THE FUTURE OF TERRORISM INSURANCE: FOSTERING PRIVATE MARKET INNOVATION TO LIMIT TAXPAYER EXPOSURE

HEARING

BEFORE THE

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CONTENTS

THE FUTURE OF TERRORISM INSURANCE: FOSTERING PRIVATE MARKET INNOVATION TO LIMIT TAXPAYER EXPOSURE

Wednesday, November 13, 2013

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Luetkemeyer, Royce, Capito, Garrett, Westmoreland, Duffy, Stivers, Ross; Capuano, Cleaver, Sherman, Himes, Sinema, and Beatty.

Ex officio present: Representatives Hensarling and Waters.

Also present: Representatives Grimm, Maloney, and Green.

Chairman NEUGEBAUER. Good morning. The Subcommittee on Housing and Insurance will come to order. The title of today's hearing is, "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure."

I am going to limit opening statements to 2 minutes per side, and I ask unanimous consent that members of the full Financial Services Committee who are not members of the Housing Subcommittee, and who have joined us today, will be entitled to participate in the hearing.

I will begin now with the opening statements, and I will recognize myself for 5 minutes.

This is our second in a series of hearings on TRIA, a very important subject. As I mentioned in the title of this hearing, today is really to focus on getting more private market participation in this process.

In addition to the previous hearing that we have had, we have had numerous sessions, both at the staff level and the Member level, with market participants, people who have an interest in TRIA and the impact to both the users, the people who are insured for terrorism, and the people who provide that, the reinsurance market. We have tried to be as inclusive as we can of bringing people in to get their perspectives on this.

As many of you know, TRIA was passed in 2002. It was meant to be temporary.

And what we know in Washington is that there is really never any temporary policy. Temporary moves very quickly to permanent.

And here we are over 10 years later and we still have this temporary policy on our books.

The purpose of TRIA initially was to provide a transition period for the industry to kind of regroup after the terrible events of September 11th (9/11) where we saw the industry take a hit of, I think, over $40 billion.

The transition really hasn't taken place as robustly as I think a lot of folks hoped and as I think was promised. And so what we are here to really to talk about today is how do we accelerate that transition period and how do we accelerate the private participation at a larger level.

Now, there is some good news along the way. The markets have stabilized, and today the industry has more capital in reserves than ever before in spite of some fairly major big hits that the industry has taken over the last few years. We have had several events even larger than 9/11, yet today the industry is capitalized and the reinsurance market has a tremendous amount of capital on the sidelines.

Risk modeling has advanced. One of the things we have heard from other people who came and gave testimony was that it is hard to model this risk for terrorism but, in fact, there has been some progress in that.

And the price of the insurance, the coverage, has reduced by over 70 percent since those early days. So, there are some encouraging factors out there.

But quite honestly, the innovation in TRIA hasn't kept pace with really the rest of the financial markets. One of the things that we enjoy in this world today is some of the most sophisticated financial products in the world. And we have provided opportunity to cover a number of different kinds of risk in a lot of different ways. Yet we haven't seen that same innovation, quite honestly, in TRIA.

And so today, as we begin to have our discussion, I am looking forward to hearing from this panel. I told my staff earlier that I think we have put together an A panel today of some very smart people who have different perspectives.

But I hope that our conversation will center around today that if we are to continue to provide terrorism insurance in this country, what are the ways that we can do it better, but at the same time, make sure that the taxpayers have a smaller footprint.

One of the things we know about government, particularly the U.S. Government, is that we don't do an extremely good job of pricing risk.

I don't think our government, the founders, ever meant for us to be in the insurance business. But we have found ourselves in that business in a number of ways, whether insuring mortgages or insuring people against flood.

And when we look across-the-board at those programs, what we see today is that the FHA is not adequately capitalized. The flood insurance program is $30 billion underwater, and there is no pun intended in that statement.

And so I hope to hear from our witnesses today of ways that we can move forward. And what I would say is that my guess is that this is our last pre-legislative hearing.

And where we go from here, we will begin to then put some of the ideas that we have heard from market participants and from the two hearings that we have had and moving forward with something that we think is a positive direction.

With that, I yield back my time, and I recognize Mrs. Beatty from Ohio for 2½ minutes.

Mrs. BEATTY. Thank you so much, Mr. Chairman.

