, Berardinelli, Freeman and DeShaw, pages 131, 133, 135.

[41] Bad Faith Class Actions, Whitten, Reggie, PowerPoint Presentation, November 9, 2006.

[42] Ibid.

Programs like Colossus are designed to systematically underpay policyholders without adequately examining the validity of each individual claim. The use of these programs severs the promise of good faith that insurers owe to their policyholders. Any increase in profits that results cannot be considered to be legitimate. Moreover, the introduction of these systems could explain part of the decline in benefits that policyholders have been receiving as a percentage of premiums paid in recent years.

CONCLUSION AND POLICY SOLUTIONS

The property/casualty industry has been remarkably successful in recent years in maximizing profit through rate increases, coverage reductions, inappropriate claims practices and the shifting of high risks onto taxpayers. As a result, insurers are underpaying losses as a percentage of premiums. In fact, insurers have significantly abdicated their corporate purpose as risk takers and sentinels for safety.

Proposed Policy Solution 1. States should strengthen weakened regulatory systems to gain control of excessive rates, inadequate coverage and claims abuses. CFA has proposed a comprehensive set of principals and standards for states to use to increase the consumer protections that they offer. (See Addendum D.)

In the near future, states should move to block RMS and other modelers from using short-term projections and require them to go back to the long-term projections they promised to use when these models were introduced in the mid-1990s. State regulators should also undertake research on the fairness of insurance rates similar to that done by California on home insurance and by the New York City Comptroller on auto insurance.

Coastal states should consider uniting to develop a coastal weather modeling system of their own, perhaps starting with the model developed by Florida State University. This model should be used to test the accuracy of projections developed by private modelers and to evaluate insurer rate requests to determine if they are excessive, inadequate or unfairly discriminatory.

If any insurer fails to market a line of insurance that it is selling elsewhere in all or part of a state, regulators should also consider convening hearings to determine if the insurer's license should be revoked for geographic discrimination, in not making insurance available to all or some of citizens of the state. Insurers should be required to fully document their actions in such cases by demonstrating, for example, why all residents of the state or a particular region do not qualify for insurance that is being sold elsewhere. Absent such a proceeding, it is very hard for regulators and the public to understand or accept as valid, for example, why an insurer would stop writing homeowner's insurance in an entire state where only some of the residents live along the coast.

CFA will be releasing comprehensive reports later this year on the severe problems that consumers face under the largely deregulated state system of insurance regulation, as well as an analysis of how state oversight has failed in recent years and what can be done to fix it.

Proposed Policy Solution 2. To solve the mounting coastal insurance crisis, policymakers should consider whether increasing rates, decreasing coverage and the turmoil created by large number of periodic non-renewals have gotten to the point where private insurers should not be offering catastrophe coverage at all.

For example, CFA and Americans for Insurance Reform have proposed creating a state fund in Florida to cover all wind risk in the state.[43] Such a program could save Florida taxpayers at least $3 billion a year through the more efficient delivery of insurance, the ability to build reserves tax-free and non-profit status. CFA estimates that overhead costs and profits would decline from about 45 percent of premium to only about 10 percent, a 35-point advantage. Further, the ability to build tax-free reserves would save the state the 35 percent corporate tax charge on the amounts of money earned by insurers from the wind premiums that remain at year-end. Such a plan should be directed by private insurance carriers determined through a competitive bidding process. The risk of large losses during the transition to a self-funded state plan should be borne by insurers if necessary, by assessing all property-casualty insurers for all lines in Florida during the period of time in which adequate reserves are built up. If wind coverage by itself is too narrow a base upon which to make such a program work, states should consider using the entire homeowners' insurance line. An interstate compact would allow a number of states to develop this sort of arrangement to cover homeowners' wind risk along the entire coast.

Such an approach would allow private insurers to sharply lower their rates as wind coverage is removed from their policies. In fact, insurers would have virtually no excuses for unjustifiably increasing rates or reducing coverage in the future as the market would be considerably more stable.

Proposed Policy Solution 3. Congress should authorize states to use interstate compacts to create multi-state risk pools to cover wind risk. Such legislation should allow states to permit the accumulation of tax-free reserves if the funds collected are kept for the purpose of paying claims after wind disasters strike. Congress could also authorize some funding to help create these coastal pools. The federal government could also help fund the efforts by the states to development a computer weather risk model.

Proposed Policy Solution 4. Some experts have stated that federal policies may discourage the development of securities to cover catastrophic events. The federal government should undertake a study of federal laws and rules to ensure that securitization of risk is encouraged, not discouraged, by federal requirements, particularly tax policy. Aggressively pursing efforts to foster increased securitization of catastrophe risk is a far more favorable option for consumers and taxpayers than insurer efforts to provide more taxpayer subsidies.

[43] Other organizations releasing this report have not taken a position on this proposal.

CONSUMER TIPS

1. If possible, don't do business with a company that has a history of anti-consumer behavior. When purchasing or renewing a homeowner's policy, consumers can contact their state insurance departments to get information on companies in their areas that have sharply raised rates and cut back in coverage in recent years.

2. Carefully review policies at purchase or renewal to determine whether high out-of-pocket costs will be imposed. Consumers should look for special deductibles for wind damage, anti-concurrent causation clauses, limits on replacement costs, and other restrictions on coverage. Consumers should also determine whether the insurer will pay for any costs incurred if they are required to elevate their homes or make changes mandated by local building codes. Ask questions and get answers in writing before signing.

3. Consumers who live away from coastal areas should actively shop for better coverage and rates. Because insurance companies are overcapitalized, they are looking for new business in lower risk areas. Rate decreases and better coverage are possible.

4. Demand thorough oversight of insurer actions by state regulators. If consumers have a problem with rates or coverage, they should file an immediate complaint in writing with their state insurance agency and follow up for a response. Consumers should also contact insurance regulators to find out what they are doing to require that rates are fair and reasonable and that insurers are not unjustifiably withdrawing coverage.

Addendum A: Profits, Losses, Surplus for All Property/Casualty Insurers

YEAR	LOSS & LAE RATIO	POLICYHOLDERS SURPLUS	PRETAX OPERATING INCOME	GROSS NATIONAL PRODUCT	PHS as a % of GNP	YEAR	SORTED BY LOSS & LAE RATIO
1980	74.9%		$7.7	$2,945		2006	68.3%
1981	76.8%		$7.0	$3,234		1997	72.8%
1982	79.8%	$75.7	$4.6	$3,349	2.26%	2004	73.1%
1983	81.5%	$81.8	$2.7	$3,730	2.19%	2005	74.8%
1984	88.2%	$78.9	-$4.0	$4,070	1.94%	1980	74.9%
1985	88.7%	$93.1	-$5.6	$4,349	2.14%	2003	75.1%
1986	81.6%	$116.1	$5.4	$4,558	2.55%	1998	76.5%
1987	77.9%	$128.5	$13.8	$4,907	2.62%	1981	76.8%
1988	78.3%	$145.7	$15.9	$5,278	2.76%	1987	77.9%
1989	82.0%	$166.4	$10.4	$5,616	2.96%	1988	78.3%
1990	82.3%	$172.5	$11.2	$5,899	2.92%	1996	78.4%
1991	81.1%	$197.2	$13.8	$6,128	3.22%	1995	78.9%
1992	88.1%	$200.5	-$2.5	$6,513	3.08%	1999	78.9%
1993	79.5%	$224.8	$14.6	$6,822	3.30%	1993	79.5%
1994	81.1%	$237.8	$11.6	$7,257	3.28%	1982	79.8%
1995	78.9%	$284.7	$19.5	$7,560	3.77%	1991	81.1%
1996	78.4%	$311.9	$20.8	$8,036	3.88%	1994	81.1%
1997	72.8%	$384.1	$35.5	$8,500	4.52%	2000	81.4%
1998	76.5%	$423.4	$23.4	$8,971	4.72%	1983	81.5%
1999	78.9%	$428.1	$15.3	$9,558	4.48%	1986	81.6%
2000	81.4%	$400.2	$10.5	$10,008	4.00%	2002	81.6%
2001	88.4%	$374.4	-$12.8	$10,301	3.63%	1989	82.0%
2002	81.6%	$376.0	$8.4	$10,641	3.53%	1990	82.3%
2003	75.1%	$353.8	$35.5	$11,297	3.13%	1992	88.1%
2004	73.1%	$508.7	$45.4	$11,999	4.24%	1984	88.2%
2005	74.8%	$551.0	$47.3	$12,743	4.32%	2001	88.4%
2006	68.3%	$606.7	$82.8	$13,339	4.55%	1985	88.7%

Dollar figures in billions. Pretax Operating Income excludes some investment income.
Source: 2005 and earlier data from Best's Aggregates and Averages, 2006 Edition and earlier editions.
2006 data based upon an estimated 94.3% combined ratio (III Earlybird Forcast, December 21,2006)
26.0% expense and dividend ratio based on 2005 results
Surplus includes State Funds after 1997. Other figures calculated as nine month data * 4/3 to annualize.
GNP Data from US Dept. of Commerce/Bureau of Economic Affairs /2006 through September.

Addendum B: Profits, Losses, Surplus for Top 10 Property/Casualty Insurers

		Number 1	Number 2	Number 3	Number 4	Number 5	Number 6	Number 7
	INDUSTRY	State Farm	AIG	Allstate	St Paul/Trav	Berk Hath	Nationwide	Progressive
YEAR	NET INCOME	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio	Loss Ratio
1987	$10.0	66.4%	71.6%	70.9%	64.1%	64.9%	72.7%	48.8%
1988	$12.3	70.6%	69.1%	71.0%	62.8%	66.2%	70.2%	52.1%
1989	$7.2	78.8%	67.7%	72.9%	65.6%	69.2%	72.7%	53.6%
1990	$8.0	77.4%	64.8%	75.2%	64.6%	93.8%	73.1%	48.9%
1991	$8.9	72.1%	68.9%	73.2%	65.2%	112.6%	69.6%	50.4%
1992	-$2.7	83.6%	71.0%	87.2%	74.9%	91.9%	73.6%	55.4%
1993	$10.5	70.4%	69.8%	68.3%	63.6%	70.4%	65.7%	52.9%
1994	$10.9	77.5%	69.9%	75.5%	64.1%	91.5%	66.3%	54.8%
1995	$20.6	70.8%	64.5%	66.8%	61.4%	67.9%	74.1%	61.8%
1996	$24.4	67.5%	66.6%	64.6%	69.2%	66.7%	71.2%	59.5%
1997	$36.8	60.4%	66.5%	58.2%	60.7%	62.5%	61.4%	57.7%
1998	$30.8	65.6%	68.0%	54.4%	64.9%	62.0%	64.8%	55.2%
1999	$22.0	67.8%	68.5%	59.6%	60.2%	77.7%	66.5%	62.3%
2000	$20.5	74.8%	65.3%	62.4%	61.8%	78.0%	73.5%	69.6%
2001	-$6.7	83.4%	71.9%	65.7%	74.9%	98.9%	68.4%	59.3%
2002	$9.1	74.7%	74.2%	62.8%	80.4%	69.0%	59.6%	57.4%
2003	$31.2	63.3%	64.3%	58.4%	60.0%	56.4%	58.2%	54.1%
2004	$40.5	60.2%	70.0%	57.0%	65.1%	58.6%	59.3%	51.9%
2005	$48.8	66.6%	72.2%	64.6%	60.0%	77.5%	58.0%	54.9%
2006	$59.9	NA	50.9%	43.5%	46.8%	56.1%	NA	53.1%
	87-05average	0.71152632	0.68673684	0.66773684	0.65447368	0.75563158	0.67310526	0.55821053

Source: Best's Aggregates and Averages, 1988 to 2006 Editions

Notes: Net Income is after tax and includes all investment income. 2006 estimated at 4/3* 9-months results from ISO.
Top ten 2006 P/C groups are displayed
Loss Ratio is pure losses incurred to be paid to consumers, not LAE
St. Paul and Travelers data is combined in the years before 2004.
Dollars in billions
2004 data for AIG estimated based upon Loss and LAE ratio of 77.6%.
2006 data: From published reports on insurer web sites - Mutual Insurers do not report quarterly
AIG 9 mos Loss and LAE = 64.1% less 2005 LAE Ratio of 13.2%
Allstate 9 mos Loss and LAE = 57.8% less 2005 LAE Ratio of 14.3%
St. Paul Travelers 9 mos Loss and LAE = 59.9% less 2005 LAE Ratio of 13.1%
Berkshire Hathaway 9 mos Loss and LAE = 56.8% (estimated) less 2005 LAE Ratio of 9.5%
Progressive 9 mos Loss and LAE = 66.3% less 2005 LAE Ratio of 13.2%
Hartford 9 mos Loss and LAE = 64.2% less 2005 LAE Ratio of 11.0%
2006 Data for 10 companies conservatively assumed based upon the data from 6 stock companies

Addendum B: Profits, Losses, Surplus for Top 10 Property/Casualty Insurers -- Continued

Number 8 Liberty Mut Loss Ratio	Number 9 Farmers Loss Ratio	Number 10 Hartford Loss Ratio	YEAR	Simple Loss Ratio Top 10 L/R	10 Company 5 yr moving Average	10 Company 3 yr moving Average	Average L/R Top 6 Stock Cos	6 Stock Co 5 yr moving Average	YEAR
82.7%	67.9%	63.2%	1987	67.3%			63.9%		1987
83.1%	68.9%	63.4%	1988	67.7%			64.1%		1988
85.8%	74.5%	65.5%	1989	70.6%		68.6%	65.8%		1989
84.3%	75.6%	68.9%	1990	72.7%		70.3%	69.4%		1990
83.9%	75.5%	69.2%	1991	74.1%	70.5%	72.5%	73.3%	67.3%	1991
85.2%	73.6%	67.4%	1992	76.4%	72.3%	74.4%	74.6%	69.4%	1992
82.2%	68.2%	63.3%	1993	67.5%	72.2%	72.6%	64.7%	69.5%	1993
73.5%	85.7%	64.8%	1994	72.4%	72.6%	72.1%	70.1%	70.4%	1994
72.9%	75.2%	65.9%	1995	68.1%	71.7%	69.3%	64.7%	69.5%	1995
72.3%	65.6%	78.3%	1996	68.2%	70.5%	69.5%	67.5%	68.3%	1996
72.6%	62.0%	62.3%	1997	62.4%	67.7%	66.2%	61.3%	65.7%	1997
75.5%	64.9%	61.6%	1998	63.7%	67.0%	64.8%	61.0%	64.9%	1998
73.4%	68.5%	61.8%	1999	66.6%	65.8%	64.3%	65.0%	63.9%	1999
74.8%	72.4%	60.0%	2000	69.3%	66.0%	66.5%	66.2%	64.2%	2000
85.2%	74.7%	66.1%	2001	74.9%	67.4%	70.2%	72.8%	65.3%	2001
68.1%	62.4%	60.1%	2002	66.9%	68.3%	70.3%	67.3%	66.5%	2002
64.0%	59.0%	79.9%	2003	61.8%	67.9%	67.8%	62.2%	66.7%	2003
63.9%	56.8%	58.2%	2004	60.1%	66.6%	62.9%	60.1%	65.7%	2004
60.9%	56.9%	56.0%	2005	62.8%	65.3%	61.5%	64.2%	65.3%	2005
NA	NA	53.2%	2006	52.0%	60.7%	58.3%	50.6%	60.9%	2006
0.76015789	0.68857895	0.65047368							

Addendum C: Reprinted from the Los Angeles Times, November 28, 2006

Insurance company cutbacks have left more than 1 million coastal residents scrambling to land new insurers or learning to live with weakened policies. As insurers retreat, states and homeowners are left to bear the biggest risks.

Massachusetts

During the last two years, six insurers have stopped selling or renewing policies along the coast, especially on Cape Cod, leaving 45,000 homeowners to look for coverage elsewhere. Most have turned to the state-created insurer of last resort. The Massachusetts FAIR Plan, now the state's largest homeowners insurer, recently received permission to raise rates 12.4 percent.

Connecticut

Atty. Gen. Richard Blumenthal has subpoenaed nine insurance companies to explain why they are requiring thousands of policyholders whose houses are near any water —coast, river or lake —to install storm shutters within 45 days or have their coverage cut or canceled.

New York

Allstate has refused to renew 30,000 policies in New York City and Long Island, and suggested it may make further cuts. Other insurers, including Nationwide and MetLife, have raised to as much as 5 percent of a home's value the amount policyholders must pay before insurance kicks in, or say they will write no new policies in coastal areas.

South Carolina

Agents say most insurers have stopped selling hurricane coverage along the coast. Those that still do have raised their rates by as much as 100 percent. The state-created fallback insurer is expected to more than double its business from 21,000 policies last year to more than 50,000.

Florida

Allstate has offloaded 120,000 homeowners to a start-up insurer and has said it will drop more as policies come up for renewal. State-created Citizens Property, now the state's largest homeowners insurer with 1.2 million policies, was forced to use tax dollars and issue bonds to plug a $1.6- billion financial hole due to hurricane claims. The second-largest, Poe Financial Group, went bankrupt this summer, leaving 300,000 to find coverage elsewhere. The state also has separate funds to sell insurers below-market reinsurance and cover businesses. Controversy over insurance was a major issue in this fall's election campaign, causing fissures in the dominant GOP.

Louisiana

The state's largest residential insurer, State Farm, will no longer offer wind and hail coverage as part of homeowners policies in southern Louisiana. In areas where it still covers these dangers, it will require homeowners to pay up to 5 percent of losses themselves before insurance kicks in. In a move state regulators call illegal and are fighting, Allstate is seeking to transfer wind and hail coverage for 30,000 of its existing customers to the statecreated Citizens Insurance.

Texas

Allstate and five smaller insurers have canceled hurricane coverage for about 100,000 homeowners and have said they will write no new policies in coastal areas. Texas' largest insurer, State Farm, is seeking to raise its rates by more than 50 percent along the coast and 20 percent statewide.

California

The state has bucked the trend toward higher homeowners insurance rates with three major insurers, State Farm, Hartford and USAA, seeking rate reductions of 11 percent to 22 percent. Regulators have begun to question whether insurers are making excessive profits after finding that major companies spent only 41 cents of every premium dollar paying claims and related expenses. Alone among major firms, Allstate is seeking a 12.2 percent rate hike.

Washington

Allstate has dropped earthquake coverage for about 40,000 customers and will have its agents offer the quake insurance of another company when selling homeowners policies in the state. Nationally, the company has canceled quake coverage for more than 400,000.

Sources: Risk Management Solutions (map); interviews with state insurance regulators

NOTE: Since the Los Angeles Times ran this recap of actions on the coasts, Allstate has announced it will stop writing new homeowner's insurance policies in many areas near the coast, including the entire state of Connecticut, the entire state of Delaware, and large portions of Maryland and Virginia. In California, several additional insurers have announced that they will be reducing rates. Regulators have begun to question whether insurers are making excessive profits after finding that major carriers have spent only 41 cents of every premium dollar paying claims and related expenses. Alone among major companies, Allstate is seeking a 12.2 percent rate hike, although the state insurance commissioner has suggested that the company may be required to lower rates and issue refunds for past overcharges instead. Regulators in California have more authority to question rates than in other states under Proposition 103, the voter-approved regulation system.

Addendum D: Consumer Principles and Standards for Insurance Regulation

1. Consumers should have access to timely and meaningful information of the costs, terms, risks and benefits of insurance policies.