And let me just say to our witnesses today, thank you for being here.

Certainly, as you know, today's hearing was scheduled specifically for the purpose of evaluating the ability of the private sector to sustain a robust terrorism risk insurance market in the absence of a Federal Government backstop.

And I believe it is fair to say that the ability to purchase broadly available and reasonably priced terrorism risk insurance is a critical part of our modern American society, covering everything, as you know, from property damage to business interruptions to injury or loss of life liability to workers' compensation. And businesses' ability to secure terrorism risk coverage facilitates every facet of the modern American corporate climate.

Without broadly available and reasonably priced terrorism risk insurance, commercial real estate markets would likely seize up and sports entertainment venues could lose their ability to operate.

I am from a district where we have a large number of venues that fall into this category. Even the high-risk office buildings that create the iconic skylines from coast to coast would be vacant as companies could not justify housing employees in these terrorism magnets without workers' compensation coverage for liability stemming from an act of terror.

The unpredictable frequency and severity of terrorist attacks prevents the use of normal risk-based pricing models used in other forms of insurance. In fact, from all the comments from industry participants, insurance and reinsurance industries are simply not ready to bear the entire burden of losses from one or more major terrorism events.

And without the extension of the TRIA government backstop, all indicators suggest that there would be a large-scale withdrawal of this coverage from the market, which would bring us back to the untenable position in which we found ourselves in the months following September 11, 2001.

So I look forward to hearing your testimony, and I thank you for being here today.

I yield back.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now, I recognize the vice chairman of the subcommittee, Mr. Luetkemeyer, for 2 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Congress originally intended for the terrorism risk insurance program, or TRIA, to be a temporary one to stabilize the insurance sector after September 11, 2001. It was passed and then extended in order to allow time for the industry to evolve and create private market solutions.

As the chairman has mentioned and I agree, I think it is fair to say that a complete transition to the private market has not been as rapid or as robust as we would have liked.

Given what I have studied and heard, I believe there remains a real need for TRIA. But I also believe that we can identify ways to increase the amount of private sector capital in the program.

My biggest hope in doing so is that we better protect taxpayers, continue to have a robust insurance marketplace, and provide a backstop for financial security for the private sector and investors. Today, we will more closely examine the current terrorism insurance marketplace and discuss some innovative ways to increase the role of the private sector in this field.

I believe we can take steps to reform TRIA. And while I do support a continuation of an improved program, I do not believe it should be a permanent program.

At the end of this debate, it is my hope that we will have a product that promotes increased stability and taxpayer protection alike, as well as begins a process of winding down the government's role.

I look forward to a productive hearing, and I thank our witnesses for testifying.

With that, Mr. Chairman, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentlewoman from New York, Mrs. Maloney, is recognized for 2 minutes.

Mrs. MALONEY. I thank the ranking member and the chairman for calling this hearing and I thank all of my colleagues for being here.

The title of this hearing is, "Fostering Private Market Innovation to Limit Taxpayer Exposure." I would just like to point out that under the current TRIA program, the taxpayers' exposure is already extremely limited. Total industry losses have to exceed $100 million first, and then insurance companies have to pay a deductible equal to about $34 billion. And this is before any government money is used.

Even then, the insurance company has to share a portion of the losses with the government. Under TRIA, if, God forbid, a terrorist attack caused $50 billion of losses, which is $10 billion more than the terrible 9/11 attack, the government would only be on the hook for roughly $13.6 billion, according to the Government Accountability Office.

TRIA is a rare example of a government program that does exactly what Congress intended it to do. It ensures that businesses have access to terrorism insurance while also limiting taxpayers' exposure. And it has done all of this without costing taxpayers one dime.

Why, then, would we even think about ending this program? Ending this program would harm the fragile economic recovery in the short term, and in the long term it would leave our economy dangerously exposed in the event of a future terrorist attack.

I want to thank all of my colleagues for their support in the rebuilding of our Nation after the 9/11 attack. And I especially want to thank one of our panelists today from Lloyd's of London, Sean McGovern, because after 9/11 all building stopped in major urban areas. No one could get insurance.

The only place some people—and this was limited—could get insurance was from Lloyd's of London. So you couldn't build a shack until antiterrorism insurance was put in place, the TRIA program, which has not cost a dime.

So I strongly support Mr. Grimm's bill to extend this vital program. It is important to our economy. It is important to our Nation.

And I thank the chairman for having the hearing.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now the gentleman from New Jersey, Mr. Garrett, the chairman of our Capital Markets Subcommittee, is recognized for 2½ minutes.

Mr. GARRETT. Two minutes is fine.

First of all, I would like to thank the chairman for holding this hearing on potential ideas to encourage private capital and innovation, and at the same time, to protect the taxpayers from footing the bill for terrorism coverage.

I would also like to thank all the witnesses here on the panel before us as well.

It has been 11 years since TRIA was signed into law, as the chairman has already indicated, and it was intended to be a temporary program. And as most of you are aware, TRIA in its current form requires the share in the certified act of terror, as was indicated, $100 million if it exceeds that.

And while the risk is shared between the private insurers and the taxpayers, the mandatory recoupment under TRIA does not apply to catastrophic losses over a set figure, around $27 billion. Recall, then, that on September 11th, those attacks resulted in more than $41 billion of losses.

So today we are here to discuss ideas to further work to protect the taxpayer from catastrophic losses. While we hope and pray that another September-11th-like event does not occur, we cannot, unfortunately, rule out future attacks on our homeland.

And given this possibility, it is in the interest of the U.S. taxpayers for Congress to seek out innovative ways to harness the power of private markets and private capital to lessen taxpayer exposure.

So it is my hope that this hearing will provide this committee with a better understanding of how we can encourage private sector capital in the terrorism risk insurance marketplace, and ways to ensure that taxpayers are, in essence or in reality, not left footing the bill.

With that, I yield back.

Chairman NEUGEBAUER. Thank you.

The gentleman from Connecticut, Mr. Himes, is recognized for 2 minutes.

Mr. HIMES. Thank you, Mr. Chairman. I am pleased to be here at the second hearing on this very important topic.

And I would like to take a moment to welcome Mr. John Seo, whose company, Fermat Capital, is headquartered in my district, I believe in Westport, Connecticut.

Mr. Seo, I look forward to hearing your testimony.

And thank you, Mr. Chairman, for holding this hearing.

I think most of us agree that the goal here is to find a well-balanced insurance structure that steps in where the private market fears to tread for as long as that holds true. To those who are perhaps completely ideologically allergic to the idea, there are two good reasons in principle to consider having a terrorism risk insurance program.

The first is the very simple financial concept that risk should be managed and ultimately borne by the party that is in the best position to understand that risk. And unlike, perhaps, other kinds of risk, it is, of course, our intelligence agencies, our Federal Government that best understands how, when, where, and why a terrorist event may occur. And of course, we make the laws that work to mitigate the risk of a terrorist event.

Secondly and far more practically, as we saw on 9/11, and as we saw in Hurricane Katrina, and as we saw in Hurricane Sandy, in the moment of a catastrophe the Federal Government does step in in a big way. I think it is a tribute to us as Americans that when Americans are suffering anywhere, we don't act stingy. We say, "We will help you stand up again."

So as long as we are stepping in, in a big way in any event, we should do it in an organized and thoughtful way using an insurance structure that doesn't represent subsidy, that does not represent crowding out of private players, but represents an orderly way, a careful way of thinking about things that we don't want to think about.

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

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Florida, Mr. Ross, is recognized for 2 minutes.

Mr. ROSS. Thank you, Mr. Chairman, and thank you for holding this hearing.

As a stalwart of physical conservatism, I agree that taxpayer-backed programs are often poorly designed and managed and end up adding too many dollars to our national debt.

My time as chairman of the Florida House Insurance Committee years ago provided me with a deep understanding of the need to maximize private capital. And I think we all appreciate the embedded design flaws that led to our current predicament with regard to the National Flood Insurance Program.

Ideologically, I agree that taxpayers should not be asked to foot the bill for those who choose to live or build in riskier areas. However, I also believe that we are a body of practicality.

Practically speaking, I do not think it is feasible to move San Francisco away from the San Andreas Fault; neither could we move Florida away from flood zones to escape flood risk. Finally, we will not eliminate cities, take down iconic structures, or prohibit mass gatherings so as to reduce the risk of a terrorist event.

There are realities of risk in our world for which we must find the best workable solutions. In the event of a terrorist attack, I am confident that the Federal Government will step in and provide relief to all victims, including those who are uninsured.