- Meaningful disclosure prior to sale tailored for particular policies and written at the education level of average consumer sufficient to educate and enable consumers to assess particular policy and its value should be required for all insurance; should be standardized by line to facilitate comparison shopping; should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); should address non-English speaking or ESL populations.
- Insurance departments should identify, based on inquiries and market conduct exams, populations that may need directed education efforts, e.g., seniors, low-income, low education.
- Disclosure should be made appropriate for medium in which product is sold, e.g., in person, by telephone, on-line.
- Loss ratios should be disclosed in such a way that consumers can compare them for similar policies in the market, e.g., a scale based on insurer filings developed by insurance regulators or independent third party.
- Non-term life insurance policies, e.g., those that build cash values, should include rate of return disclosure. This would provide consumers with a tool, analogous to the APR required in loan contracts, with which they could compare competing cash value policies. It would also help them in deciding whether to buy cash value policies.
- Free look period with meaningful state guidelines to assess appropriateness of policy and value based on standards the state creates from data for similar policies.
- Comparative data on insurers' complaint records, length of time to settle claims by size of claim, solvency information, and coverage ratings (e.g., policies should be ranked based on actuarial value so a consumer knows if comparing apples to apples) should be available to the public.
- Significant changes at renewal must be clearly presented as warnings to consumers, e.g., changes in deductibles for wind loss.
- Information on claims policy and filing process should be readily available to all consumers and included in policy information.
- Sellers should determine and consumers should be informed of whether insurance coverage replaces or supplements already existing coverage to protect against over-insuring, e.g., life and credit.
- Consumer Bill of Rights, tailored for each line, should accompany every policy.
- Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurer should give consumer notice of feedback procedure at end of transaction, e.g., form on-line or toll-free telephone number.

2. Insurance policies should be designed to promote competition, facilitate comparison-shopping and provide meaningful and needed protection against loss.

- Disclosure requirements above apply here as well and should be included in design of policy and in the policy form approval process.
- Policies must be transparent and standardized so that true price competition can prevail. Components of the insurance policy must be clear to the consumer, e.g., the actual current and future cost, including commissions and penalties.
- Suitability or appropriateness rules should be in place and strictly enforced, particularly for investment/cash value policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.
- "Junk" policies, including those that do not meet a minimum loss ratio, should be identified and prohibited. Low-value policies should be clearly identified and subject to a set of strictly enforced standards that ensure minimum value for consumers.
- Where policies are subject to reverse competition, special protections are needed against tie-ins, overpricing, e.g., action to limit credit insurance rates.

3. All consumers should have access to adequate coverage and not be subject to unfair discrimination.

- Where coverage is mandated by the state or required as part of another transaction/purchase by the private market, e.g., mortgage, regulatory intervention is appropriate to assure reasonable affordability and guarantee availability.
- Market reforms in the area of health insurance should include guaranteed issue and community rating and where needed, subsidies to assure health care is affordable for all.
- Information sufficient to allow public determination of unfair discrimination must be available. Zip code data, rating classifications and underwriting guidelines, for example, should be reported to regulatory authority for review and made public.
- Regulatory entities should conduct ongoing, aggressive market conduct reviews to assess whether unfair discrimination is present and to punish and remedy it if found, e.g., redlining reviews (analysis of market shares by census tracts or zip codes, analysis of questionable rating criteria such as credit rating), reviews of pricing methods, reviews of all forms of underwriting instructions, including oral instructions to producers.
- Insurance companies should be required to invest in communities and market and sell policies to prevent or remedy availability problems in communities.
- Clear anti-discrimination standards must be enforced so that underwriting and pricing are not unfairly discriminatory. Prohibited criteria should include race, national origin, gender, marital status, sexual preference, income, language, religion, credit history, domestic violence, and, as feasible, age and disabilities. Underwriting and rating classes should be demonstrably related to risk and backed by a public, credible statistical analysis that proves the risk-related result.

4. <u>All consumers should reap the benefits of technological changes in the marketplace that decrease prices and promote efficiency and convenience.</u>

- Rules should be in place to protect against redlining and other forms of unfair discrimination via certain technologies, e.g., if companies only offer better rates, etc. online.

- Regulators should take steps to certify that online sellers of insurance are genuine, licensed entities and tailor consumer protection, UTPA, etc. to the technology to ensure consumers are protected to the same degree regardless of how and where they purchase policies.
- Regulators should develop rules/principles for e-commerce (or use those developed for other financial firms if appropriate and applicable)
- In order to keep pace with changes and determine whether any specific regulatory action is needed, regulators should assess whether and to what extent technological changes are decreasing costs and what, if any, harm or benefits accrue to consumers.
- A regulatory entity, on its own or through delegation to independent third party, should become the portal through which consumers go to find acceptable sites on the web. The standards for linking to acceptable insurer sites via the entity and the records of the insurers should be public; the sites should be verified/reviewed frequently and the data from the reviews also made public.

5. **Consumers should have control over whether their personal information is shared with affiliates or third parties.**

- Personal financial information should not be disclosed for other than the purpose for which it is given unless the consumer provides prior written or other form of verifiable consent.
- Consumers should have access to the information held by the insurance company to make sure it is timely, accurate and complete. They should be periodically notified how they can obtain such information and how to correct errors.
- Consumers should not be denied policies or services because they refuse to share information (unless information needed to complete transaction).
- Consumers should have meaningful and timely notice of the company's privacy policy and their rights and how the company plans to use, collect and or disclose information about the consumer.
- Insurance companies should have clear set of standards for maintaining security of information and have methods to ensure compliance.
- Health information is particularly sensitive and, in addition to a strong opt-in, requires particularly tight control and use only by persons who need to see the information for the purpose for which the consumer has agreed to sharing of the data.
- Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

6. **Consumers should have access to a meaningful redress mechanism when they suffer losses from fraud, deceptive practices or other violations; wrongdoers should be held accountable directly to consumers.**

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. UTPAs should provide private cause of action.
- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.

- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be independent, fair and neutral decision-maker.
- Private attorney general provisions should be included in insurance laws.
- There should be an independent agency that has as its mission to investigate and enforce deceptive and fraudulent practices by insurers, e.g., the reauthorization of FTC.

7. **Consumers should enjoy a regulatory structure that is accountable to the public, promotes competition, remedies market failures and abusive practices, preserves the financial soundness of the industry and protects policyholders' funds, and is responsive to the needs of consumers.**

- Insurance regulators must have clear mission statement that includes as a primary goal the protection of consumers:
- The mission statement must declare basic fundamentals by line of insurance (such as whether the state relies on rate regulation or competition for pricing). Whichever approach is used, the statement must explain how it is accomplished. For instance, if competition is used, the state must post the review of competition (e.g., market shares, concentration by zone, etc.) to show that the market for the line is workably competitive, apply anti-trust laws, allow groups to form for the sole purpose of buying insurance, allow rebates so agents will compete, assure that price information is available from an independent source, etc. If regulation is used, the process must be described, including access to proposed rates and other proposals for the public, intervention opportunities, etc.
- Consumer bills of rights should be crafted for each line of insurance and consumers should have easily accessible information about their rights.
- Insurance departments should support strong patient bill of rights.
- Focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within regulatory body should be established for education and outreach to consumers, including providing:
- Interactive websites to collect from and disseminate information to consumers, including information about complaints, complaint ratios and consumer rights with regard to policies and claims.
- Access to information sources should be user friendly.
- Counseling services to assist consumers, e.g., with health insurance purchases, claims, etc. where needed should be established.
- Consumers should have access to a national, publicly available database on complaints against companies/sellers, i.e., the NAIC database.
- To promote efficiency, centralized electronic filing and use of centralized filing data for information on rates for organizations making rate information available to consumers, e.g., help develop the information brokering business.
- Regulatory system should be subject to sunshine laws that require all regulatory actions to take place in public unless clearly warranted and specified criteria apply. Any insurer claim of trade secret status of data supplied to regulatory entity must be subject to judicial review with burden of proof on insurer.
- Strong conflict of interest, code of ethics and anti-revolving door statutes are essential to protect the public.

- Election of insurance commissioners must be accompanied by a prohibition against industry financial support in such elections.
- Adequate and enforceable standards for training and education of sellers should be in place.
- The regulatory role should in no way, directly or indirectly, be delegated to the industry or its organizations.
- The guaranty fund system should be prefunded, national fund that protects policyholders against loss due to insolvency. It is recognized that a phase-in program is essential to implement this recommendation.
- Solvency regulation/investment rules should promote a safe and sound insurance system and protect policyholder funds, e.g., rapid response to insolvency to protect against loss of assets/value.
- Laws and regulations should be up to date with and applicable to e-commerce.
- Antitrust laws should apply to the industry.
- A priority for insurance regulators should be to coordinate with other financial regulators to ensure consumer protection laws are in place and adequately enforced regardless of corporate structure or ownership of insurance entity. Insurance regulators should err on side of providing consumer protection even if regulatory jurisdiction is at issue. This should be stated mission/goal of recent changes brought about by GLB law.
- Obtain information/complaints about insurance sellers from other agencies and include in databases.
- A national system of "Consumer Alerts" should be established by the regulators, e.g., companies directed to inform consumers of significant trends of abuse such as race-based rates or life insurance churning.
- Market conduct exams should have standards that ensure compliance with consumer protection laws and be responsive to consumer complaints; exam standards should include agent licensing, training and sales/replacement activity; companies should be held responsible for training agents and monitoring agents with ultimate review/authority with regulator. Market conduct standards should be part of an accreditation process.
- The regulatory structure must ensure accountability to the public it serves. For example, if consumers in state X have been harmed by an entity that is regulated by state Y, consumers would not be able to hold their regulators/legislators accountable to their needs and interests. To help ensure accountability, a national consumer advocate office with the ability to represent consumers before each insurance department is needed when national approaches to insurance regulation or "one-stop" approval processes are implemented.
- Insurance regulator should have standards in place to ensure mergers and acquisitions by insurance companies of other insurers or financial firms, or changes in status of insurance companies (e.g., demutualization, non-profit to for-profit), meet the needs of consumers and communities.
- Penalties for violations must be updated to ensure they serve as incentives against violating consumer protections and should be indexed to inflation.

8. Consumers should be adequately represented in the regulatory process.

- Consumers should have representation before regulatory entities that is independent, external to regulatory structure and should be empowered to represent consumers before any administrative or legislative bodies. To the extent that there is national treatment of companies or "one-stop" (OS) approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the OS state or any other approving entity.

- Insurance departments should support public counsel or other external, independent consumer representation mechanisms before legislative, regulatory and NAIC bodies.
- Regulatory entities should have well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., consumer advisory committee. This is particularly true to ensure needs of certain populations in state and needs of changing technology are met.

CIAT COALITION TO INSURE AGAINST TERRORISM
insure against terrorism.org

STATEMENT OF ARTHUR M. COPPOLA
PRESIDENT & CEO, MACERICH COMPANY

ON BEHALF OF
THE COALITION TO INSURE AGAINST TERRORISM

BEFORE A HEARING OF

THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

ENTITLED

EXAMINING THE TERRORISM RISK INSURANCE PROGRAM

FEBRUARY 28, 2007

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1875 Eye Street, NW, Suite 600, Washington, DC 20006-5413
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Good morning, Chairman Dodd, Senator Shelby, and members of the Committee. Thank you very much for allowing me to testify today. My name is Arthur M. Coppola, and I am the President & CEO of Macerich Company, one of the nation's largest retail real estate investment trusts. Macerich has a diverse national portfolio that encompasses 73 regional shopping centers, as well as a dynamic mix of lifestyle, large-format retail and specialty centers. I also serve as the Chair of the National Association of Real Estate Investment Trusts (NAREIT), on the Board of the Real Estate Roundtable, and as a member of the International Council of Shopping Centers. I am testifying today on behalf of the Coalition to Insure Against Terrorism (CIAT).

CIAT is a broad coalition of commercial insurance consumers formed immediately after 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. CIAT joined Congress and the Administration in recognizing that only the Federal government could provide the framework to make this coverage available to all those who required it. The diverse CIAT membership represents virtually every sector of the U.S. economy: hotels, banking, energy, construction, entertainment, real estate, stadium owners, manufacturing, transportation, as well as public sector buyers of insurance. For example, the U.S. Chamber of Commerce, the Real Estate Roundtable, the National Association of Manufacturers, and the National Retail Federation are members. So are, to name a few sectors, transportation interests (e.g., the Association of American Railroads, the General Aviation Manufacturers Association, and the Taxicab, Limousine and Paratransit Association), utilities (e.g., American Gas Association, American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association), finance (e.g., American Bankers Association, America's Community Bankers, Mortgage Bankers Association of America, Commercial Mortgage-Backed Securities Association), real estate (American Resort Development Association, National Association of Realtors, Building Owners and Manufacturers International, International Council of Shopping Centers, and National Association of Industrial and Office Properties) and sports (e.g., Major League Baseball, NFL, NBA, NHL, and the NCAA).

CIAT is the true consumer voice on terrorism risk insurance, as we are comprised of the principal policyholders of commercial property and casualty lines of insurance in the United States. From this perspective we offer our testimony today.

We are gratified that Chairman Dodd and Ranking member Shelby have so clearly made this issue a priority today – as both of you have in the past – by scheduling this hearing as one of the Committee's first items of business in the year. As we have seen before in 2005 when the Terrorism Risk Insurance Act (TRIA) was set to expire, problems associated with the availability of terrorism risk insurance will increasingly get worse as the year wears on.

Frankly, we believe there is no need for delay in action by Congress. The facts are in – terrorism is clearly a risk that the private insurance industry alone can not and will not underwrite. The means and courses of future attacks are unknown, but we do know that the potential for loss in such an attack or in a series of such attacks is exceedingly large, potentially catastrophic.

Moreover, the Government Accountability Office (GAO) and the President's Working Group on Capital Markets (PWG) have recently issued reports that confirm that, other than for workers' compensation insurance mandated by state law, no meaningful amount of insurance against loss from weapons of mass destruction (nuclear, biological, chemical and radiological or "NBCR") is available in the market today – notwithstanding the fact that TRIA backstops such insurance.

To avert disruption in the "conventional" terrorism risk insurance market and to address the gap in coverage against NBCR terrorism-related risk, we encourage this Committee to follow this hearing promptly with the introduction and passage of a bill that will extend TRIA permanently and improve it to keep the economy running smoothly in the face of the ongoing threat of terrorist attacks.

TRIA HAS BEEN A POST-9/11 SUCCESS BUT MUST BE IMPROVED

There is no question that the Terrorism Risk Insurance Act (TRIA) accomplished its main objectives, which were to help stabilize the US economy following 9/11, to provide for the availability of terrorism insurance for commercial policyholders in the face of the ongoing threat of terrorism, and to also provide a system for the efficient recovery of the economy in the case of another severe attack. The situation was dire: in the 14-month period between 9/11 and the enactment of TRIA – over $15 billion in real estate related transactions were stalled or even cancelled because of a lack of terrorism insurance, according to a Real Estate Roundtable study. Furthermore, the White House Council of Economic Advisors indicated that approximately 300,000 jobs were lost over that period. Congress and the President worked together to enact TRIA, which required insurers to make terrorism coverage available in commercial lines, and in return provided a Federal backstop that allows the economy to recover quickly from a terrorist attack. Without it, not only was the economy slowed and at risk, but economic recovery following any further attack would have been retarded. The same is still true today.

TRIA, and its extension in 2005, the Terrorism Risk Insurance Extension Act (TRIEA), were part of a series of measures Congress passed to protect the US economy from terrorism threats, and continues today to be an integral part of our homeland security strategy. For instance, U.S. airlines are directly insured by the Department of Transportation (DOT) for both terrorism and war risk. The Federal Government, through the Overseas Private Investment Corporation (OPIC), also directly insures U.S. investors overseas for both terrorism and political risk outside the United States. It would be ironic and senseless if TRIA, which is the only similar protection of the domestic economy and which, unlike the DOT and OPIC programs, is not a direct liability of the Federal Government, were allowed to expire or even linger in limbo through the remainder of this year.

Terrorism is the major threat facing our nation today. We hear about it on daily basis from the Administration, our national security team and from almost every corner of Capitol Hill. Whatever one's view of the wars in Iraq and Afghanistan, the threat of attack to our country does not now seem to be diminishing. The threat of "enemy attack" is part of our daily lives and shows no sign of going away.

Terrorism risk remains an evolving picture that insurers and reinsurers have a difficult (if not impossible) time modeling. Primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses without adequate reinsurance, and the current private reinsurance market provides only a fraction of the capacity needed. This problem is evident in the fact that, as we once again approach the sunset of the TRIA program, many policies again are being issued with "pop-up" and "springing" exclusions that void terrorism coverage after termination of the Federal backstop. We witnessed the same sort of exclusions in 2005 before TRIA was extended for two years.

Quite simply, economic security is central to an effective homeland security strategy. American businesses must have adequate terrorism risk coverage. Without terrorism insurance, the nation's economic infrastructure is totally exposed to large-scale business disruptions after an attack, and to a retarded recovery from the damage that is caused by the attack. As our economic interests continue to be targeted by terrorists, it is appropriate, necessary and vital that the Federal Government play a role in maintaining the security of our insurance system which helps provide for recovery of the economy.

LONG TERM SOLUTION NEEDED

The conditions that necessitated TRIA and TRIEA – insurers that are not willing or able to quantify man-made risks which are potentially catastrophic and a withdrawal of all significant reinsurance capacity – have not gone away. We believe that the time has come for Congress to enact a long-term solution for insuring against terror – one that is either permanent or at least guaranteed to be in place until Congress declares that terrorism is no longer a risk. At least fourteen other major industrial nations have recognized that the private markets are unable to effectively manage terrorism risk and have adopted permanent national programs. The US market is no different. Terrorism risk is a national problem that requires a Federal solution.

We believe that the Federal role should focus most heavily on what the private markets have been unwilling or unable to do: enabling policyholders to purchase insurance for the most catastrophic conventional terrorism risks; ensuring adequate capacity in high risk, urban areas; and providing meaningful insurance for NBCR risks. A permanent program should also seek over time to reduce the Federal role in conventional terrorism markets and maximize long-term private capacity by facilitating entry of new capital. We believe that over time the private market may be able to develop enough capacity to address many terrorism risks, but the risk of truly catastrophic events – involving both conventional attacks in urban areas as well as NBCR terrorism everywhere– will continue to be virtually uninsurable without some sort of Federal program in place.

CIAT has developed a set of principles for a long-term solution, and I will devote the remainder of my testimony to describing this plan.

CIAT'S PRINCIPLES FOR TRIA MODERNIZATION

The CIAT proposal seeks to make sure there is adequate terrorism insurance capacity in the market in the future, particularly for high risk areas; to ensure that NBCR risks will be covered; and to ensure that the Federal government will have an insurance mechanism in place so that the nation can more easily and efficiently recover from a truly catastrophic attack—whether due to conventional or unconventional terrorism. At the same time our proposal seeks to minimize over time the role of the Federal government for conventional terrorism.

Conventional Terrorism Risk

For risk of conventional (i.e., non-NBCR) terrorism attacks, the CIAT proposal would leave in place the TRIA backstop, with the insurer deductibles, industry retention, and program trigger all maintained at no higher than their 2007 levels. This ensures that policyholders will continue to have access to coverage through the "make available" provision.

While TRIA has been largely successful in making available private direct insurance coverage against conventional terrorism attacks, it has not been without some continuing problems of availability and affordability. There are major markets today, particularly high-risk urban areas with prescribed fire-following policy forms, where the combination of aggregation of risk, high retention rates and rating agency pressure are causing capacity problems for conventional terrorism coverage. Thus, Congress and the Federal government need to continue the statutory framework that is known as TRIA for conventional terrorism exposure, but this framework needs to be modernized to reflect the continuing market realities of capacity shortfalls in some areas. This is one of the reasons why CIAT favors raising the $100 billion annual program cap (which has not even been indexed for property values or general inflation in the five years since the TRIA program began).