I am a compassionate conservative. I don't think that relief is a bad thing. But I would hope that we would responsibly map out a plan for the deployment of private funds to minimize the number on the check that this Congress has to write.

In this subcommittee, we promote responsible risk management, identify uncertainty as a cause of slower growth, and view broad market participation as an indicator of healthy market conditions. It seems to me that the terrorism risk insurance program at its root targets these principles.

Now, could we do it better? Can we adjust the parameters to further engage private capital? Can we help expand the capacity of reinsurance and insurance-linked securities markets? It is certainly possible, and I certainly hope so.

I thank the panel for being here, and I look forward to the testimony.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the ranking member of the full Financial Services Committee, the gentlewoman from California, is recognized for 2 minutes.

Ms. WATERS. Thank you very much. I am pleased to participate in this hearing on the importance of the successful Terrorism Risk Insurance Act known as TRIA. For more than a decade TRIA has supported critical economic growth by ensuring access to terrorism coverage for our largest venues, businesses, and employers. And Democrats are strongly committed to renewing this program quickly and without controversy.

The terrorist attacks of September 11, 2001, caused a tragic loss of life and significant disruption to our economy. In addition, insurance losses totaled an estimated $40 billion in today's dollars.

Such losses made it financially impossible for many insurers and reinsurers to offer terrorism coverage. Most fled the market. Those that did offer coverage did so at a cost that was prohibitively high.

In 2002, Congress enacted TRIA to address the problem. The program makes terrorism insurance both available and affordable—by requiring insurance companies to offer coverage to commercial entities in exchange for a Federal backstop—which is used to protect against only those terrorism-related losses at the highest levels.

Support for TRIA is so strong and so widespread that it has been reauthorized twice by the House, both times without controversy and with overwhelming bipartisan support.

But as we approach TRIA's 2014 expiration, leading Republicans oppose this measure, arguing that TRIA is hindering private sector participation and that private capital is available to cover terrorism risk.

By continuing to drag out this noncontroversial reauthorization, they are putting up roadblocks that threaten the renewal and effectiveness of this important program. This hurts our economic growth.

Industry itself has reported that private capital could cover no more than a fraction of the gap that would result from TRIA's expiration.

Contributing to this problem is an inability to appropriately model and price the terrorism risk due to an absence of actuarial data. This is because of the extreme difficulty in predicting the frequency, location, and severity of loss associated with a potential terrorist attack. Attacks are random, infrequent, and details are largely classified.

Additionally, Republican opponents of TRIA argue that the current structure leaves taxpayers exposed and that increasing private participation will limit this exposure. However, TRIA actually reduces taxpayer risk because it keeps most of the terrorism risk with the private sector.

Without TRIA, many buildings, schools, and large venues would remain uninsured against terrorist attacks, meaning that the government likely will pick up 100 percent of the tab for catastrophic losses.

But don't take my word for it. A wide array of TRIA's policyholders and beneficiaries have expressed support for the program, including shopping centers, hotels, and office buildings, to insurers and reinsurers, as well as market analysts, lenders, and developers. All these interests and more depend on the quick, clean, and long-term reauthorization of TRIA.

For all these reasons, I believe we need to reauthorize TRIA as soon as possible. TRIA must remain in place to ensure a speedy recovery after an attack, to avoid market disruptions, and to protect schools, jobs, and businesses. We need to realize that now is not the time to be having a debate over alternatives to TRIA. The private market cannot and does not want to step into the void.

I thank you again for holding this hearing. I continue to believe it is of the utmost importance that TRIA is reauthorized quickly, cleanly, and for the long term. Democrats support it. Insurers support it. Businesses and the U.S. Chamber of Commerce support it. There's no reason this should not have broad bipartisan support in Congress as well. I look forward to the witnesses' testimony and I yield back the balance of my time.

Chairman NEUGEBAUER. Now, the ranking member of the subcommittee, Mr. Capuano, is recognized for—

Mr. CAPUANO. Thanks for having this hearing, Mr. Chairman. I yield back.

Chairman NEUGEBAUER. I appreciate that.

And now, we will go to our witnesses.

It is my pleasure to introduce: Mr. Sean McGovern, director of risk management and general counsel for Lloyd's of London; Mr. Kean Driscoll, chief executive officer of Validus Reinsurance, Limited; Mr. Ernest Csiszar, associate fellow, R Street Institute; Mr. John Seo, Co-Founder and Managing Principal, Fermat Capital Management, LLC; and Dr. Robert Hartwig, president and economist, the Insurance Information Institute.

I thank all of you for being here. You will be each recognized for 5 minutes to summarize your testimony.

And with that, I will begin with Mr. McGovern. You are recognized for 5 minutes.

STATEMENT OF SEAN McGOVERN, DIRECTOR, RISK MANAGEMENT, AND GENERAL COUNSEL, LLOYD'S OF LONDON

Mr. MCGOVERN. Thank you, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee for the opportunity to testify this morning on behalf of Lloyd's of London.

My name is Sean McGovern. I am responsible for risk management at Lloyd's and I am also general counsel.

Over our 325-year history, Lloyd's has earned a reputation for having the capacity, the skill, and the appetite to underwrite the world's most difficult risks. This is particularly true in the United States, which is our largest market and where we are a major direct insurer and reinsurer.

Our specialty is catastrophe coverage, and we have been there to support the U.S. economy since the conclusion of the Civil War, cementing our reputation with our response to the 1906 San Francisco earthquake and, more recently, claims paid arising from Hurricanes Katrina, Rita, and Wilma in 2005.

We know how to underwrite catastrophic risk and we have an appetite to take risk that others will not. It is our business.

With that in mind, our views on terrorism risk and TRIA are informed by the following: First, Lloyd's paid more claims than any other insurer or reinsurer following the tragic events of September 11th—almost $8 billion.

Second, Lloyd's led the development of the standalone terrorism risk market in the United States in the days following 9/11. And third, Lloyd's is generally wary of government intervention and believes in free markets and private market solutions wherever possible.

With all that said, we support the renewal of TRIA. Like it or not, the coverage of terrorism risk is different and the United States is not the only country confronted with the challenge of ensuring that the national economy is protected in the event of the failure of counterterrorism measures.

The U.K. has lived with the threat of domestic terrorism for many years, and while the structure of the government industry arrangement is different than TRIA, the U.K. program has an unlimited government backstop. And similar arrangements exist in major European economies.

Terrorism risk is different because, as demonstrated by the tragic events in Boston, risk assessment is very difficult. Frequency and severity are very difficult to predict. Only the government has access to intelligence information but cannot share it.

And although terrorism modeling exists, it has limitations. In particular, the supply of historic data is much more limited than for natural catastrophes.

Now that is not to say that terrorism risk cannot be underwritten. We have an active and growing standalone terrorism risk market in Lloyd's, but it remains small.

All of these factors act to substantially limit the appetite of the insurance and reinsurance industry to absorb this risk, particularly in major urban areas where the density and accumulation of asset values.

TRIA has succeeded in giving the insurance industry the confidence to make terrorism coverage available. Without TRIA, the aggregation of risk will quickly lead to the industry to exclude coverage or withdraw capacity from key economic centers in the United States.

While the industry is well-capitalized, it would be wrong to assume that more capital leads to a dramatic increase in the overall appetite to write U.S. terrorism risk insurance. Reinsurers need to manage risk aggregation and seek diversification.

Now, we accept the need to assess whether or not TRIA should change, and it may well be that the balance between government and private market involvement could tilt more towards the private market. But any changes to TRIA to facilitate greater private market involvement should not sacrifice the stability that TRIA has already achieved.

And how changes are made can be just as important as what changes are made. For example, sudden and dramatic increases in retentions or co-shares could prompt some insurers and reinsurers to concentrate their capacity elsewhere.

By contrast, well-defined, incremental changes over the course of a long-term extension of the program may provide a transparent process of reductions in the risk borne by taxpayers.

For the avoidance of doubts, we do not see this as a mechanism to transition to a complete removal of TRIA. We struggle with the notion that there is no Federal backstop.

Whatever the future of TRIA, Lloyd's will remain committed to providing the fullest coverage we can to our American customers, just as we did immediately after 9/11. But our ability to do that will be limited by our need to manage our risk aggregation.

The same issue will apply to others, and we have no confidence that the private sector alone is capable of providing the entirety of the coverage that would be needed if TRIA is not renewed.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. McGovern can be found on page 94 of the appendix.]

Chairman NEUGEBAUER. Thank you.