However, CIAT also suggests Committee consideration of a privately-funded "Terrorism Risk Trust Fund" that would be maintained by Treasury and used to help cover a portion of the Federal share of insured losses under the TRIA program. The trust fund, for example, could be funded with both "pre-event" (i) assessments on insurers and (ii) matching surcharges on policyholders in an "above the line" amount separate and discrete from their property/casualty insurance premium (and therefore not be subject to state rate approval).

These collections could be forwarded to Treasury where they would be managed in a segregated, tax-free trust or maintained in a separate corporation similar to the FDIC. Treasury would get the benefit of the surcharged accounts which would have the effect of decreasing the government's exposure as the trust fund grew over time. For example, even a 1% surcharge on the premiums in the TRIEA covered lines – with a matching 1% insurer assessment – together with a conservative investment return (government bond rate) would grow to tens of billions of dollars in capital in the same amount of time that TRIA has already been in place.

We believe that, over time, this trust fund will accumulate enough capital through these pre-event surcharges and assessments that the likelihood of taxpayer exposure to terrorism risk will be limited to only the most extreme events. The result would be a public-private partnership that will reduce the Federal role and maximize private capacity. We also note that the use of "pre-event" surcharges in our proposal does not in any way effect the operation of post-event surcharges for purposes of recoupment that are already in the TRIA program.

NBCR Terrorism Risk

NBCR terrorism risk is a different matter. Even if the Federal backstop exposure to conventional terrorism can be reduced over time to all but the most catastrophic attacks, the challenges are different for NBCR, according to all of the expert actuarial estimates. As it presently stands, although TRIA covers NBCR perils, we have not seen any evidence that such coverage is being written except where mandated for workers compensation. Because TRIA only requires that terrorism coverage be made available on the same terms, amounts and limitations as non-terrorism perils, insurers are not required to make NBCR terrorism coverage available if NBCR coverage for non-terror events is not offered.

The GAO, the Treasury Department, and the President's Working Group have all recognized that markets simply cannot price the risks associated with NBCR perils. Accordingly, we believe that this is a crucial area that the long-term solution should address.

Our proposal would add NBCR perils to the "make available" requirement under TRIA and would call for lower insurer deductibles and co-pays with respect to NBCR risks, creating a separate formula to determine the industry retentions. The proposal would also remove the annual $100 billion program cap, to clarify that insurers are not liable for truly catastrophic attacks – whether NBCR or conventional. With such confirmation of protection against the most catastrophic attacks, private insurers should be able and willing to devote more of their existing capacity to conventional terrorism risks as well.

Other Changes

CIAT urges removal the distinction between foreign and domestic terrorism in the statute's definition of "act of terrorism." This distinction may force the Treasury Secretary to make determinations that may not serve our national security needs, and it serves no sound policy goal. As the London bombings demonstrated all to well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims.

Finally, in order to enhance the stability of our financial markets, the modernized program should be made permanent – or should be in place at least until Congress declares that terrorism is no longer a risk.

In all, we believe that the CIAT-endorsed modernization principles for TRIA will reduce the Federal role over time but ensure economic security by keeping a backstop in place for the most extreme and catastrophic attacks, whether conventional or NBCR. We think it is a fair measure and we urge the Committee and Congress to incorporate these features into the measure to be adopted this year.

CONCLUSION

Again, we applaud you for making long-term renewal of TRIA solution a priority early in the year, and we thank you for the opportunity to testify at this important hearing. We urge you to incorporate the CIAT principles in your renewal legislation. As always, CIAT is committed to working with you, the insurance community, and other stakeholders in crafting a meaningful long-term solution as swiftly as possible.

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Statement of Janno Lieber
before a Hearing of
the Committee on Banking, Housing and Urban Affairs
Room SD-538, Dirksen Senate Office Building
"Examining the Terrorism Risk Insurance Program"

February 28, 2007

Introduction:

My name is Janno Lieber. I am the World Trade Center Project Director for Silverstein Properties. On behalf of the Silverstein organization, I'd like to thank you for inviting us to participate in this important hearing today. We greatly appreciate this committee's continued support over the last several years as we have dealt with the various impacts of 9.11 -- not least in the area of terrorism insurance. I'd also like to thank Chairman Dodd and Ranking Member Shelby for scheduling this hearing early in the session, and for making TRIA extension a priority – as you both have done in the past.

Background:

As most of you know, the Silverstein organization leased the commercial office portions of the World Trade Center site from the Port Authority of New York and New Jersey just six weeks prior to September 11, 2001. Since that terrible day, our entire effort has been focused on rebuilding Lower Manhattan as a dynamic mixed-use district and commemorating the lives lost with an appropriate memorial.

After several years of planning and public dialogue, all parties are united as to what will be built at the World Trade Center – and also where, when and by whom. In late 2006, the new business arrangements between Silverstein Properties and our partners at the Port Authority of New York and New Jersey were formally and finally agreed upon – with the full support of the State of New York, the State of New Jersey and the City of New York. This means that the entire World Trade Center site -- with four exceptional skyscrapers designed by world-renowned architects -- will be rebuilt by 2012. These office towers – and the retail they will house at the lower levels -- will be a magnificent addition to the rebirth of Lower Manhattan, restoring the City's historic birthplace and joining the Calatrava-designed PATH Transportation Hub, the Memorial, and a new Performing Arts Center to make lower Manhattan one of the most exceptional destinations in the world.

As you know, the federal terrorism insurance program (TRIA) was enacted in the wake of the attacks on the World Trade Center in order to fill the gap left by the private market and to prevent economic disruptions due to insufficient availability of insurance. Prior to 9/11, terrorism was implicitly included as a covered peril, and not specifically excluded from coverage. After the attacks of 9/11, insurers began specifically excluding damage from terrorism from traditional all risk or special causes of loss property policies as well as from other coverage such as commercial general liability. The effect of TRIA was to make it possible once again to obtain coverage against the peril of terrorism within lines of coverage such as property -- including builder's risk -- and commercial general liability.

Over the past few years, since the enactment of TRIA, the private insurance market has rebounded -- to a degree. However, in some areas, especially densely developed areas perceived as "high risk," there is simply insufficient insurance capacity – both terrorism insurance, and other insurances that have a terrorism component, such as builder's risk insurance. Thus, the circumstances that prompted Congress to create TRIA – a shortage or unavailability of insurance, threatening market disruption – still apply. As detailed below, this is very much the case in Lower Manhattan, which has suffered two terrorist attacks since 1993. Worse, there is a very real possibility that the expiration of TRIA or the program's inability to deal with lower Manhattan's unique circumstances could actually *trigger* a halt to the rebuilding of the World Trade Center and the rest of lower Manhattan.

Need for Permanent or Long-Term TRIA Extension:

The most important action Congress can take to assure availability of terrorism coverage for densely developed "high risk" areas with a market perception of "high risk" is to extend TRIA either permanently or for a very long period, i.e., no less than fifteen years. A long-term program is necessitated by the interplay between insurance, financing, contracting and design on large-scale development projects. Large-scale development projects can take a very long time from start to finish – including a three-to-five year design, planning and approval process, followed by several years of construction, and another few years of lease-up. TRIA needs to be tailored to match the

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exposure that the construction industry, lenders and insurers face when making decisions about whether to build, finance or insure these large-scale projects. The failure to do so will impede new construction. And a short term renewal will not solve this problem.

Real estate loans are of course secured by the borrower's real property. However, today most large, commercial loans are securitized in order to create bonds that are purchased by institutional investors. Lenders often do not hold the loans that they originate, but usually sell all or a portion of the loans for regulatory or liquidity reasons. In order to receive investment-grade ratings from rating agencies -- ratings which are often necessary to get investors to purchase the bonds -- the underlying collateral must be secured. A lack of access to terrorism coverage may impact on a project's ability to obtain investment-grade ratings from bond rating agencies for securitization of loans for large construction projects; this is especially true of construction projects in highly concentrated, "high-risk" areas like Lower Manhattan and the World Trade Center site. The federal backstop provided by TRIA, of course, does not guarantee that terrorism insurance will be available to these and other "high-risk" areas; other changes to the program will be necessary to accomplish that goal. However, it substantially increases the likelihood that *most* projects can purchase insurance in the marketplace.

Further, the TRIA backstop must be of sufficient duration to the address the lender 's viewpoint. A substantial percentage of large, fixed-rate commercial loans are for terms of at least ten years -- in some cases longer. If the term of a loan exceeds the length of a TRIA extension, the lenders must assess the risk of having to terminate the loan early because the borrower defaults on the covenant to maintain specified terrorism

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coverage; or the lender will simply decide not to write the loans for a longer period than TRIA or not to write such loans at all. In addition, construction lenders need to know that permanent financing will be available to re-pay construction loans at the time of project completion -- financing that may not be available if TRIA has expired before the project is completed and the buildings are fully leased. Without the market certainty that a long term extension of TRIA would provide, many large, high-profile development projects are likely to be delayed indefinitely or come to a halt due to the inability to sufficiently finance such projects.

Yet another factor militating for a long term extension of TRIA is that construction project participants -- including construction managers, contractors, owners, and lenders -- require that project insurance policies be non-cancelable during the course of construction. Some insurers may reserve the right to cancel if reinsurance changes. A long term extension of TRIA is necessary to address this situation – to give all parties the confidence that terrorism insurance would *not* be cancelled as a result of the disappearance of the federal backstop.

Need for Additional Capacity:

I want to discuss one other major challenge today faced by large-scale projects in high risk areas -- a shortage of capacity. The World Trade Center rebuilding will cost in the range of $13-$15 billion in total, including the four office towers, PATH Hub, Memorial and all the infrastructure to serve this new community. But according to the leading insurance consultants and brokers in New York City, even with the current TRIA extension in place there is currently less than $750 million worth of coverage available in

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the entire Lower Manhattan market. And, I should add, there is no viable alternative beyond the traditional private marketplace.

We strongly believe that a TRIA extension ought to address the capacity problem in lower Manhattan and other perceived areas of maximum aggregation and level of risk. Today you are hearing Arthur Coppola of the Coalition to Insure Against Terrorism and others testify today about addressing the problems to the current TRIEA relating to certified and non-certified acts – the foreign versus domestic distinction -- and so-called NBCR events. These general "fixes" to TRIA are badly needed in order to free up terrorism insurance capacity. However, even if these important corrections are made there will still be questions about whether it will be sufficient to attract more capacity to certain areas perceived as "high risk." Therefore, we suggest that consideration given to additional actions – for example, (a) reducing the current "deductible retention" applicable to insurers under the current TRIEA for policies written to cover projects in areas that have previously experienced acts of terrorism or are otherwise judged "high-risk," and/or (b) reducing the current $100 million TRIEA program trigger. We are not absolutely wedded to any particular mechanism. But we do need this committee's leadership and creativity to find a way to assure that terrorism insurance is available to Lower Manhattan and other areas like it, where there is now a significant capacity shortfall.

There is one other step Congress can take in order to free up terrorism insurance capacity. We also urge that a TRIA extension clarify the scope of TRIA coverage by making it clear that TRIA is a backstop for *all* proximate consequences of a terrorist attack, including a fire or collapse following an attack – as well as damages from the initial impact or explosion. Unfortunately, the scope of TRIA coverage is currently somewhat unclear, and therefore terrorism risk is bleeding into builders risk and property insurances and causing a shortage of capacity for those insurances – especially in certain highly concentrated, "high-risk" areas like Lower Manhattan.

Conclusion:

Like other mega-project developers, the Silverstein organization cannot finance billion-plus dollar office buildings without adequate terrorism insurance coverage. While a substantial portion of the $8 billion needed to construct the new office towers at the World Trade Center will come from insurance proceeds, we will also need to obtain billions of dollars worth of financing in the form of Liberty Bonds. To obtain this financing, our lenders will require terrorism insurance.

The TRIA program is essential to give us any chance of obtaining the terrorism insurance which lenders and investors will require. It has been a success and it should be made permanent. However, according to our insurance professionals, it would not now be possible, even with the TRIA extension in place -- to adequately insure even one of the four office buildings now planned for construction on the World Trade Center site. Also, this doesn't account for the terrorism insurance needs of several other office buildings and a major transportation hub being constructed nearby – which will all have the effect of lessening capacity even further. In order to assure that commercial development thrives in Lower Manhattan and, indeed, in all major urban centers, it is critical that the Government continue to work closely with the private sector and develop a long-term, workable solution, including some adjustments to the TRIA program.

Thank you again for allowing us to participate today.

STATEMENT SUBMITTED

BY

DON BAILEY, CEO OF WILLIS NORTH AMERICA

TO

SENATE BANKING COMMITTEE

ON

THE TERRORISM RISK INSURANCE PROGRAM

February 28, 2007

Willis

Chairman Dodd, Ranking Member Shelby, and members of the Committee, thank you for the opportunity to testify before you today regarding the terrorism risk insurance program. My name is Don Bailey. I am the CEO of Willis North America, Inc., a subsidiary of The Willis Group (Willis). My testimony today is on behalf of my firm, as well as the member firms of the Council of Insurance Agents and Brokers (The Council).

Willis is one of the world's largest professional services firms specializing in risk management. Our 15,400 experienced and highly knowledgeable employees provide a wide range of strategic and operational risk management services across all industries, worldwide.

The Council represents the nation's leading, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place approximately 80 percent – well over $200 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

Willis and the members of The Council share your belief that terrorism risk protection is an issue of utmost importance and a critical element in our Nation's efforts to confront and defeat the terrorist threat. The members of this Committee have been leaders in this effort and we commend you for all of your hard work, including the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the Terrorism Risk Insurance Extension Act (TRIEA) in 2005.

Introduction

It has been more than five years since thousands of our fellow citizens, our friends, colleagues and family members, were killed in the September 11, 2001, terrorist attacks. For many Council members, the loss was personal, and our industry lost many good people that terrible day.

One of the most important of the many steps that Congress and the President have taken to protect Americans from the effects of terror attacks was the enactment of TRIA in 2002, and its extension in 2005. Passage of TRIA was critical for individual businesses and for the economy as a whole. Although the spotlight was on the insurance industry's capacity to withstand further terror attacks and to cover terror risks going forward, the national risk was – and is – much broader. Because insurance provides individuals and businesses with the ability to take risks essential to the functioning of our economy, constraining that ability would be economically devastating. TRIA has prevented that from happening. Indeed, not only have federal funds provided by the TRIA "backstop" never been tapped and not one taxpayer dollar spent, the program has proved to be an unqualified success in stabilizing the insurance markets, allowing insurers to provide much-needed terrorism coverage to consumers at prices they are able to afford. TRIA is not about protecting the balance sheets of insurers and brokers – it is about protecting commercial policyholders and creating and sustaining a national economy that encourages investment and development.

When TRIA was originally adopted in 2002, the assumption of many was that the private sector would be able to create a market for terror insurance coverage and the federal program would be a stop-gap measure to ensure stability while that market developed. Since that time, however, it has become clear that the private sector – insurance companies, the capital markets and rating agencies – have a very limited ability to insure and rate terrorism risks that are only questionably quantifiable, totally unpredictable and, essentially, impossible to underwrite. This is further exacerbated with respect to coverage of nuclear, biological, and radiological risks (NBCR), for which coverage is essentially non-existent even with TRIA in place.

Given these realities, Willis and the members of The Council believe a long-term solution to the terrorism insurance crisis is essential and that the federal government will have an important role to play in terrorism risk coverage for the foreseeable future. The insurance market needs some level of stability and predictability. The prospect of TRIA's demise – or the uncertainty that would come with periodic renewal or extension of the program every few years – is not viable for the long-term. Failure to implement a long-term or, ideally, a permanent fix before TRIA expires at the end of the year will not only vastly decrease risk transfer options, it will expose the U.S. economy to potentially devastating uninsured economic loss in the event of another catastrophic terrorism attack.

The issue before Congress, then, is not whether the government will be the insurer of last resort in the event of such an attack, but rather whether the government will work with the insurance industry to thoughtfully and deliberately develop a plan before an attack to maximize private sector coverage of the massive damages that will result from a terror strike, rather than reacting in crisis mode after an attack occurs. Any such plan must encompass NBCR risks that – today – are almost completely uninsured.

We do not have to look far to see what can happen in the aftermath of a catastrophe in the absence of proper financial preparation. New Orleans remains a disaster nearly 18 months after Katrina struck. Pouring billions of dollars into the Gulf Coast in a non-directed and uncoordinated way has not brought that great American city back. In the event of a terrorist attack, we know the federal government will step in to provide assistance, particularly if there is insufficient private sector relief. But without TRIA or some sort of federal involvement enabling the private insurance market to be involved in providing terror coverage, you lose all that the insurance industry has to offer: direct contribution through upfront premium payments, relief delivery through established claims processes, and a repayment mechanism through policyholder surcharges after the event. So it is not a question of whether the federal government will pay, but rather whether the federal government will work with the insurance industry to ensure that the preparation and response to a terrorist attack is handled in the most efficient way possible. Better TRIA than FEMA.

Insurance Brokers' Interest in Terrorism Insurance

The role of insurance agents and brokers (producers) in general, and Willis and Council members in particular, is to help our clients manage risks and secure the insurance coverage they need to protect them from the risk of loss. As the insurance experts closest to insurance consumers and the insurance marketplace, we understand our clients' needs and the needs and appetite of the market, and thus bring a unique perspective to the discussion of terrorism insurance coverage. Commercial insureds need terrorism coverage not just for piece of mind, but for their businesses. Indeed, in many cases, purchase of terrorism coverage is mandatory – it is required to obtain a mortgage or financing for new construction, the expansion of a business or a new entrepreneurial venture, sometimes by state laws and regulations, and often by contract.

The most important issue for the broker community, therefore, is maintaining consumer access to coverage at a price the business consumer can afford. In order to get this access, we need insurers who are able and willing to provide the coverage. It is clear that they cannot and will not be able to provide terror coverage without a federal backstop or some other mechanism to cap their exposure.

Let me be clear: Willis's business is not dependent on any federal backstop. We will continue to help our clients mitigate their risks with all the best means available. But insurance is an important component in a comprehensive risk management program, and the availability and affordability of terror coverage is a critical issue for our clients and the U.S. economy. We supported TRIA in 2002 and 2005 and do so again today because of our clients' need for terror coverage, the lack of capacity in the private market, and the high cost of the small amount of coverage that was available absent TRIA. For the same reasons, and because TRIA successfully brought stability to the private market for terrorism risk insurance, Willis and the Council believe the creation of a long-term or permanent solution to the terrorism insurance affordability and availability crisis is essential. There is no more important policy issue for Council members.

The Success of TRIA and TRIEA

Since its inception in 2002, TRIA has been incredibly successful in providing the commercial property and casualty market, and insurance buyers, with increased terrorism capacity and in significantly decreased prices without costing taxpayers one dollar. In addition to providing readily available and affordable terrorism capacity for U.S. based risks, the program has also allowed the private market to progressively increase its role in coverage terrorism risks through retained terrorism exposures under TRIA.

Coverage that is both available and affordable is directly due to the existence of the federal backstop. Since TRIA's enactment, as the availability of terrorism coverage has grown and premium prices have dropped, take-up rates for terrorism coverage have steadily increased. A brief history of the terrorism insurance marketplace since 9/11 illustrates TRIA's success:

- Prior to September 11, 2001, terrorism risk was considered minimal and coverage for terrorism was generally included at no additional cost in most property and casualty policies.

- After September 11 and prior to the enactment of TRIA, terrorism insurance became almost entirely unavailable, and the small amount that was available was prohibitively expensive. The lack of coverage for terrorism risk at a time when the perceived risk was enormous resulted in uncertainties whose effects rippled far beyond the insurance industry.