And now, Mr. Driscoll, you are recognized for 5 minutes.

STATEMENT OF KEAN DRISCOLL, CHIEF EXECUTIVE OFFICER, VALIDUS RE

Mr. DRISCOLL. Good morning. My name is Kean Driscoll and I am the chief executive officer of Validus Re. I am pleased to appear before you today to provide my company's perspective on possible changes to the terrorism risk insurance program that would incent more private market involvement.

I commend Chairman Neugebauer for holding this important hearing and I welcome the opportunity to address the Subcommittee on Housing and Insurance. Validus Group is a leader in the global insurance and reinsurance markets, operating principally through Talbot Syndicate 1183 at Lloyd's of London and Validus Re.

Talbot has written direct and facultative terrorism at Lloyd's for more than 12 years, and is now the largest writer of that business by income.

Validus Re is one of the largest standalone property terrorism treaty coverage providers in the world, with an estimated 10 percent market share, and it evaluates business opportunities on approximately 90 percent of all direct and facultative terrorism business written throughout the world.

Since 2001, insurers and reinsurers have worked hard to develop a better understanding of conventional terrorism risk. Reinsurers have created task forces, consulted military and intelligence experts, hired specialty risk modeling firms, invested in research and development, and implemented new underwriting standards, all with the intention of offering private market solutions for the transfer of conventional terrorism risk.

Conventional terrorism can be modeled, priced, and managed on a portfolio basis. The probability or frequency of an event can be estimated, albeit with less certainty than with risk classes of a more robust historical record.

However, the insurance and reinsurance industries have pioneered risk transfer solutions for many other classes of business that suffer the same shortcomings. To supplement the lack of a rich data set on frequency, we use open source intelligence that helps us estimate both the intent and capability of terror threat agents.

The question is not whether conventional terrorism risk can be priced, but rather the precision of the parameters in a pricing model. We can and do currently price conventional terrorism risk and estimate that approximately $7 billion to $8 billion of reinsurance coverage is purchased annually on a standalone basis for conventional U.S. terrorism. This excludes coverage that is included as part of general, property, casualty, workers' compensation, and other specialty-lines coverages.

We believe presently there is adequate reinsurance capacity to cover the insurance industry's current $27.5 billion retention under TRIA. And if the industry retention for conventional terrorism grew over time, so too would the capacity of the reinsurance industry for conventional terrorism risk.

TRIA is valuable to the insurance industry in underwriting conventional terrorism risk, but it takes a one-size-fits-all approach that could be modified to encourage more private market insurance and reinsurance participation.

If the committee is inclined to make changes to the program, Validus encourages you to tailor the program in accordance with the following comments: The program should continue to cover catastrophic terrorism loss scenarios related to nuclear, biological, chemical, and radiological attacks. The broader industry cannot effectively address these perils, as the breadth of potential events is either unknowable or could potentially bankrupt the industry.

Cyber terrorism, a peril distinct from cyber liability, should be clearly covered by the program. The scope, duration, potential damage, and economic loss from this risk are also unknowable, and therefore, uninsurable. The program should clarify the process for certifying a terrorism event, including a defined time for making the certification.

Validus has the ability and willingness to assume more conventional terrorism risk exposure and I believe the reinsurance industry also has the ability and willingness to meaningfully expand its capacity for conventional terrorism risk.

To reflect the fact that the industry's appetite for writing conventional terrorism risk has grown since the last extension, the program could be modified in a variety of ways, including gradually increasing the insurance industry retention and size of a qualifying terrorism loss under the program. This reduces the likelihood of having to fund a loss through taxpayer funds and it avoids short-term price and capacity dislocation in the broader industry.

An expansion of the co-participation would better align the insurance industry with the program. The insurance industry is a critical facilitator of effective risk management in virtually every industry, and every facet of life.

Risky behavior or highly exposed assets typically result in a higher premium charge. Policyholders can reduce higher premiums through effective risk mitigation techniques.

Currently, the program impedes the ability of the insurance industry to properly price its products. By shifting the risk of conventional terror attack from the policyholder to the taxpayer, the improper allocation of risk premium facilitates unintended outcomes.

We see this phenomenon playing out in the flood market, as the heavily subsidized National Flood Insurance Program has produced significant deficits. Congress should encourage a greater private sector risk-bearing role and appropriate risk pricing.