- In the months after enactment of TRIA, the initial pricing for terror coverage was high and the take-up was low.

- Since that time, the purchase of terrorism insurance has been steadily increasing. For example, in 2003, the first full year of the program, less than 40 % of large- and mid-sized U.S. businesses, according to some estimates, obtained insurance to cover property terrorism risks. That number has jumped to more than 60% today.

- The increase in take-up rates reflects the increasing demand by America's business community for terrorism coverage at commercially viable prices. Statistics show that the average rates for terrorism coverage dropped 25% between 2004 and 2005, and another 25% between 2005 and 2006, providing much-needed stability to the market. This is because of the "make available" provisions in TRIA and TRIEA. Affordable terrorism coverage has allowed numerous business transactions that would otherwise have been stalled to go forward, without threatening the solvency of the parties involved or their insurers. Policyholders – the businesses of our economy – have not had to deal with extremely high — and volatile — terrorism insurance costs and have been able to budget for their business plans.

- Statistics also show that terrorism risk is not limited to urban, coastal areas and is not limited to particular industries. Industry reports indicate that the take-up rates are high across the country and across industries, and policyholders are generally willing to purchase terrorism coverage when it is available at an affordable price. For companies with a higher perceived risk, whether due to size, location, industry or other factors, the take-up rates are even higher. According to industry reports, take-up rates were highest in the Northeast and Midwest, followed by the South and West. Within specific industrial sectors, the largest percentage of insureds buying terrorism insurance were in real estate, financial services, health care, media, hospitality, transportation and education. Even companies in the sectors with comparatively low take-up rates – energy and manufacturing, for example – each had take-up rates exceeding 30% percent in 2006. These relatively high rates show not only demand, but that we are making progress toward the public policy goal of encouraging coverage in affected areas and industries. By comparison, in California – where the likelihood of a major earthquake can be better modeled, understood and underwritten – price and complexity have capped take up rates of earthquake insurance at only 11%.

Where We Stand Now

Unfortunately, despite the success of TRIA and TRIEA in stabilizing the terrorism insurance market, the basic facts that prompted the enactment of TRIA and TRIEA in the first place have not changed and still call for federal involvement in providing terrorism insurance after the expiration of TRIEA. Although the particular ways of federal involvement are open to discussion, some sort of federal involvement has to be preserved in order to avoid the potentially devastating effects caused by the expiration of TRIEA. This conclusion will be obvious if we consider the following facts:

First, the treat of terrorism remains unabated and unpredictable. More than five years after September 11, we have been fortunate enough to not have had another terrorism attack on the American soil. Nonetheless, terrorism attacks elsewhere in the world since September 11 — including the bombings in Madrid and London — remind us that terrorists could strike any time, at any place. The continuing conflicts in Iraq and Afghanistan make the security situation even worse.

Second, without the federal involvement, reinsurers would be unable to quantify the risk and would have to effectively withdraw from the terrorism reinsurance market. This conclusion was true when TRIA and TRIEA were first enacted, and remains true today. The private reinsurance industry paid about two thirds of the roughly $33 billion insured losses related to 9/11 claims. After September 11 and prior to TRIA, the reinsurance industry withdrew from the terrorism reinsurance market due to the huge and unpredictable terrorism risk. Today, despite the success of TRIA and TRIEA over the past several years, the reinsurance industry estimates that there is only about $6 to $8 billion in global terrorism reinsurance capacity available, and only $1 to $2 billion in capacity available for nuclear, biological, chemical and radiological (NBCR) coverage. This current capacity is nowhere near the level needed to adequately insure our economy against terrorism risk without the TRIA backstop. It is estimated that terrorism losses could reach $100 billion and that losses from a large NBCR attack in New York City alone could reach $778 billion. Without the TRIA backstop, private reinsurers would want as little exposure to terrorism risk as possible. Indeed, even with TRIA backstop now, reinsurers are not meeting the capacity demand of primary insurers for their deductible and coinsurance layers.

Finally, without TRIA backstop or adequate reinsurance coverage from reinsurers, primary insurers are reluctant to expose themselves to potentially unlimited terrorism risks. We saw this quite clearly the last time when Congress was debating whether to enact TRIEA and extend TRIA, in 2005. Back then, primary insurers were including "springing exclusions" that would have voided terrorism coverage beginning January 1, 2006, had TRIEA not been enacted. A Moody's report indicates that 50-75% of all policies written prior to TRIEA's enactment included such exclusions. Now, with the possible expiration of TRIEA at the end of 2007, all primary insurers are again asking policyholders in the market shopping for policies that run past the end of 2007 to accept those springing exclusions in their insurance policies. It is obvious that if TRIA were allowed to expire after 2007, a large percentage of those policyholders who have no choices but to accept those springing exclusions would see their terrorism risks uninsured—and their business plans disrupted or even put to a halt as a result.

Ways Forward

The purpose of my testimony today is not to discuss any particular plans in details. We understand that there will be a lot of issues, whether we will choose to modify and extend the current TRIA program or to create a different long-term private market solution. We just want to emphasize that the path forward should be carefully chosen based on considerations of economic realities, and whatever we choose to do, we need to do it with inputs from all relevant players—the government, the policyholders, the insurers and reinsurers, and the brokers.

Going forward, there are essentially three options: (1) take no further action and let TRIA expire; (2) modify and extend the current TRIA program; or (3) take a new approach aimed at creating a permanent private market solution that allows TRIA to sunset.

Considering the inability of the insurance industry to handle terrorism risk on its own, as discussed in detail above, we believe that the first option is not an option at all. Simply letting TRIA expire would throw our economy back to the post September 11 and pre-TRIA era and undo the progress we have made in the past five years under TRIA and TRIEA.

The second option, or the first "real" option, is to modify and extend the current TRIA program. Extending the life of TRIA, expanding the program to better encompass NBCR exposures and readjusting its terms to address the changed parameters, will keep terrorism coverage available and the market and economy stable, which would continue the positive trends I outlined earlier. For example, we believe the dollar threshold and the applicable lines of coverage included within the program merit review although any change must recognize the financial abilities of smaller insurers.

Another option is to create an alternative permanent private market solution. We are aware of a number of proposals circulating which envision a pooling arrangement. Such a mechanism could allow the insurance industry to essentially "backstop" itself, by growing the capacity to handle a catastrophic terrorism attack like those of September 11. The existence of a terrorism insurance pool and backstop may provide insurers with a reinsurance vehicle that will allow them to further expand capacity. Growth in capacity will stabilize prices and decrease the need for the federal backstop over time until the government's potential liability is zero.

Conclusion

We have come a long way since TRIA was first enacted. With the help of TRIA, the terrorism insurance market has been largely stabilized, the terrorism coverage has been steadily expanding, and the price of coverage has been becoming more affordable. All of this provided relief that is essential to the smooth functioning of our economy. Best of all, we have managed to achieve all of this without tapping any taxpayers' money.

Despite the success of TRIA, now is not the time for the federal government to withdraw its involvement in the terrorism insurance market. As seen above, the terrorism threats facing our country remain significant and unpredictable, our reinsurance industry still lacks sufficient capacity to address terrorism risks on its own, and the primary insurers are still not willing to expose themselves to enormous terrorism risks without charging prohibitively high prices. Allowing TRIA to expire at this time will certainly cripple, if not completely paralyze, a non-insignificant portion of our economy. It is our duty, we believe, to keep that from happening.

Once again, we commend you for holding this important hearing today.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM CHARLES CLARKE

Q.1. Access and affordability of terrorism risk insurance has improved since 2001, and since TRIA's reauthorization in 2005. This has happened even as the TRIA program has been scaled back significantly. Do you forecast this trend continuing under current market conditions?

A.1. While the data show that access and affordability for terrorism insurance have improved since TRIA was enacted in late 2002, and that the federal legislation has had a stabilizing effect on the market, this was not the case during the period following September 11, 2001, and the passage of TRIA. Equally important, without a federal program that continues to fulfill these goals, there are predictions that market conditions would return to those that commercial insurance consumers saw post-September 11 and pre-TRIA. For example, according to the American Academy of Actuaries, "without a federal backstop, there will be a long-term, rather than just an immediate negative effect where there will be higher prices, decreased availability, and lower take-up rates."

On the other hand, with federal legislation in place, we have seen the types of market improvement that you describe. The most recent (July 2006) "Marketwatch" report by Marsh indicates that the percentage of companies buying terrorism insurance covering property risks has increased consistently since TRIA was enacted, reaching nearly 60 percent as of mid-2006. The Council of Insurance Agents and Brokers' most recent "Market Survey" (covering the fourth quarter 2006) indicates that terrorism premium rates are stable for most policyholders. These market data are an indication that TRIA and the TRIA Extension Act are working effectively to achieve the goal of a stable insurance market despite the ongoing difficulties of managing terrorism risk.

Although the TRIA Extension Act requires private insurers to assume a significant amount of terrorism risk through per company retentions, quota shares, and the removal of several commercial lines from the program, the presence of the federal backstop puts a box around the volatility associated with terrorism risk and therefore facilitates both the availability and affordability of coverage.

Many insurers—particularly those with large, diversified client portfolios—manage their terrorism accumulations to a level that is significantly less than their very substantial retentions. This may be why scaling back the program, as was done in the TRIA Extension Act, did not change the market dynamic significantly.

Removing the backstop or further increasing retentions, however, could have a more adverse impact, and undermine the legislative goal of stability achieved under TRIA and its successor. The current TRIA retention levels are already so high that they preclude meaningful backstop protection for some insurers, while for others, the program functions as more of a solvency protection mechanism than an underwriting tool. However, if retentions are raised further or the program is scaled back to the extent that it ceases to perform even this vital solvency role, regulators and rating agencies may step in to limit exposure levels. As noted, this could lead to market conditions akin to those we saw between September 11, 2001, and the statute's enactment in November 2002, and the long-term negative effects described by the American Academy of Actuaries.

Q.1.a. Is the goal of the insurance industry to operate in a market without a TRIA program? Should it be their goal?

A.1.a. The insurance industry's goal is to manage terrorism insurance as efficiently and effectively as possible, given myriad factors that make this an uninsurable risk, particularly for chemical, nuclear, biological, and radiological (CNBR) attacks. Right now, and for the foreseeable future, there is no way to change the characteristics of terrorism risk to "make" it insurable and much of the information necessary to assess the frequency of acts of terrorism understandably lies solely in the hands of the federal government. Therefore, the government is a necessary partner in managing our Nation's exposure to terrorism.

Nonetheless, the industry is doing everything it possibly can in the private market to enhance its understanding of this risk and to assess the probability and severity of another attack or series of attacks on U.S. soil. Improvements to computer-based modeling are an example of what private insurers are doing to assess and manage their exposure both at individual locations and for aggregates of exposures. However, the models do not quantify the likelihood of a terrorist attack or provide insurers with any additional capacity to insure terrorism risk. In fact, by helping insurers to allocate capacity more efficiently, they actually may reduce the amount of coverage provided by individual insurers in perceived high-risk or high-density locations in the absence of federal involvement in the management of this risk, or as the federal program becomes only a solvency protection mechanism.

Additionally, the high degree of state regulatory restrictions and the resulting lack of free market is a further impediment to insurers' ability to operate without a federal backstop. These price and product controls impede insurers' ability to price terrorism adequately and therefore restrict the supply of insurance that they are able to make available, consistent with sound financial management, a situation that would be exacerbated were TRIA to expire.

Thus, if Congress's goal is to stabilize and, hopefully, improve the availability and affordability of terrorism insurance, then a meaningful federal program must be continued. We also strongly support preemption of state rate and form regulation.

Q.1.b. What is your reaction to the CBO statement that a long term program would contribute to marketplace distortions?

A.1.b. We disagree strongly with the Congressional Budget Office's ("CBO's") statement, taken from a January 2005 Report ("Federal Terrorism Reinsurance: An Update"), that a long term program would contribute to marketplace distortions. The industry retention under the TRIA Extension Act, estimated at $35 billion in 2007, allows private reinsurers ample opportunity to play a significant role in taking on and managing terrorism risk. Yet, since CBO made those statements, there have been only incremental increases in the amount of private sector terrorism reinsurance capacity. According to Mr. Veghte's testimony at the hearing, there is currently about \$6–8 billion in private sector terrorism reinsurance capacity, about the same as a year ago.

Reinsurers view this risk much the same way that primary insurers do. As a result, they are reluctant to take on more risk than is prudent. The one important distinction between primary insurers and reinsurers is that reinsurers do not operate under government price controls and are able to charge free-market, competitive rates for reinsurance. The current regulatory differences between the primary and reinsurance markets mean that the premiums that reinsurers require from primary insurers often exceed the amount of terrorism premium that primary insurers are able to obtain from policyholders, due to these state rate regulatory restrictions and the policyholders' interest in purchasing coverage required to be made available under TRIA. According to the PWG, a little less than \$1 billion in primary terrorism insurance premiums is collected annually. Virtually all of this is being used to fund the \$6–8 billion private reinsurance layer, and many carriers are self-insuring their retentions by exposing more of their capital to risk. TRIA is not distorting the market; rather, it is allowing it to function in a manner that addresses fundamental economic realities facing insurers and policyholders.

Q.2. Accurate risk modeling is key to increasing the availability of insurance. Mr. Veghte discusses risk modeling in his testimony. Like other catastrophic events, terrorist attacks are unexpected, unpredictable, and carry a large potential for destruction. What makes terrorism risk impossible to model where other catastrophic events can be modeled with a certain degree of accuracy?

A.2. While both natural catastrophes and terrorism are capable of causing extreme loss, they are fundamentally different from an insurability perspective. For terrorism, private sector reinsurance or other risk-sharing capital remains woefully inadequate and shows no signs of robust growth in the near future. This is a strong indicator that the capital markets have reached the same conclusions about the private insurability of terrorism risk. Moreover, there is no reliable method for determining the likelihood of a terrorist attack (event frequency) within the United States, a critical component in determining the insurability of a risk. This is complicated by the fact that terrorism is a deliberate act committed by individuals bent on doing the worst possible harm. Additionally, the interdependence of terrorism risk also limits the potential effectiveness of mitigation. Finally, for national security reasons, vital information necessary to assess the terrorism threat is strictly classified and unavailable to insurers as they attempt to manage this risk.

Unlike natural catastrophe models, which take both frequency and severity into account, current terrorism models in use are deterministic, not probabilistic—i.e., they quantify the impact of representative terrorist attack scenarios but do not assess the likelihood of an attack. However, both the frequency and severity of attacks are important considerations with respect to the underwriting and pricing of terrorism coverage. As long as the frequency of such events remains unpredictable, the models will be of limited assistance to insurers as they grapple with the dimensions of terrorism risk.

Q.3. According to the President's Working Group study, about forty percent of all policyholders do not purchase terrorism insurance. A contributing factor to this may be the belief by some that the federal government will step in if another attack occurs. Do you think government subsidies to the insurance industry contribute to this perception?

A.3. TRIA does not provide a subsidy to the insurance industry. It is a federal program intended to stabilize terrorism risk insurance markets, that provides a benefit to policyholders and enables the U.S. economy to operate and grow in the face of potential terrorist attacks in this country. Pursuant to the National Association of Insurance Commissioners Model Disclosure form (which has been accepted by the U.S. Treasury), insurers are required to warrant that the premiums paid by policyholders do not include any charges for the portion of losses covered by the TRIA backstop.

According to research by the Center for Terrorism Risk Management Policy at RAND, the structure of the current program helps to keep premiums more affordable for policyholders and therefore encourages a higher take-up rate. Moreover, RAND believes that, "if TRIA is allowed to sunset, given the likely increase in prices [paid by policyholders], and assuming no change in the perception of risk by those who are insured, it is likely that take-up rates will fall." Thus, rather than depressing take-up rates, we believe that the federal backstop in TRIA helps to keep rates affordable and encourages the purchase of insurance.

Prior to Hurricane Katrina, most post-disaster response and recovery grants provided by the federal government went to pay for products and services that traditionally are not covered by private insurance, such as government infrastructure repairs and small business loan programs. Hurricane Katrina changed that equation by expanding the categories of federal assistance to some areas that traditionally have been covered exclusively by insurance. Changing expectations about the role of post-event government assistance, rather than TRIA's support for the insurance marketplace, may change the willingness of policyholders to purchase insurance in the future. To understand this better, we encourage a thorough analysis of how federal aid following a natural or manmade catastrophe should be distributed in the future, particularly as it relates to losses that typically are covered by private insurance.

Q.3.a. Would increased purchases of terrorism insurance increase availability of policies in the marketplace?

A.3.a. TRIA requires that insurers make terrorism insurance available for all TRIA-covered lines, on the same terms and conditions that they make non-terrorism insurance available. Thus, to increase property insurance take-up rates, it is not a matter of more insurers making the coverage available, but of more policyholders choosing to purchase it. For workers' compensation, state laws in every jurisdiction not only require insurers to make insurance available, but also mandate its purchase as part of comprehensive workers' compensation policies that cover all workplace accidents and injuries. As a result, for workers' compensation, the take-up rate is effectively 100%, so there is no need to increase take-up rates.

As I noted previously, the percentage of companies buying terrorism insurance covering property risks has increased consistently since TRIA was enacted, suggesting both increased demand and more acceptable pricing. The 60 percent take-up rate actually compares favorably to other voluntary purchases of catastrophic risk insurance, particularly flood insurance and earthquake insurance.

Looking ahead, supply is dependent on underwriters' perception of risk and it will remain very limited for certain target exposures and concentrations of risk. Increased ability of insurers to provide coverage beneath the TRIA retentions will only occur with the improvement in terms and conditions of reinsurance available to the industry.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM CHARLES CLARKE

Q.1. Has industry proposed a long-term private sector solution or is the federal program the only long-term solution? If the federal backstop is the long-term solution, then what modifications does industry propose?

A.1. TRIA is a public/private partnership which requires insurers to retain significant losses before the federal backstop is triggered. Based on the current year's retention levels (20 percent of premiums covered lines), it is likely that an event would have to exceed the magnitude of the September 11, 2001 attack on the World Trade Center—more than $30 billion—before the backstop comes into play. Additionally, there are mechanisms in TRIA which provide for a post-event policyholder surcharge through which Treasury can recoup federal dollars that are expended. Through the per-company retentions and policyholder surcharges, both insurers and insureds make a significant private sector commitment to managing terrorism risk.

We continue to believe, however, that a federal backstop, particularly for CNBR risk, will remain necessary for the foreseeable future. As I outlined in my testimony, the characteristics that make terrorism an uninsurable risk remain as strong today as they were immediately following September 11, 2001. While TRIA and its extension do not change this basic dynamic, they put a box around the volatility associated with terrorism risk and, therefore, facilitate both coverage availability and affordability.

For the past six and a half years, we have been working diligently with Congress, the Administration, capital markets experts, the policyholder community, and others to examine alternatives to TRIA. We continue to believe it is the most operationally effective and fiscally efficient structure for balancing market needs and solvency concerns. While well-intentioned, the "pool" proposals that we have analyzed could undermine sound underwriting and are unlikely to provide significant new capital for the spreading of this risk.

We believe that the most important change that could be made to TRIA is to provide financial certainty for insurers and increased federal financial participation in the event of a CNBR attack. Our greatest concern relates to the current $100 billion program cap, which would be wholly insufficient in the event of a nuclear strike on a U.S. city. We also support recalibrating insurer participation in a manner that is consistent with the potential financial and operational consequences of a CNBR attack. In my testimony, I outlined several other suggested program changes applicable to conventional terrorism risk, but we believe that appropriately addressing CNBR risk is the highest priority in terms of proposed modifications to the current program.

Q.2. What effect would tax-deductible reserves for future terrorism losses have on an insurer's balance sheet? What effect does it have on the ability to provide coverage?

A.2. Under current federal tax laws, GAAP, and state insurance regulatory accounting standards (known as SAP), insurers are not permitted to establish reserves for events which have not yet occurred. This results in considerable volatility of losses and earnings, depending on catastrophe loss experience (natural catastrophes as well as terrorism) in a particular year.

To address this issue fully (i.e., from both a tax and an accounting perspective), it would be necessary to amend the Internal Revenue Code, GAAP, and SAP. Insurers then could establish tax-deductible terrorism/catastrophe reserves, and reflect them on their accounting statements.

These changes might reduce volatility initially as a reserve build-up would allow for payment of some or all claims with potentially little impact on an insurer's capital; however, the reserve fund would have to be built up again over time and those costs would have to be factored into perspective costs and could create volatility post event. There are differences of opinion in the financial community as to whether this would put companies in better position to manage catastrophe risk. There are, for example, concerns that a catastrophe reserve would decrease insurers' surplus (because the money is taken from surplus and put into a reserve), thus "trapping" capital that may be needed for other purposes, as well as potentially reducing the capital that would otherwise be used to underwrite risks. There is also a timing issue. Certainly, in the case of a CNBR terrorist attack, it would take many, many years for insurers to build reserves sufficient to pay losses that could total hundreds of billions of dollars. As this is occurring, money that otherwise would be paid in taxes is allocated to the tax-deductible reserve, leading to a federal revenue loss that might actually exceed the budgetary impacts of the TRIA program.

Additionally, absent a federal backstop, tax-deductible pre-event reserves are not likely to aid availability in a material way because insurers must continue to manage their terrorism risk based on exposure models and overall exposure levels. They cannot take on more risk than is prudent in the short-term because of the possibility that a tax-deductible reserve will grow in the future. Moreover, rates are not likely to decline, and in fact could increase, because the money that is being set aside in the reserve to pay for future events is not available to pay non-terrorism losses in the current year, but both must be funded.

Q.3. If it does not become mandatory for insurers to offer CNBR coverage, how would insurers adjust or allocate a loss in the event of a terrorist attack involving both a conventional and unconventional weapon? In the case of, say, a dirty bomb it causes a large amount of physical damage to the building, but only a small amount of radioactive or chemical clean-up. Would insurers look to exclude the entire loss?

A.3. Absent the specific facts as they apply to each policyholder, it is not possible to comment on how insurers would adjust or allocate a loss in the event of a terrorist attack involving both a conventional and unconventional weapon. However, your question underscores one of the problems that could arise from the current statutory framework, which recognizes that the current TRIA backstop is not robust enough to alleviate the solvency threat posed by unconventional weapons and therefore allows insurers to utilize CNBR exclusions to the extent permitted by state law. For workers' compensation, there would be coverage for both conventional and CNBR terrorism losses, with no distinctions.

Q.4. If industry could understand the long term probabilities of terrorism occurrences, how could the industry price the risk in a reasonable way that would spread the cost over time? In other words, if the private industry could learn to model and price the risk should insureds be able to expect little to no charge in advance of an event, and enormous charges after, dwindling over time? Is that desirable?

A.4. As a general proposition, insurers use terrorism models to estimate the amount of insured loss from a static event so that they can manage their respective accumulations of risk; this is known as a deterministic model. This technique allows insurers to spread their allocations of capacity geographically so that the insurers' responsibility to compensate for physical damage and human loss is expected to fall within its risk tolerance. It does not, however, allow them to factor in the likelihood of a future terrorist attack, which requires probabilistic modeling. Probabilistic modeling for terrorism is in its infancy, and it is likely to take years, if not decades, for it to advance to the point where insurers have any confidence in the predictions.

Even if credible probabilistic models were available, one should not confuse the ability to quantify terrorism risk with the ability to insure it. Models do not provide insurers with any additional capacity to insure terrorism risk and in fact may result in reducing the amount of coverage provided by individual insurers in perceived high-risk or high-density locations. While developing this improved understanding of the terrorism loss potential is important to protect solvency, it does not further TRIA's goals of improving availability and affordability of terrorism insurance.

State rate regulatory requirements generally prohibit insurers from retrospectively recouping past losses in their rating base (i.e., rates are based on projected future costs, not recovery of past losses). Even if state regulations permitted such charges, they probably could not be sustained in the market, because new entrants who are not burdened by the losses in question could undercut insurers who need to recoup past losses. Thus, private insurers do not have the legal or practical ability to charge "little or no" premium in advance of an event, and larger amounts after the fact, as suggested by your question. TRIA, however, provides such a framework for the federal government to recoup monies its pays for insured losses through a post-event policyholder surcharge (capped at 3% of premium annually). The federal backstop results in lower premiums in the absence of a terrorist attack and the policyholder surcharges result in higher post-event costs to allow for recoupment to the Treasury.

Q.5. Granting that TRIA provides insurers some certainty about Federal support and their own retention of risk, whether we have TRIA in place or not, is it not true that a severe terrorist event will end up in the lap of the Federal Government to fund, after the fact, since insurers' equity is insufficient?

A.5. TRIA provides certainty not only to insurers but also to policyholders, the Treasury, and the economy at large. For insurers, the per-company retention has increased each year since TRIA was enacted (7% in 2003; 10% in 2004; 15% in 2005; 17.5% in 2006; 20% in 2007) and is unlikely to be breached in any but the most extreme terrorist attacks. Nonetheless, the backstop does provide stability to the marketplace and solvency protection in the event of a large scale terrorist attack. TRIA also provides policyholders who purchase terrorism coverage with the certainty of knowing that they have an economic safety net in place to cover workers' compensation, property loss, and liability claims.

The policyholder surcharge mechanism in TRIA provides fiscal certainty for taxpayers through recoupments to Treasury. The program imposes mandatory policyholder surcharges for aggregate loss levels to the extent those losses are paid by the federal government up to $27.5 billion, and allows policyholder surcharges at Treasury's discretion above that level, up to the $100 billion annual program cap.

Greater certainty in each of the aforementioned areas provides short- and long-term benefits to the economy. This certainty would be severely compromised in the absence of TRIA, however. Insurers would face the risk of ruin in the event of a catastrophic terrorist attack. As noted above, this could result in higher costs and reduced availability of terrorism insurance coverage, leading to more uninsured losses in the event of a large-scale attack and adversely affecting not only the policyholders who are the targets of the terrorists, but also the broader economy. The federal government may step in to pay these losses, but without TRIA's policyholder surcharge mechanism, there is little likelihood that these federal expenditures will be recouped.

Thus, while TRIA is perceived to be providing a federal benefit to the insurance system, it is altogether possible that federal payments would be higher if the program is allowed to expire than if a backstop remains in place.

Q.6. Would it not be preferable for all parties to provide for some advance funding of this risk (possibly in combination with other risks to lower the burden of any one on the taxpayers and the society), so the cost could be spread over time, so the uncertainty concerning the consequences be diminished and so that the government would receive some income for its inevitable support?

A.6. As noted above, insurers do not charge any premium to policyholders for the protection provided by the federal backstop, with the understanding that policyholders will be assessed for post-event surcharges if a terrorist attack triggers federal payments under the program to the levels specified in the legislation. Should TRIA become "pre-funded" in some fashion, terrorism insurance rates are likely to increase to finance the layer of risk that currently is funded through the post-event policyholder surcharge, potentially resulting in a drop in take-up rates and less protection for the economy. We believe that an appropriate balance between the per-company retentions, which provide advance funding through the private insurance system, and policyholder surcharges, which provide after-the-fact recoupment to Treasury, provides greater overall economic efficiency than would a program that requires more advance funding of the loss layer that currently is post-event funded, and therefore higher insurance rates.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM MICHAEL J. PENINGER

Q.1.a. In your testimony, you state that if group life insurance is added as a covered line under TRIA, a separate recoupment mechanism should be created for group life insurers because they take on different types of risks than P&C insurers. Please explain why the risk covered by TRIA—the risk of loss from an act of terrorism—is not the same for both group life and P&C insurers?

A.1.a. The business of group life insurance is very different than that of P&C insurance. P&C policies are generally priced to take into account the immediate and complete destruction of each property from various events, including fires, tornadoes, earthquakes and hurricanes. Terrorism risk simply adds to the probability of total loss (although at an indeterminable rate). Group life policies, on the other hand, are priced according to actuarially-sound mortality and morbidity tables that accurately estimate the independent death rates of individuals over various periods of time. These tables, and the resulting policy premiums, do not, and cannot, take into account unpredictable man-made terrorist attacks that can kill a significant number of insured individuals *all at once*. In this case, the probability of death is not just increased by the terrorism risk (once again, at an indeterminable rate), but magnified by the concentration risk prevalent by having groups of people all located in one place.

In addition, unlike most P&C carriers, most (if not all) group life insurers do not exclude nuclear, biological, chemical and radiological terrorist events from coverage. As a result, life insurers are more susceptible to financial distress than P&C insurers if a major NBCR attack were to occur.

Q.1.b. Please explain why the taxpayer should not have the right to recoup payouts under TRIA from all of the beneficiaries of the program? If an insurer receives the profits associated with writing a line of insurance covered by TRIA, why would they not also have to pay for the costs of the government backstop provided by TRIA?

If TRIA is an insurance program, should not beneficiaries have to pay for the cost of the insurance even if a beneficiary does not receive any payments under the program?

A.1.b. We agree that the beneficiaries of the TRIA program should pay for the cost of the program. The proposal for separate recoupment provisions does nothing to prevent that from occurring. It simply allocates the recoupment in proportion to the benefits received from the program. Because group life and P&C insurance are very different from each other in terms of risks that are assumed, premiums that are charged and duration of coverage, we believe it would be inappropriate and inadvisable to commingle the recoupment of funds that were remitted for group life and/or P&C claims. Separate recoupment provisions should be included in any TRIA extension in order to properly and equitably match the repayment of taxpayer funds (via "terrorism loss risk-spreading premiums") with those major lines of insurance that triggered the disbursement of such funds.

Group life insurers should not have to reimburse the Treasury for financial assistance that relates to P&C losses, and vice versa. Otherwise, in the event of a terrorist attack that causes mostly P&C losses in terms of dollars, life insurers would have to pay the Treasury billions of dollars for P&C losses that are completely unrelated to their line of business and for which they derived no benefit from. Group life insurers would not derive any benefit under TRIA (e.g., amount of deductibles, recoupment) by P&C insurance being covered in the program, just as P&C insurers would not derive any benefit by group life insurance being added to the program.

Our recommended approach is similar to how our nation's insurance guaranty association system works. All states but one (Wisconsin) have separate guaranty associations for P&C and the life/health insurers. This system is designed so only life/health insurers are responsible for contributing toward the unpaid claims of another life or health insurer, while only P&C insurers are responsible for contributing toward the unpaid claims of another P&C insurer. The TRIA program should be designed similarly.

Q.2.a. In your written testimony, you argue that group life insurance should be covered by TRIA because competitive pressures will force companies to write group life insurance. You state that "unless the entire industry took the same approach, any group life insurer that tried to prudently manage its risk exposure by excluding terrorism coverage would be placed at a severe competitive disadvantage in the marketplace." As a general proposition, do you believe that life insurance companies have the discipline necessary to abide by their own underwriting standards and not to sell insurance that exposes them to risks they can not effectively manage?

A.2.a. It is not a matter of discipline, but instead, a matter of economic necessity and good public policy that group insurers offer group life insurance to its policyholders at affordable rates. Since group life is generally offered to employers or associations as part of a package of other insurance benefits (e.g., medical, dental, disability, accidental death and dismemberment), an insurer would be significantly jeopardizing its ability to obtain any group insurance business if it decided not to include group life in its benefits packages (since its competitors are including group life in their packages).

While it is true that each and every insurer could decide not to offer group life (which would eliminate the competitive disadvantage of not offering it), group insurers believe that its policyholders and their employees and members (for whom group life is often their only form of life insurance) are better protected if group life is included in these benefit packages, despite the additional risk and potential financial loss if a major terrorist attack were to kill an extraordinary large number of certificate holders.

Insurers attempt to minimize their own risks of loss by purchasing appropriate amounts of reinsurance. Immediately after September 11, 2001, group life insurers were generally unable to obtain catastrophic reinsurance, especially for terrorist events. While such reinsurance has generally become more available, it is often limited (e.g., it usually comes with higher premiums, deductibles, various exclusions and lower coverage limits).

Q.2.b. If so, does not the fact that life insurers are presently offering group life at affordable rates, as the President's Working Group on Financial Markets has reported, demonstrate that there is no need to include group life insurance as a line covered under TRIA?

A.2.b. No. The fact that group life remains affordable is a function of competitive pressure as described above. To be able to sell employee or group benefit packages in today's competitive market, insurers must not only offer group life insurance, but they must also price it low enough to remain competitive enough to obtain the underlying contracts.

The life insurance industry is highly regulated in order to make sure that it has sufficient reserves and surpluses to withstand expected, as well as unexpected, death claims. Notwithstanding, a group insurer's reserves and surplus accounts are not designed or expected to withstand a terrorist attack that kills a disproportionately large number of its insured. In addition, most carriers have limited amounts of catastrophic reinsurance that could be used to pay such claims. Furthermore, if a multi-line insurer's reserves and surplus are completely depleted by group life claims, there would not be any other funds available to support other lines of insurance (e.g., health, disability).

If one or several insurers are unable to meet some or most of its obligations after a small or medium-sized terrorist attack, state life and health guaranty associations are in place to assure that such obligations are indeed met (up to state-set limits). However, in the case of a major, cataclysmic terrorist attack (e.g., NBCR event), several (or many) insurers, including medium to large-size carriers, may become insolvent, and the guaranty association system may not have the capacity to fund unpaid claims. It is this potential system collapse that concerns the group life industry and is why it urges that group life be included in any TRIA extension.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM MICHAEL J. PENINGER

Q.1. Studies have shown that terrorism risk insurance in group life policies remains available, and that prices have even declined, despite the fact that group life insurance is not part of the TRIA program. What is the rationale for including group life given these facts?

A.1. As mentioned above, group life insurance remains available and affordable largely due to market competition, and will probably remain so regardless of whether group life is included in the TRIA program. What will change if group life is included in TRIA is the insurance industry's increased ability to withstand a major terrorist event (since the reinsurance market for group life will be rejuvenated, just like it was for workers' compensation when it was included in TRIA). TRIA would provide the necessary backstop for the group life industry, its policyholders and certificate holders—it would prevent many insurers from becoming insolvent after such an attack and provide the assurance that death claims will be paid.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM JAMES H. VEGHTE

Q.1. Accurate risk modeling is key to increasing the availability of insurance. Mr. Veghte discusses risk modeling in his testimony. Like other catastrophic events, terrorist attacks are unexpected, unpredictable, and carry a large potential for destruction. What makes terrorism risk impossible to model where other catastrophic events can be modeled with a certain degree of accuracy?

A.1. In an attempt to better understand terrorism risk, reinsurance companies have created task forces, consulted military and intelligence experts, hired specialty risk modeling firms, invested in research and development, and developed new underwriting standards with the intention of trying to determine if a private market could develop to absorb this risk. Despite these efforts, a key struggle in the development of a private market is that terrorism is not conventional. It has characteristics, particularly with regard to frequency, severity, and correlation, unlike any other peril or risk.

Terrorists act willfully and unpredictably to cause fear and inflict maximum harm and damages and confound those who study terrorism. They can learn from their prior attacks and attempt to defeat loss prevention and mitigation methods. In addition, the insurance industry does not have access to all potentially relevant information because the government keeps it confidential due to national security interests.

The potential severity of terrorism losses, particularly nuclear, radiological, biological and chemical (NRBC), is enormous. The extreme loss scenarios would cause losses that far outstrip insurer financial resources and therefore are uninsurable.

Unlike natural disaster risk, reinsurers achieve virtually no spread of risk or diversification with terrorism coverage. Natural disasters such as hurricanes in Japan and Florida and earthquakes in the far west are not correlated. This means that premiums can be collected from each risk knowing that one loss will not lead to another. With terrorism risk there is an aggregation of losses arising from multiple clients and multiple insurance products implicated in the same occurrence. Thus, terrorism risk in Europe and North America may lead to closely related loss events. Such high correlation thus minimizes any benefit of risk spreading geographically.

At the same time, a terrorist attack can lead to major disruptions in the financial markets, where reinsurers may be liquidating assets to pay claims, while the asset values themselves may be under market pressure due to investors' concerns over the terrorist risk.

For these reasons, it has been impossible to effectively model terrorism.

Q.2. The President's Working Group study noted that TRIA appears to negatively affect the emergence of private reinsurance capacity. How do you respond to this?

A.2. In fact, the opposite is true. By establishing definitive loss parameters, TRIA has provided a defined layer for reinsurers to participate in sharing the retained risk of loss that primary companies face under the federal terrorism program. The limited emergence of a private reinsurance market is explained by the factors in question 1.

Q.3. You estimate that reinsurance capacity is currently between $6 billion and $8 billion. This is an increase from 2005, when the capacity was estimated by RAA to be between $4 billion and $6 billion, correct?

A.3. This is correct.

Q.3.a. This growth also corresponds with a significant scaling back of the TRIA program from the 2005 reauthorization. Do you project this growth to continue?

A.3.a. Favorable loss experience and surplus growth may moderately increase the supply of private terrorism reinsurance but not to the extent that it would fill current capacity needs of the primary industry to meet its retentions under TRIEA. It would be difficult to expand participation in the current environment. First, there is only so much capital that companies are willing to dedicate to a TRIA-type program due to the nature of terrorism risk. Second, because of the 2005 hurricane season, rating agencies and catastrophe modelers began requiring companies to maintain more capital/surplus to write the same amount of business as before the 2005 hurricanes. The private reinsurance market does not provide coverage in the layers retained by the government under the program.

Q.3.b. Do you envision a marketplace without TRIA?

A.3.b. Although progress has been made in modeling terrorism loss scenarios, forecasts of the frequency and the severity of terrorism losses are extremely problematic. Absent a lessening of the risk of terrorism, the RAA does not see a time in the foreseeable future when the frequency or severity of terrorism risk can be successfully modeled and underwritten such that reinsurers will be able to provide enough capacity to replace TRIEA coverage. Reinsurers can provide only limited capacity for terrorism because the magnitude of these potential losses would otherwise put these companies at risk of insolvency. Reinsurers' capital is necessary to support many other outstanding underwriting commitments made by reinsurers, including natural disasters, workers' compensation, and other casualty coverages.

The insurance industry's retention under TRIEA is approximately $36 billion now, but the reinsurance market is only $6 to $8 billion. Since this gap has not been closed even with TRIEA, it does not make sense to significantly alter TRIEA at this time.

There is even less reinsurance appetite for NRBC risk, which is even more difficult to model and underwrite.

Q.4. Mr. McRaith, you stated in your testimony that any successor program should be of, "sufficient time and means for the private sector to build the appropriate capacity." Mr. Veghte, you noted that RAA does not see an industry without a TRIA program. Do you disagree here?

A.4. We seem to agree that the industry currently is unable to provide enough capacity to replace TRIEA coverage and will not be able to do so for the foreseeable future. Mr. McGraith notes that TRIEA coverage must continue until the private sector can build the appropriate capacity, but does not address how the private sector could do that, how long it would take or if, in fact, it would necessarily occur. Thus, we do not appear to be in serious disagreement at this time.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM JAMES H. VEGHTE

Q.1. Has industry proposed a long-term private sector solution or is the federal program the only long-term solution? If the federal backstop is the long-term solution, then what modifications does industry propose?

A.1. Due to the nature of the terrorism peril, the RAA believes that private market mechanisms alone are insufficient at this time to spread the risk of catastrophic terrorism loss in a meaningful way. Instead, a continued public-private partnership is critical to address terrorism risk. Without some form of a federal role we would expect less coverage available at the policyholder level, rising prices for terrorism cover and even more limited private reinsurance capacity.

With regard to modifications to TRIEA, because reinsurance is not covered under the program, we generally would defer to the primary industry as to modifications that would be necessary for a long-term program.

Q.2.a. What effect would tax-deductible reserves for future terrorism losses have on an insurer's balance sheet? What effect does it have on the ability to provide coverage?

A.2.a. The effect on insurers and reinsurers would be different. For insurers, the ability to set aside terrorism reserves for events that have not yet occurred and the attendant investment securities and related investment income would increase the surplus of the insurance industry. This is because insurers could record a tax deductible reserve for losses that have not been incurred or paid, thus reducing current taxes that must be paid. These funds would be invested and would grow and earn investment income until a qualifying terrorism event occurred. The qualifying terrorism event (if and when it occurs) would cause these reserves to be released and the investments disposed to pay terrorism claims.

Tax deductible reserves for terrorism would be used as an alternative to traditional reinsurance by insurers. Instead of transferring terrorism risk, tax deductible reserves would likely encourage insurers to retain it. That does not necessarily mean, however, that insurers' appetite to assume that risk would increase.

Q.2.b. What effect does it have on the ability to provide coverage?

A.2.b. The effect on capacity may be different for insurers and reinsurers. In theory, if insurers have a larger pool of assets and surplus they would be able, all other things equal, to write more insurance business. There are several important caveats to this. First, the additional surplus and assets in the terrorism reserve are supposed to be earmarked to pay terrorism claims, so it is questionable whether this excess surplus would be allowed to be counted to support additional writings. The rating agencies, state insurance regulators or even the federal legislation may limit or prohibit this. Second, if insurers are allowed to use the additional surplus to support additional writings, there is no guarantee that the insurers will write additional terrorism insurance. The concentration of terrorism exposures may be too high or there may be alternative lines that are more profitable or prudent to write. Finally, whether or not the additional terrorism reserves are used to support other writings, other capital considerations would have to be considered such as when the price of coverage in the market is too low based on the insurer's assessment of risk, etc.

For reinsurers, the effect of tax deductible catastrophe reserves on capacity is clearer. A government tax incentive for insurers will discourage participation in the private reinsurance market. Risk transfer will suffer as insurers retain risk.

Q.3. If it does not become mandatory for insurers to offer NRBC coverage, how would insurers adjust or allocate a loss in the event of a terrorist attack involving both a conventional and unconventional weapon? In the case of, say, a dirty bomb it causes a large amount of physical damage to the building, but only a small amount of radioactive or chemical clean-up. Would insurers look to exclude the entire loss?

A.3. Each reinsurance company would makes its decisions based on the relevant law and contract language.

Q.4. If industry could understand the long-term probabilities of terrorism occurrences, how could the industry price the risk in a reasonable way that would spread the cost over time? In other words, if the private industry could learn to model and price the risk should insureds be able to expect little to no charge in advance of an event, and enormous charges after, dwindling over time? Is that desirable?

A.4. Insurers do not, and generally cannot by law, price coverage to recover past losses. Prices are based on estimates of future events. Improvements in modeling will obviously assist in pricing.

Q.5. Granting that TRIA provides insurers some certainty about Federal support and their own retention of risk, whether we have TRIA in place or not, is it not true that a severe terrorist event will end up in the lap of the Federal Government to fund, after the fact, since insurers' equity is insufficient?

A.5. It is true that without insurance, the Federal Government likely would decide to pay for the vast majority of recovery after a terrorist event. Through a public-private partnership developed in advance of such an event, the Government creates a viable market wherein the insurance industry can participate up to a certain cap, which allows insurers to maintain solvency in the event of an attack. This ultimately reduces the cost to the Federal Government in the event of an attack because the insurance industry is sharing in the costs.

Q.6. Would it not be preferable for all parties to provide for some advance funding of this risk (possibly in combination with other risks to lower the burden of any one on the taxpayers and the society), so the cost could be spread over time, so the uncertainty concerning the consequences be diminished and so that the government would receive some income for its inevitable support?

A.6. Current insurance coverage is pre-funded to the extent insureds buy policies covering acts of terrorism. TRIEA provides for post-event funding for any government contribution by requiring insurance companies to pay back the federal government for the reinsurance through post-event assessments on insurance companies. The RAA supports this provision.

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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HEARING BEFORE THE SENATE BANKING COMMITTEE

ON

"Examining the Terrorism Risk Insurance Program"

Statement of the

NATIONAL ASSOCIATION OF REALTORS® AND THE INSTITUTE OF REAL ESTATE MANAGEMENT

FEBRUARY 28, 2007

EQUAL HOUSING OPPORTUNITY

The National Association of REALTORS® (NAR), and the Institute of Real Estate Management (IREM) are pleased to submit this statement for the record to the Senate Banking Committee. We appreciate the time and effort that its members, including Chairman Dodd and ranking member Shelby, have spent on this very important issue. IREM and NAR look forward to working with committee to ensure that a long term solution that will ensure the availability of terrorism insurance is in place following the expiration of the Terrorism Risk Insurance Extension Act.

With over 1.3 million members, the National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association, including NAR's five commercial real estate institutes, societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS®. IREM is the only professional real estate management association serving both the multifamily and the commercial real estate sectors. With 81 U.S chapters and 8 international chapters, IREM is an international organization that serves as an advocate on issues facing the real estate management industry. Collectively, IREM members manage more than 6.5 billion square feet of commercial space and more than 13 million residential units totaling $848.2 billion in real estate assets. Given the importance of terrorism coverage to the health of the commercial real estate markets, NAR and IREM urge Congress to pass a long term terrorism insurance program that ensures the long term sustainability and availability of coverage.

NAR and IREM urge Congress to enact legislation that:

1. Ensures the long term availability of terrorism insurance;
2. Creates a backstop program that would cover chemical, biological, nuclear and radiological events and require insurers to make this coverage available;
3. Makes no distinction between foreign and domestic acts of terrorism; and
4. Authorizes a Treasury managed trust fund that would be capitalized by insurance premiums that would be used prior to taxpayer funds to cover losses in excess of insurer deductibles.

Nature of the Threat of Terrorism and the Real Estate Industry Response:

A study conducted by the RAND Corporation's Center for Terrorism Risk Management Policy finds that "soft" targets, such as office buildings and retail centers are increasingly at risk from both Al Qaeda and domestic radical terrorist groups. This shift in emphasis comes from the realization that the "hard" targets, such as "iconic" office buildings (e.g., Empire State Building, Sears Tower, etc.), government centers and embassies have become more secure and harder to penetrate, and that attacking more vulnerable soft targets would still allow Al Qaeda to cause significant civilian casualties and economic disruption.

As the result of the ever changing nature of terrorism threat, both IREM and NAR are members of the Real Estate Information Sharing and Analysis Center, a partnership created by the

Department of Homeland Security and the real estate industry. The partnership facilitates information sharing on terrorist threats, warnings, incidents, vulnerabilities and response planning in order to counter terrorism and protect buildings and the people who occupy and use them. This important partnership helps the real estate industry stay aware of all the emerging threats facing each real estate sector, and enables property managers and other real estate professionals to take appropriate measures to protect those who work live and play in the nation's buildings.

The Importance of Terrorism Insurance to Commercial Real Estate:

The story of a property manager, responsible for over three million square feet in the Washington, DC region, exemplifies the importance of terrorism insurance and its long term availability.

Following the September 11th attacks and prior to the enactment of TRIA, the property manager was unable to find terrorism coverage at a reasonable cost. Following the enactment of TRIA, the property manager was able to find coverage, however, insurance costs rose from 11 cents a foot prior to 9/11 to 50 cents a foot following the bill's enactment. Though the initial premiums following the enactment of TRIA were high, during the subsequent years, terrorism insurance costs have moderated somewhat. However prices fluctuated during periods of uncertainty as in 2004 when the "make available" requirement was in question for TRIA's third year (2005), and the uncertainty as to whether TRIA would be extended in 2005. Today, there is concern that the uncertainty of the future of the terrorism insurance program may cause prices to fluctuate, and prompt insurers to drop terrorism coverage should a more permanent terrorism insurance solution not be in place by year's end.

Affordable and available terrorism insurance is a vital component of most commercial real estate transactions. It is estimated that 84 percent of outstanding commercial mortgage balances require terrorism insurance. Thus, if TRIEA (Terrorism Risk Insurance Extension Act) were to expire, and insurers subsequently dropped terrorism coverage, those loans would be in technical default.

The pricing and availability of coverage is an important component to both the commercial real estate transaction and the ongoing management of the property. The inability to obtain terrorism insurance may either limit the financing options of a particular transaction, or may jeopardize the transaction entirely. If terrorism insurance costs rise significantly, it will negatively impact the price of commercial real estate.

Furthermore, the rising costs of terrorism insurance can outweigh any potential income from a particular property creating a disincentive to property ownership, and potentially forcing the property managers and owners to pass on the costs of the additional costs of terrorism coverage to tenants. If a property owner is unable to pass those increased costs, as for example in the case where a property is triple net leased (tenant assumes all costs), or as in the case with multifamily units receiving a public subsidy, the owner may be forced to operate the property at a potential loss.

TRIEA has, by and large, kept insurance available and affordable. However, at the end of this year we will again face the same economic uncertainty. The debate on the future of TRIEA is set against the backdrop of ever increasing problems of either unavailable or unaffordable property and casualty insurance throughout many areas of the country. NAR and IREM urge Congress to limit the effects of economic uncertainty associated with the looming expiration of TRIEA by passing a long term solution before within the first half of the year.

The Success of TRIA and TRIEA, and the Uncertainty of Insurance Availability After 2007

The passage of the Terrorism Risk Insurance Act of 2002 helped stabilize the commercial real estate markets following the disruptions of the September 11, 2001 terrorist attacks by making terrorism coverage available and, over time, more affordable. Commercial property owners, brokers, managers, leasing agents and lenders throughout the country have all benefited from having sufficient affordable terrorism insurance in place. Development projects and related loans are no longer held up due to inadequate coverage; leasing of office, industrial and multi-family properties has gone uninterrupted; and lenders no longer have to "force-place" coverage for their clients in order to satisfy loan agreements.

Yet, while TRIA has been effective in stabilizing the insurance markets in recent years, a private reinsurance market had not demonstrated the capacity to fill the breach if TRIA's federal backstop had expired. Initially driven by a concern that the private insurers would not be able to provide terrorism coverage on their own, in June 2004 the Treasury Secretary extended the "make available" requirement of TRIA ensuring that insurers would continue to offer terrorism coverage in the final year of TRIA's three year program.[1]

During 2005, it became evident that private insurers would be reluctant to provide terrorism coverage should TRIA sunset and the reinsurance market had not yet become strong enough to cover insured losses. In June 2005 the RAND Corporation released a study which suggested that if TRIA were permitted to expire, premiums would likely rise and "take up rates", i.e. the number of businesses purchasing coverage would decline.[2] Yet, this decline in coverage would come at a time of continued uncertainty about the specter of terrorist attacks in the United States. At the same time, a Treasury Department report recommended that TRIA be allowed to sunset to enable the market to develop without the interference of a federal backstop.[3]

The Terrorism Risk Insurance Extension Act of 2005 (TRIEA) strikes a balance between the two views. TRIEA extends the federal backstop program for an additional two years and increases reliance on the private sector. TRIEA specifically increases the trigger point at which the federal

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[1] The Treasury Secretary extended the "make available" provision of TRIA through 2005 on June 18, 2004. http://www.treas.gov/press/releases/js1734.htm

[2] RAND Center for Terrorism and Risk Management Policy, "Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act."

[3] United States Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002."

government will provide assistance from $5 million in 2005, to $50 million in 2006, and $100 million in 2007; while also raising insurer deductibles to 20% by the end of 2007.

NAR and IREM are concerned that reinsurance market has not yet developed the capacity to handle losses associated with a terrorist attack without a federal backstop in place. In fact, the President's Working Group on Financial Markets, acknowledged in its report that insurers had little confidence in their ability to model terrorism risk. As a result insurers and reinsurers are unable to gauge the proper level of capital reserves to cover such risk. It is estimated that the reinsurance capacity is between $6 and $8 billion, which given the potential magnitude of a coordinated terrorist attack seems fairly small.

Given this continued weakness in the reinsurance market, and the importance of terrorism insurance to the continued health of the commercial real estate markets, NAR and IREM fear that the expiration of TRIEA at the end of 2007 will again cause uncertainty in the insurance markets and make terrorism coverage either unavailable or unaffordable. For these reasons, NAR and IREM support a long term extension of a federal backstop program.

The Challenges of Terrorism Insurance:

Long-Term Availability and Affordability of Terrorism Risk Insurance

The development of private reinsurance capacity to spread catastrophic risk is necessary to adequately insure against terrorism risks. Although Treasury's June 2005 study acknowledges the role of reinsurance in an insurer's capacity to absorb losses, the study did not adequately address the issue of developing long-term private reinsurance capacity. Nevertheless, the study seemed to assume that private market capacity would grow in the absence of a federal backstop.

Insurance industry experts believe that the federal reinsurance backstop provided under TRIA is responsible for the existing private market capacity. There has been no evidence to suggest that private market capacity will increase following the expiration of TRIA. In fact, the American Insurance Association noted that "[g]iven the continued grave uncertainty and potentially catastrophic levels of loss, insurers simply lack the tools to underwrite and price this risk without a new mechanism to provide capacity." [4] The federal government possesses substantially more expertise concerning terrorism risks than the insurance industry. Accordingly, federal participation in a long-term solution is appropriate. In the continued absence of such evidence, we urge Congress to consider long-term solutions to the availability and affordability of terrorism risk insurance.

The Challenge of Chemical, Nuclear, Biological, Radiological Coverage

There is currently little affordable coverage for CNBR events caused by terrorism. It appears most terrorism risk insurance coverage excludes CNBR events, except where such coverage is expressly required under state law (e.g., with respect to workers' compensation coverage).

[4] Testimony of Debra T. Ballen, American Insurance Association at "NAIC Public Hearing on Terrorism Insurance Matters" March 29, 2006.

When, in a 2005 survey, NAR asked members whether CNBR was included in their terrorism coverage, most indicated that it was not.

Insurance industry representatives believe that CNBR events are not conducive to modeling, and likely to trigger greater losses than conventional terrorist acts. The AIA notes that "[i]nsurance models suggest that the potential loss is so enormous that accumulation management techniques—essential to managing conventional terrorism risk—are of little practical value." [5] The American Academy of Actuaries (AAA) noted that "after anthrax was sent through the U.S. mail in 2001, the cost of cleaning up the postal facilities alone exceeded the structural value of those facilities."[6] It is estimated that the reinsurance capacity for CNBR coverage lags behind that of terrorism at between $1 and $2 billion. Since the value of the insurance claims would exceed the value of the real estate affected, and due to the near impossibility to appropriately measure risk and price coverage, insurers are unlikely to offer coverage without federal assistance.

Legislative Principles for a Long Term Solution:

The legislation that succeeds TRIEA should promote the long term availability of terrorism insurance, ensure that insurance availability for lines of coverage that the private sector is unable to provide (such as CNBR) and maximize long term capacity by encouraging the entry of new capital into the program.

Foreign vs. Domestic Acts:

The legislation should remove the problematic distinction that excludes coverage for domestic acts of terrorism. Terrorism, regardless of its source can have a profoundly destabilizing effect on the nation's economy. The legislation should reflect the nebulous nature of the threat of terrorism in that the direct source of influence behind a terrorist act may not be readily apparent and that terrorist acts may be developed and executed by individuals who may be citizens.

Coverage of CNBR and Non CNBR:

NAR believes that the legislation that succeeds TRIEA should cover all potential terrorist acts, including CNBR. However because insurers are unable to model or price CNBR risk, the legislation should create a distinct federal backstop program to cover CNBR losses. Insurers should also make CNBR lines of coverage available. However, because the private market can not price this risk, the legislation should eliminate or significantly reduce insurer deductibles and co-pays. This would help ensure that the pricing of CNBR coverage will be affordable.

The backstop program for non-CNBR events, with its make available provision, should be continued. Because there is some reinsurance capacity for non-CNBR events, and because

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[5] Ibid.

[6] Statement of Michael G. McCarter, FCAS, MAAA Chairperson of the Terrorism Risk Insurance Subgroup, American Academy of Actuaries, before the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners.

there is a history of fairly consistent pricing under TRIA and TRIEA, Treasury should be authorized to create a segregated trust fund that would offset government exposure. The fund would be capitalized by insurance premiums and to a lesser extent, policy holder surcharges. This fund would be used prior to taxpayer funds to cover losses beyond insurer deductibles and co-pays.

The program trigger should not be higher than the current $100 million, with a possible exception for smaller insurers. NAR believes that Congress should consider lowering the trigger for smaller insurers to that coverage that is offered is also affordable.

Conclusion

Affordable and available terrorism insurance is an integral part of the health of the commercial real estate markets. Given that the reinsurance industry has not yet been able to develop a long term solution that would eliminate the need for some form of federal assistance, IREM and NAR are concerned that the sunset of TRIEA will result in a spike in terrorism coverage premiums, and cause coverage to become unavailable in numerous markets.

IREM and NAR's members work in every commercial real estate market across the country, and broker and manage properties of every size and class – from large marquis trophy properties in major urban centers, to small family owned retail centers in rural areas. The consistent and affordable pricing of insurance is critical to all of NAR and IREM members.

The legislation that succeeds TRIEA must be designed to ensure the continued availability and affordability of terrorism coverage. Since the terrorism threat is ever changing, NAR asks Congress keep these legislative recommendations in mind. By keeping terrorism coverage available and affordable, it is hoped that the number of firms acquiring terrorism coverage continues to grow, thereby adding an extra layer of economic security in the face of an ever changing terrorist threat.

Thank you for this opportunity for us to express our views on this very important matter.

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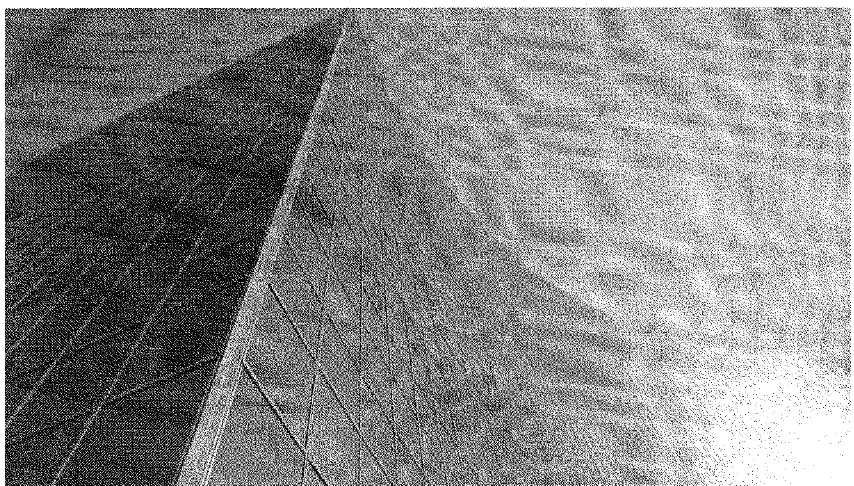

REALTORS® Commercial Alliance Series

HOT TOPICS–

ANSWERS TO CURRENT BUSINESS ISSUES

COMMERCIAL REAL ESTATE INSURANCE: MEETING THE CHALLENGE

NATIONAL ASSOCIATION OF REALTORS®

The Voice for Real Estate®

Real Strength.
Real Advantages.

Why should I be concerned about terrorism and natural disaster insurance?

2007 may become a historic year for commercial real estate professionals. Two key insurance issues will come before Congress in the months ahead – terrorism insurance and natural disaster insurance – which could significantly impact profit margins on many commercial real estate deals.

Many commercial real estate professionals believe these two issues don't directly impact their businesses. That's no longer true. Both issues have grown to international proportions. The fact is manmade and natural disasters will challenge economic, political, and business agendas in other countries – and here in the U.S. – for a long time to come.

With so much at stake, it is important for all commercial real estate practitioners to understand the issues and prepare to speak out. This Hot Topic has been prepared by the REALTORS® Commercial Alliance of the National Association of REALTORS® to arm members with timely information about the controversies, positions and actions that will shape the national agenda on terrorism and natural disaster insurance in 2007.

Since 9/11, and the hurricanes of 2004–2005, the National Association of REALTORS® has been a leader in representing the interests of our members regarding terrorism and natural disaster insurance. We have actively developed positions, offered testimony before key congressional committees, written opinions used for advocacy efforts, hosted symposia, partnered with other commercial real estate organizations, and worked collaboratively with insurance industry representatives and other business interests to bring balance to legislation. We will continue to give voice to our members' interests throughout this decisive year and beyond.

TERRORISM INSURANCE

Why is legislation for terrorism insurance a priority in 2007?

Terrorism risk poses an evolving risk and the potential losses are incalculable. For years, commercial insurance for acts of terrorism was implicitly included in property and casualty coverage. But that changed with the terrorist attacks on September 11, 2001. Suddenly, the concept of a foreign terrorist act on U.S. soil became a horrifying reality. The tragic cost in lives was unprecedented. The cost to businesses, an estimated $40.2 billion, was also devastating.

Within weeks of the disaster, reinsurers withdrew from the market, leaving direct insurers with no mechanism to manage their risks for this peril. As a result, direct insurers largely withdrew from offering any terrorism insurance coverage and capacity plummeted. Insurers that remained combined high costs with policy restrictions that translated into less coverage at much higher prices. Insurance companies justified these actions by claiming that there was no longer adequate capital in the private market to cover the financial risks associated with future acts of terrorism. At the same time, lenders continued to require commercial real estate owners to carry insurance for terrorism disasters. The lack of availability and affordability for the coverage began impacting real estate deals, including the complete cancellation of a number of projects in major metropolitan areas. Ultimately, the issue was raised before Congress.

In 2002, the federal government enacted the Terrorism Risk Insurance Act (TRIA) to begin resolving the underlying problems. The government's objectives in legislating this policy were twofold: to ensure that terrorism insurance was available to all businesses and to allow time for the reinsurance market to expand its capacity to cover potential terrorism losses in the future.

To accomplish these goals, TRIA set up a federally backed reinsurance mechanism to backstop direct insurers for acts of terrorism. The model defined a "trigger point," at which level the federal government would step in and cover significant portions of the total accumulated insured damages from a foreign-sponsored terrorist event (or events). Implementing this federal backstop meant that direct insurers would not be forced to bear all the risks and costs of future terrorist events – costs that could conceivably wipe out private market capital and bankrupt the insurance industry.

With the backstop in place, insurers were required to make "conventional" terrorism risk coverage available to policyholders under the same terms and conditions of other property-based coverage. The program also applies a backstop to a number of other coverage lines including nuclear, biological, chemical, and radiological perils as well as workers compensation.

TRIA was scheduled to sunset in 2005. As the expiration date approached, Congress considered extending the program. TRIA succeeded in restoring market capacity and making terrorism insurance broadly available to businesses. However, it was clear that the reinsurance market had not developed the capacity to cover losses for a large-scale act of terrorism. At the end of 2005, President Bush signed the Terrorism Risk Insurance Extension Act (TRIEA), which authorized continuation of TRIA for two more years. In an effort to induce growth in private market capacity, the new legislation reduced the government's risk by increasing the federal trigger level for the backstop and increasing the level of insurers' deductibles before federal intervention kicked in.

TRIEA is scheduled to expire at the end of 2007. It is expected that legislation, creating a permanent backstop solution will be both controversial and a high priority for the 110th Congress. Fourteen other nations recognize that markets cannot underwrite this risk, and each has a permanent terrorism insurance law.

What happens if TRIA expires?

Fundamentally, legislators and business professionals across all industries agree that to protect our national economy, the long-term solution for terrorism coverage must depend upon stronger private-market financial capacity. But controversies abound regarding whether or not the federal government should be involved in a long-term solution. Three key questions dominate the dialogue:

1. Can the reinsurance market cover losses from a large-scale terrorist act in the future or will a federal backstop be needed?

Despite pressures to increase their capacity, reinsurers remain reluctant to cover terrorism losses. Current reinsurance capacity is nowhere near the level needed to protect the economy without a federal insurance backstop. The Reinsurance Association of America estimates that there is only $6 billion to $8 billion in private-sector terrorism reinsurance capacity available to cover foreign acts of terrorism. Yet, estimates for potential losses from a single terrorist act have exceeded $100 billion.

That leaves only two options: either the federal government acts as the reinsurer-of-last-resort or the cost of terrorist attacks falls to its victims.

2. What are the likely consequences to businesses and the economy if TRIA is allowed to expire?

In today's environment, allowing TRIA to expire could have serious repercussions for businesses, particularly those in commercial real estate. In a statement submitted to the Congressional Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises in September 2006, the National Association of REALTORS® stated that "the expiration of TRIA will result in a dramatic run up in terrorism insurance premiums and a complete lack of coverage in certain

Nuclear, Biological, Chemical and Radiological Terrorism

Some of the most nefarious, challenging – and costly – scenarios imagined for terrorist acts involve nuclear, biological, chemical, and radiological (NBCR) attacks. Unfortunately, it is nearly impossible to estimate the cost of risk associated with these types of terrorism because of their unpredictable nature and indeterminate scope. The anthrax attack against the U.S. postal system in 2001 highlighted another problem with nuclear, biological, chemical, and radiological attacks – insurance claims are likely to exceed the value of the real estate affected. Despite the fact that the federal program provides a backstop for nuclear, biological, chemical, and radiological perils, little to no coverage for these types of terrorism is commercially available for businesses except where mandated under workers compensation policies. The National Association of REALTORS® strongly believes that any evaluation of terrorism insurance coverage in the future must include solutions for making nuclear, biological, chemical, and radiological coverage available to policyholders.

markets." A study released by the RAND Corporation in 2005 supports this position. The study suggests that without TRIA, premiums would likely rise and take-up rates (the number of businesses purchasing coverage) would decline.

Without a federal backstop, the danger of returning to market conditions that existed after 9/11 and prior to TRIA's enactment create great challenges for small businesses and large real estate property owners who worry that they won't be able to secure the policy limits they need to satisfy lenders. The matter is significant – in January 2007, 84 percent of commercial mortgage balances would have been at risk if real estate owners could not have acquired terrorism insurance. Without terrorism coverage, the risk is shifted to lenders, shareholders, pensioners and bondholders.

In addition, the RAND Corporation's Center for Terrorism Risk Management Policy concluded in a recent study that potential terrorist targets could include a broad range of office buildings, and retail centers—not just "trophy" office buildings, government buildings, and embassies. Terrorists could launch a series of relatively small attacks in addition to a single, large one. Unlike natural catastrophe risks, there is no terrorism "season" or "zone." As a result, the imperative for commercial real estate coverage becomes more important throughout the country. Without adequate coverage, commercial real estate owners will be forced to bear more of the risks and costs of terrorist attacks.

The National Association of REALTORS® believes that without adequate coverage, financing options will once again become limited and could jeopardize real estate transactions and new construction and negatively impact the price of commercial real estate and the overall economy.

3. Is there a viable long-term solution?

While some insurers remain focused on an extension and expansion of the current program, a number of groups are trying to devise solutions that integrate a federal backstop with increased participation by private markets. One example of this is a plan put forward by The Real Estate Roundtable in 2006 – called Homeland Security Mutual (HSM). The HSM plan recommends either the creation of a state-chartered mutual reinsurance entity or a "pooling" mechanism residing in the U.S. Department of Treasury. HSM seeks to create a layer of private capital between primary insurers and the federal government. The program achieves continuity to the marketplace so that policyholders can get the coverage they need, while diminishing the role of the federal government – and taxpayers – in the terrorism risk insurance market. Using defined triggers, claims would be paid first through private insurance industry capacity, then through the HSM pool and, lastly, through federal backstop participation. Under HSM, a federal terrorism risk program would continue for a limited time as the pool accumulates, but would eventually be shifted to this new mutual reinsurance entity.

Many elements of this model mirror effective solutions used in TRIA, such as program triggers, industry risk retention levels, and caps on liability. But the most important difference is the addition of a layer of capital, which ensures that total costs from a terrorist event are more evenly distributed between the private and public sectors.

Who supports federal intervention?

Supporters of a federal role as the reinsurer-of-last-resort include:

Many insurance and reinsurance industry groups concede that a government backstop makes sense, either until the private sector grows its capacity or indefinitely. They point out that there is no evidence that the private market would or could develop capacity if TRIA expires. There is a growing consensus within the insurance industry that without a federal reinsurance backstop, insurers will largely exclude this type of coverage from their policies in the future.

Businesses, most notably in the commercial real estate, hospitality, manufacturers, public utilities, stadium owners, and most American businesses, believe that the relatively large size of terrorism risks will always require a government backstop if our economy is to retain any stability following a major terrorist attack.

The Coalition to Insure Against Terrorism, comprised of over 80 industry associations and American businesses representing the policyholders who must purchase terrorism risk insurance, delivered Congressional testimony in 2006 stating that "an effective homeland security program must include provisions to ensure long-term availability and affordable terrorism risk insurance to safeguard the assets of businesses, which fuel the nation's economy."

Are there any arguments against federal intervention?

There are a number of policymakers who oppose extending a government reinsurance program, because they believe this role is best served by the private market. However, there is no evidence private markets can develop adequate insurance market capacity without some type of federal backstop.

NATURAL DISASTER INSURANCE

What makes natural disaster insurance important in 2007?

In the past decade, the U.S. has experienced an unprecedented increase in the frequency and intensity of natural disasters. In fact, eight out of the top 10 property and casualty losses in U.S. history occurred between 2000 and 2004. High underwriting losses from recent mega-disasters, such as Hurricane Katrina, have driven some insurers out of the market altogether, while others have opted to cancel existing policies or significantly raise premiums. Commercial real estate professionals in some regions of the country now face the same lack of availability and affordability for natural disaster insurance as they do for terrorism insurance.

The main reason our nation is struggling with this challenge right now is because of the unprecedented number of natural disasters that have occurred over the past few years and the unparalleled costs for damages that resulted. *The Wall Street Journal* reports that, overall, the insurance and reinsurance industries have held up their obligations and reimbursed policyholders for covered damages. But despite the limited geographic reach of these disasters, exorbitant costs have consumed virtually all the private market capital reserved for this coverage. Essentially, the storehouses have been depleted and there isn't enough capital left to cover the next natural disaster that hits the same areas. That's why some insurers have pulled out of these markets, premium costs have skyrocketed, and policy restrictions are tighter than ever.

The insurance industry has a history of business cycles that fluctuate between years of adequate or excess reserves (which lead to reductions in premium prices) followed by years of inadequate reserves (which lead to increases in premium prices). The actions taken by insurers today are not new. What does differ is the level of cost that can be incurred in a short period of time. The outcomes of recent mega-disasters have demonstrated that the private sector and local and state governments are not equal to the task of paying for the damages caused by multiple mega-disasters. For example, a repeat of the 1906 San Francisco earthquake would cause an estimated $400 billion in damage in today's dollars. This new realization is what is driving increased pressures for a federal role as a reinsurer-of-last-resort.

The National Association of REALTORS® is working in conjunction with other interests to engage Congress to define a comprehensive natural disaster policy.

No one is better poised to offer an opinion on this issue than Kevin McCarty, Florida's Insurance Commissioner, who has extensive, first-hand experience dealing with the aftermath of Katrina. At a National Symposium on Federal Natural Disaster Policy hosted by the National Association of REALTORS® in September 2006, Mr. McCarty opined, "If I can leave you with one message today, it is this: natural catastrophes are a national problem that requires a national solution."

During his presentation, McCarty argued that state resources are not sufficient to handle a mega-catastrophe and that the impact goes well beyond insurance coverage issues. "When a catastrophe hits, it affects far more than insurance companies and the victims of these events. It places stress on the homebuilders market, the banking market, land development markets, real estate values, community tax bases, unemployment rates, and ultimately affects the economic security of all Americans," he stated.

What are the alternatives for a federal role in natural disaster insurance?

During the 109th Congress, a variety of bills were introduced to address part or all of natural disaster insurance issues in Congress. Generally, the recommended policies fall into two camps: one that supports a federal backstop and one that doesn't. Proponents for a federal role believe that some risks are too large or unpredictable to be insurable. They recognize that the magnitude of mega-catastrophes may soon exceed the ability and capacity of private insurance markets to respond effectively. They also cite existing federal programs to insure against natural disasters, such as the National Flood Insurance Program and the Federal Crop Insurance Program. These and other approaches may be considered during the 110th Congress.

Most of the proposals for federal participation in natural disaster coverage involve a three-layer plan: policies sold by primary insurance companies; state or regional catastrophe pools that provide reinsurance; and a national mega-catastrophe fund that provides a federal backstop for large-scale insured losses.

Three interesting proposals add new dimensions to the dialogue. One plan suggests an amendment to the federal tax code that would allow insurers to set aside reserves that would accumulate on a tax-deferred basis in order to pay for future catastrophic losses. Two other proposals call for the creation of "personal disaster accounts" or "catastrophic savings accounts" which would allow property owners to accumulate savings on a tax-free basis to cover potential future catastrophic losses.

What arguments are made by opponents of a federal role in natural disaster insurance?

Opponents of federal legislation believe that the private sector and the free markets are in the best position to manage natural disaster risks for those who choose to insure privately. They argue that the solution to this problem is not more government involvement and regulation, but less. By relaxing existing regulatory constraints and stringent tax policies, private markets would be stimulated to devise creative solutions to the problem of who pays for mega-catastrophes. Opponents also criticize the examples presented by the federal crop and flood insurance programs for their inherent difficulties in assessing the government's true risk, and, therefore, establishing fair premium rates for those exposures.

In general, the insurance industry supports a federal role in natural disaster coverage. In testimony to the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises in September 2006, David Daniel, representing the Independent Insurance Agents and Brokers of America, articulated his group's support for a "limited and appropriate" role for the federal government to help increase insurance availability and affordability in disaster-prone areas. This includes establishment of a clear, well-structured mechanism that encourages the private sector to handle as much of the risk as possible. Federal involvement would only be triggered as a last resort.

It is important to note that proponents and opponents of federal legislation do agree that any solution must include a substantial risk mitigation process to eliminate as much risk as possible in advance of any future catastrophic event.

Presently, the National Association of REALTORS® doesn't have a position on a federal backstop for natural disaster insurance.

What does a federal role in natural disaster insurance mean to my business?

In the aftermath of Hurricanes Katrina, Wilma, and Rita, along with the hurricanes of 2004, the housing market in Florida and the rest of the Gulf Coast has suffered like never before. Research indicates that housing markets in areas hit by hurricanes prior to 2004 generally recovered within about 12 to 18 months to at least the same level of property values as was evidenced before each hurricane. That's not the case in the Gulf Coast today. Nearly two years after Katrina struck, both residential and commercial property values remain depressed.

One other important aspect of this debate affects all businesses and individuals in the country, and centers on a more philosophical question. Should states outside of disaster-prone areas be required to help pay damages from a mega-disaster in another geographic area, or should each state create private reserves to cover any potential natural disasters that are likely to strike within their borders? What portion of mega-disaster costs should be shouldered by victims and what portion, if any, do we take on as a society? There are no simple answers to these questions. Good arguments can be made for and against both sides of this issue. Clearly, more dialogue is needed to crystallize a predominant opinion.

What can I do to protect the interests of commercial real estate practitioners?

Your future as a commercial real estate professional will be directly impacted whether the legislation is passed – or passed over – in the 110th Congress. The National Association of REALTORS® will continue its leadership initiatives in these areas, but it is important for you to be prepared so that you can participate effectively in grassroots advocacy at key junctures throughout the year.

We encourage all commercial real estate practitioners to:

1. Keep up with the issues. Just go to the National Association of REALTORS® Government Affairs Web page (www.REALTOR.org/government_affairs.com) for updates on the debate, policy statements, recent legislative activity, and more.

2. Examine your coverages. Make sure you take a look at your current property and casualty coverage levels for terrorism and natural disaster insurance. Find out what your carrier might do if TRIA expires. Learn the issues associated with state, local, and regional policies that shape your disaster insurance coverage; search 'state issues' on REALTOR.org to access the State Issues Tracker. Let state associations and NationalAssociation of REALTORS® know of significant changes.

3. Talk with local representatives. Take the time to converse individually or at public events with government officials, insurance industry representatives, and influential local business leaders to make sure your interests and concerns are on *their* radar.

4. Find out more. Watch for more communications from the National Association of REALTORS® about everything from the international agenda for effective terrorism insurance models to specific policy and financial trends in natural disasters and the insurance industry's response in your part of the country.

5. Be prepared to act. Watch for information from the National Association of REALTORS® about participating in grassroots advocacy efforts when legislative issues move out of committee and toward a vote.

Where can I find more information?

For more information about terrorism and natural disaster insurance issues, including the National Association of REALTORS® most current policy statements and efforts on behalf of commercial real estate practitioners, please go to the Government Affairs page at the National Association of REALTORS® Web site: www.REALTOR.org.

The REALTORS® Commercial Alliance would like to thank the following people for sharing their expertise.

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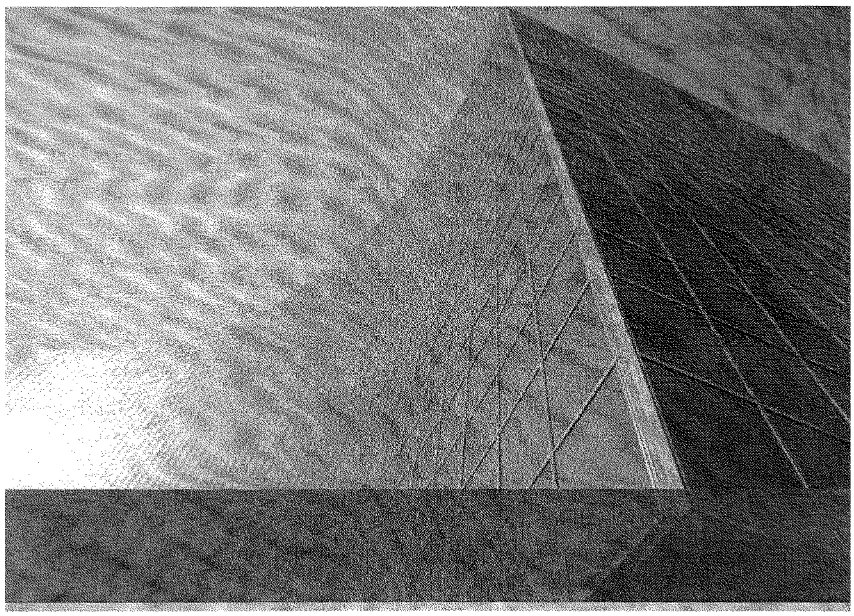

REALTORS® Commercial Alliance
The commercial division of the
National Association of REALTORS® and its affiliates

Property Casualty Insurers
Association of America

Shaping the Future of American Insurance

**Testimony of the Property Casualty Insurers
Association of America (PCI)
Before the U.S. Senate Banking, Housing & Urban Affairs Committee
Examining the Terrorism Risk Insurance Program**

February 28, 2007

The Property Casualty Insurers Association of America (PCI) is the nation's premier property/casualty trade association, representing more than 1,000 member companies. PCI member companies include large national insurance companies, mid-size regional writers, insurers doing business in a single state, and specialty companies that serve specific niche markets. PCI members write $173.6 billion in annual premium, nearly 40 percent of all the property/casualty insurance written in the United States. PCI members write 31.5 percent of the business insurance policies and 40.2 percent of the of the private workers compensation insurance market.

The PCI appreciates the opportunity to comment to the Committee on the Terrorism Risk Insurance Program created by the Terrorism Risk Insurance Act of 2002 (TRIA), and later extended by the Terrorism Risk Insurance Extension Act of 2005 (TRIEA). We begin by articulating a few basic principles, then provide a perspective on the role of small and medium-size insurers in the terrorism insurance market.

Basic Principles

TRIA is an essential part of our national security efforts against the threat of terrorism.

By protecting our economy and making it more resilient against terrorist attacks, TRIA makes all of us more secure. Participation in this effort is a fundamental obligation of the Federal government.

TRIA has played an integral role in making terrorism insurance available and affordable to America's large and small businesses.

Terrorism insurance purchase rates have increased from 27 percent to nearly 60 percent in the last three years because of TRIA, and the cost of terrorism insurance has steadily declined, especially for smaller companies, providing a critical layer of stability and protection to America's businesses and their workers. This could not have taken place without TRIA.

Absent a Federal backstop the market for terrorism insurance would be virtually nonexistent.

Experts from industry, academia and government agree that, without a Federal backstop, the stand-alone market for terrorism insurance would be virtually nonexistent. The economic consequences of a vacuum of affordable, available terrorism insurance are hard to fathom.

A strong Federal role in terrorism insurance protection must continue, even as we work to reduce the Federal responsibility gradually over time.

Proposals that would suddenly and severely curtail the Federal role in the terrorism re-insurance market in the immediate future would likely result in a drastic reduction in the availability of affordable terrorism insurance and seriously harm the economy.

Ensure that all potential victims of terrorist attacks, regardless of geographic location or the source of an attack, have access to terrorism insurance protection.

Just as all Americans mourned the losses of the terrorist attacks of September 11, 2001, we should share in the responsibility of securing the nation's economy in the event of another attack. Terrorism is not a problem only for America's urban centers. Steps which limit the protection provided by this program would reduce the nation's economic preparedness and limit the ability of our businesses and workers to purchase terrorism insurance.

Ensure that all acts of terrorism are covered.

Proposals that would limit a government role to only "foreign-inspired" terrorist attack or to a few types of attacks (i.e. NBCR) would curtail the essential protection afforded to American businesses and their workers, and ignore the significant threat from other forms of terrorism on American soil. The attacks the world has witnessed in recent years - on September 11, 2001 in New York and Washington, and the events in London and Madrid - do not fall in the nuclear, biological, chemical, or radiological (NBCR) category.

Ensure that robust competition in the marketplace for terrorism insurance continues without disruption.

America's small, medium, and large insurance companies provide terrorism insurance to our nation's businesses and their workers every day. TRIA policy should maintain full and equal access to the program to ensure that insurance customers have available to them the widest possible range of options for coverage and robust competition for their business.

Effects of the Program on Smaller Insurers

The design of the program going forward has implications for smaller and medium size providers of commercial (or, more precisely, TRIA-covered) property/casualty insurance coverage.

Two key design features have particular significance for smaller insurers – the size of the individual insurer deductible and the program trigger.

Higher Deductibles Hurt Smaller and Medium Size Insurers

Under TRIA, every insurer writing covered lines of business faces an individual company deductible or retention. The deductible is based not on the level of the insurer's policyholder surplus, or capital (which would be an indicator of the insurer's ability to assume risk), but rather on the premiums earned in covered lines of business. There are policy reasons for this design, but an implication is that the deductible any insurer will absorb after a terrorist attack is not tied to the insurer's capital position.[1] This also means that many insurers currently writing TRIA-covered lines of business may have a significant share of their capital at risk in the event of a terrorist attack.

Individual insurer deductibles have increased significantly since the program's inception in 2002.[2] Kunreuther and Michel-Kerjan have provided helpful research into the effects on much of the industry of the increases in deductibles.[3] Using the Kunreuther and Kerjan approach from a somewhat different perspective illustrates the potential impact of rising deductibles on smaller and medium-size insurers and on their presence and role in the industry's competitive balance. For this analysis, we have used a database composed of the entire property/casualty industry writing TRIA-covered lines of business. The database includes 1,027 insurer groups or individual insurers at least $500 of earned premiums in TRIA-covered lines of insurance in

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[1] Indeed, there have been those in the industry who have argued that the TRIA deductibles should be a percentage of surplus (capital), rather than premiums.

[2] The individual insurer deductibles under TRIA and TRIA have been as follows: 7.0%-2003, 10%-2004, 15%-2005, 17.5%-2006, 20%-2007.

[3] "Looking Beyond TRIA A Clinical Examination of Potential Terrorism Loss Sharing", p. 338 in "Seeds of Disaster, Roots of Response How Private Action Can Reduce Public Vulnerability", edited in 2006 by Auwrswald, Branscomb, LaPorte, Michel-Kerjan

2005, the latest year for which complete data are available. In the analysis, we have calculated each insurer's TRIA deductible[4] and compared it to that insurer's reported policyholder surplus, or capital. The analysis takes account of the deductibles of insurer groups, where the companies in the groups file a consolidated Annual Statement, but treats as individual companies those that do not file consolidated Annual Statements. In practice, TRIA's implementing regulations would bring more of these insurers together for purposes of determining deductibles.

Exhibit 1 provides a distribution of insurers by their TRIA deductible to policyholder surplus ratios (D/S ratio), using the 2006 deductible level (17.5 percent) and 2005 premium and surplus data. There are many insurers whose D/S ratios are at a relatively modest level (41 percent at 5 percent or less), typically due to a relatively modest share of their total book of business being written in TRIA-covered lines. On the other hand, some 21 percent of insurers writing TRIA-covered lines in 2005 had D/S ratios exceeding 20 percent. That is, in the event of a terrorist attack that triggers the program, these insurers face a deductible or retention potentially greater than 20 percent of total capital. Although not measured in Exhibit 1, this exposure is only made worse by the insurer's retention of an additional 15 percent of losses above its deductible (the coinsurance share).

There is a high likelihood that this problem will grow worse for a number of insurers in 2007, given that program deductibles are now to 20 percent of premiums. For those insurers whose surplus (capital base) did not rise proportionately with both the increase in deductibles and their TRIA-premiums increase, exposure to TRIA deductibles will worsen.

Even with the TRIA program in place in 2007, these insurers will face important questions regarding their exposure to terrorism risk. They will face questions about how they can manage and reduce their exposure to terrorism risk, as well as likely pressure from regulators, catastrophe modelers, and independent rating agencies. In a 2005 analysis, A.M. Best Company (the leading financial strength rating organization in the insurance industry) has noted that exposure to losses greater than ten percent of surplus can have "negative rating

[4] TRIA deductibles are calculated as follows: Direct Premiums Earned in the immediate prior year in TRIA-covered lines of insurance, multiplied by the TRIA deductible percentage (e.g., 17.5%).

implications."[5] Recently, A.M. Best has made the need to manage this exposure even more explicit with its use of a detailed Supplemental Rating Questionnaire (SRQ) seeking important details on an individual insurers' potential maximum exposure. If TRIA is not renewed or if its passage is significantly delayed, this pressure will only intensify.

Looking further into the characteristics of those insurers with D/S ratios greater than 20 percent, it's clear that they are predominantly smaller and medium-size insurers. Exhibit 2 provides a size distribution of these insurers, ranked according to their 2005 total company premium volume (including non-TRIA lines). The dividing line between large, medium, and small insurers is defined as follows: Large – total direct earned premiums at or exceeding $1 billion; Medium – total direct earned premiums at least $50 million, but less than $1 billion; Small – total direct earned premiums less than $50 million.

Exhibit 2 demonstrates that the overwhelming majority (95 percent) of insurers with D/S ratios greater than 20+ percent are medium and smaller insurers. Clearly, many of these companies have significant capital exposed to loss from a terrorist attack. Just as clearly, any further net increase in individual insurer deductibles or insurer co-payment requirement will worsen this problem and fall most directly on medium and smaller insurers. While raising deductibles is a concern for all insurers writing TRIA-covered lines, Exhibit 2 makes clear that it can also be seen as a particular problem for medium and smaller insurers. These companies are greatly and rightly concerned about this issue as the debate over a future program begins and will be significantly affected by program design decisions made.

Higher Program Triggers Hurt Smaller and Medium Size Insurers

The level of program "trigger" is perhaps an even more significant issue for medium and smaller insurers. The level of the trigger determines when the program will be activated, that is, whether it will pay for <u>any</u> losses. Participating insurers face a risk that they may suffer a terrorism loss that will be less than the program trigger, leaving them with no protection from the program. The higher the program trigger, the greater the risk. The trigger was $5 million from 2002 – 2005, but raised to $50 million in 2006 and $100 million in 2007.

[5] A.M. Best Company, "Terrorism: Too Risky Without TRIA?", December 2005.

One way to understand the effect of increasing the trigger is to look at the number of insurers whose capital is less than the trigger – that is, the number of insurers who could face a loss that does not trigger the program, but which exceeds their total capital. In fact, even this approach significantly understates the problem – no insurer wants to face the risk of any single loss that can wipe out its entire capital base and losses even much less than this total capital can have very negative financial consequences for an insurer. An insurer's capital base must support the entire portfolio of risks it assumes, not a single exposure such as terrorism.

Exhibit 3 provides a clear picture of the risk created by a policy decision to raise the program trigger. Of the 1,027 insurers writing some TRIA-covered insurance in 2005, three-fourths (75.5 percent) had policyholder surplus less than the $100 million 2007 program trigger. If the trigger is raised to $500 million in future program years, as some have suggested, nine in ten (90.6 percent) will likely have capital below the trigger. A trigger of $1 billion, would leave 94 percent of current terrorism insurance carriers with capital below the trigger, versus only 61 companies with capital greater than the trigger.

Some have argued that it is highly unlikely that any single insurer will face a terrorism loss of significant size that doesn't also trigger the program. Given the current state of our knowledge about the probability target, and potential damage from a terrorist strike, that is impossible to know. Moreover, there are certainly relevant examples of terrorist attacks that have done most of this damage to a single building and its occupants.[6]

Combining this fact with workers compensation benefits can easily produce losses in excess of acceptable parameters. For example, A.M. Best estimates (in its SRQ) that a typical death benefit paid in Massachusetts is $1 million. An attack on a single small employer in Boston that killed 80 employees (less than half the number of those killed in Oklahoma City in 1995) would produce gross losses of $80 million. If un-reinsured, a loss of this level would be devastating to at least 75 percent of the insurers currently writing terrorism risk. Given the lack of significant private reinsurance capacity for terrorism risk, the odds are high that the risk would be un-reinsured or only partially reinsured without TRIA. If this is the exposure to be faced by an individual insurer, many will face very difficult questions about their ability to

[6] The 1995 attack on the Murrah Federal Building in Oklahoma City is a case in point. 163 people died in the Murrah Building; five died elsewhere.

continue participating in these markets.

Small and Medium-Size Insurers Provide Essential Competition and Consumer Choice

Given that several TRIA program features have a disproportionate impact on small and medium-size insurers, how important is this to insurance markets and consumers? Indeed, some have argued that public policy should not be concerned with the effects of a terrorist attack on any particular segment of the insurance industry, but only with the impact of an attack on the insurance market itself. This argument seems to suggest that concerns about the impact on small and medium-size insurers is misplaced – the only concern of policymakers should be whether a "market" exists.

Competition

This argument is illogical on its face, as well as being bad public policy. First, it would be a curious public policy perspective that expressed its concern for a "market", but not for the vast majority of the firms that actually populate that market! Second, it is one thing for unregulated markets to develop over time in a way that makes some business models obsolete and allows others to thrive. That happens normally in a market economy and is one of the primary reasons for the success of market systems. However, terrorism is fundamentally different from other risks that arise in a market economy and requires changes in business models. First, for all of the reasons insurers have argued that terrorism is different and uninsurable, allowing the structure of a government policy response to itself to make small and medium-size insurers less competitive is inappropriate public policy. The issue at hand is the design of a government program. It is no more fair to establish program triggers and deductibles in a way that disadvantages small and medium-size insurers than it would be to structure the program in a way that disadvantages the largest insurers. The program itself should be neutral with respect to the competitive playing field. Finally, government policy itself has a strong impact on the risk insurers face. Insurers have no control or influence over the way the government chooses to address and fight international terrorism and, thus, are placed in the position of bearing a risk that they cannot effectively mitigate. That is unsound public policy.

Consumer Concerns

From the perspective of insurance consumers, a program structure that imperils small and medium-size insurers and forces their reconsideration of or withdrawal from terrorism insurance markets can only be negative. Given the level of market participation by these insurers, the effects would not be trivial. Exhibit 4 illustrates the market shares of total premiums of small and medium-size insurers in the three largest TRIA-covered lines of business in 2005, as well as the number of insurers writing these lines. The market shares of the small and medium-size carriers varies from 18 percent in general liability to 27 percent in workers compensation. The number of small and medium-size carriers, as a proportion of the total number of carriers serving these lines, ranges from 85 percent in workers compensation to 92 percent in general liability.

Market shares written by small and medium-size carriers vary across the states. Exhibit 5 illustrates this variation. In 17 states, these carriers write 10 to 20 percent of the TRIA-covered lines; in 22 states, they write 20 to 30 percent; in 11 states, 30 to 40 percent; and in one state (Hawaii), over 40 percent. These are market shares, representing tremendous competition "presence", the abrupt loss of which due to a policy change in federal law would severely disrupt these markets and rob consumers of valuable choices and market alternatives.

Small and medium-size insurers have an economic impact well beyond the market shares they write. They are significant employers, estimated to employ some 220,000 people nationwide, with a payroll exceeding $11.6 billion. They are significant taxpayers, paying approximately $14.9 billion in state premium taxes and $2.6 billion in federal corporate income taxes in 2005. The "downstream" annual economic impact of the payroll provided by these insurers is estimated to be over $17.5 billion[7].

Small and medium-size insurers, almost by definition, are more "regional" in nature, serving tightly defined markets and consumer market segments. They are often highly specialized, possessing unique knowledge of their market segments or niches. Given their size and the scale disadvantages they face in the market, most are highly focused on consumer service and risk knowledge, providing significant benefits to their policyholders. Their loss from these markets would be a loss of consumer choice and consumer service and is not a loss that ought to be created or encouraged by Federal program design.

Conclusion

The enactment of a long-term federal terrorism reinsurance program is essential to the stability and continued growth of the U.S. economy. It is a critical element in efforts to protect the economic security and resilience of the country against the threat of terrorist attack. Given that we cannot hope to prevent every possible terrorist attack, strengthening economic security and resilience is a vital goal of our national security and the responsibility of the federal government.

In designing a future program, a key principle should be that it not interfere with or disrupt the competitive playing field that otherwise exists in the market. In this instance, the provisions of an extended terrorism reinsurance program should not create barriers to the ability of smaller and medium-size insurers to continue serving markets and consumers.

At the end of the day, insurance consumers will have more choices, prices will be lower, and product innovation will be greater when the greatest possible number of strong, viable competitors can serve the market. The design of the federal terrorism reinsurance program must not disrupt that competition.

We thank the Chairman and the Committee for the opportunity to share our perspectives on this issue and welcome the opportunity to continue working together in finding a long-term solution to the availability of terrorism insurance.

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Property Casualty Insurers Association of America (PCI)

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[7] PCI estimates.

Exhibit 1

TRIA Deductible-to-Surplus Ratio Distribution

17.5 Percent TRIA Deductible

D/S Ratio Level	Company Count	Distribution Pct.
5% or less	422	41.1%
Greater than 5% to 20%	387	37.7%
Greater than 20%	218	21.2%
	1,027	100.0%

Note: Exhibit reflects the industry's 1,027 TRIA-covered lines writers in 2005.

Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

Exhibit 2

TRIA Deductible-to-Surplus Ratio Greater Than 20 Percent Distribution by Company Size

17.5 Percent TRIA Deductible

Company Size	Company Count	Distribution Pct.
Small	120	55.0%
Medium	89	40.8%
Large	9	4.1%
	218	100.0%

Note: TRIA-writer company size definitions: Small - total p-c lines direct earned premiums less than $50 million; Medium - total p-c lines direct earned premiums at least $50 million and less than $1 billion; Large - total p-c lines at or exceeding $1 billion.

Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

Exhibit 3

Insurers Writing TRIA-Covered Lines of Insurance
Distribution by Surplus Level

Surplus Level	Company Count	Distribution Pct.
Less than $100 Million	775	75.5%
Less than $500 Million	930	90.6%
Less than $1 Billion	966	94.1%
More than $1 Billion	61	5.9%
Total	1,027	100.0%

Note: Exhibit reflects the industry's 1,027 TRIA-covered lines writers in 2005.

Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

Exhibit 4

2005 Direct Premiums Earned Market Share and Company Counts

Workers Compensation, Commercial Multi-Peril, Other Liability, and All TRIA Lines

	Companies Writing WC	WC DPE ($000) 2005	WC Market Share
Large Companies	49	32,602,066	72.6%
Medium Companies	160	11,073,430	24.7%
Small Companies	123	1,232,383	2.7%
Total Number of WC Writers	332		

	Companies Writing CMP	Total CMP DPE ($000) 2005	Total CMP Market Share
Large Companies	54	25,990,803	76.7%
Medium Companies	183	7,153,641	21.1%
Small Companies	167	745,523	2.2%
Total Number of CMP Writers	404		

	Companies Writing Other Liab.	Other Liab. DPE ($000) 2005	Other Liab. Market Share
Large Companies	61	43,574,710	82.2%
Medium Companies	286	8,361,060	15.8%
Small Companies	407	1,081,848	2.0%
Total Number of Other Liab. Writers	754		

	Companies Writing Any TRIA	All TRIA Lines DPE ($000) 2005	All TRIA Lines Market Share
Total Large Companies	63	134,763,268	78.0%
Total Medium Companies	343	34,141,629	19.8%
Total Small Companies	621	3,876,171	2.2%
Total Number of TRIA Line Writers	1,027		

Notes: Large companies represent those with at least $1 billion total p-c direct premiums earned.
Medium companies represent those with $50 million to less than $1 billion total p-c direct premiums earned.
Small companies represent those with less than $50 million total p-c direct premiums earned.

Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

Exhibit 5

Small and Medium-size TRIA Writers
2005 State TRIA-Lines Market Share

State Counts by TRIA-Lines Direct Premiums Earned Market Share Level

Sm & Med Cos. TRIA DPE Market Share	Number of States
10 to 20 Percent	17
20 to 30 Percent	22
30 to 40 Percent	11
Over 40 Percent	1

Note: Company size definitions: Small - total p-c lines direct earned premiums less than $50 million; Medium - total p-c lines direct earned premiums at least $50 million and less than $1 billion.

Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data