Insureds and insurers will then have an incentive to mitigate risk and price it appropriately and Congress can focus on generally becoming a reinsurer of last resort for conventional terrorism risk.

Finally, special consideration should be made for smaller insurers as well as for the insurance industry generally with respect to workers' comp exposure accumulations in metropolitan areas, both of which could be disproportionately impacted in the near term by any of the changes to the program.

Thank you for the opportunity to testify, and we look forward to continuing the dialogue as the renewal process continues.

[The prepared statement of Mr. Driscoll can be found on page 59 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Csiszar, you are now recognized for 5 minutes.

STATEMENT OF ERNEST N. CSISZAR, ASSOCIATE FELLOW, R STREET INSTITUTE

Mr. CSISZAR. Thank you. Mr. Chairman, and members of the subcommittee, I appreciate the opportunity to appear before you today. And let me add that while officially I am here on behalf of the R Institute, which is an institute committed to free markets, to which I am also fully committed, I am also a former insurance commissioner, a former president of the NAIC, and I sit on the board of a workers' compensation company that sells this stuff, and I sit on the board of a company that buys a lot of terrorism insurance.

I have a lot more interest in this than just good policy. I have some practical reasons for being here as well.

Having said that, I want to address two issues, really. One, how can we make reinsurance more attractive? Because reinsurance is really the key here. Without reinsurance, there is no insurance.

And the second point that I want to address is, can we make the insurance-linked security market—and I am sure my friend here will pick up on that as well to comment on it—more attractive?

So to begin with, I think, Mr. Chairman, in your statement you came out and said there had been a lot of change—improvement in the insurance-reinsurance market. The point really is that the capital—when I look back 10 years ago, capital was around $250 billion, $280 billion. Today, that capital is over $500 billion. It is hard to pinpoint an exact number because a lot of insurance companies also sell reinsurance.

The capital, in particular, has grown between 1 and 5 percent every year consistently since—actually, since the financial crisis. More money has come in because it is such a—the yield environment in other areas is so low.

So companies are looking for higher returns and the reinsurance industry has naturally benefited from that to the point where I would say when I recall Hurricane Hugo in my own State of South Carolina, which was a disaster, and Hurricane Andrew, as I recall, created severe disruptions in the market.

Now I look at it and I say, look, here we have had Hurricane Sandy, slightly less than $20 billion, and it has barely caused a blip. If anything, reinsurance rates have gone down.

I look at wildfires in California and Nevada and Utah, all through the entire West, storms in the Northeast, hurricanes. The industry, as a natural course, almost ritualistically every year pays out $15 billion, $20 billion to $25 billion in catastrophe.

So my approach to this entire issue was can the private market, in effect, take over at a much higher stage than that $100 million? And while I am in favor of renewing TRIA for an extended period of time—5 years, 10 years, whatever it may be—I also think that I would suggest that we can take steps to make it more private-market friendly.

First of all, my suggestion would be that you take a very close look at that $100 million trigger, that it could—when you look at, again, what the industry has been able to cover in the billions—$20 billion, $15 billion, $25 billion—that trigger can be set much higher than what it currently is.

I would caution that we are not quite sure here whether the money that has come into this industry is really what I would call hot money—quick in, quick out. I would caution that there are still some modeling problems with this. I would caution that the data isn't the best in the world.

So I would suggest that if you were to take that kind of approach, it can be staggered. All of this is severable. You can do it in pieces and parts. But take a close look at that trigger.

The second thing I would suggest is there is room for increasing both the horizontal kind of deductible as well as that vertical kind of cost-sharing arrangement. Increase it by 10, 15 percent or so to leave the industry with more skin in the game. And also, it would reflect the fact that there is much more capacity in the industry.

And then third, I would suggest you take a close look at charging for this. You charge for flood insurance, albeit the charges that you have are inadequate. Nonetheless, people pay for flood insurance.

As far as the insurance-linked securities market is concerned, I would suggest you take a very close look at the accounting environment and at the tax environment.

I would love to bring this industry back onshore. It is down 90 percent in the Cayman Islands in terms of these special purpose vehicles. Bring it back onshore, allow some tax flow so that there is no double taxation, perhaps look at how it is reserved, and certainly look at the accounting issue where there is an enormous difference between how these insurance-linked securities are treated for creditor insurance versus true insurance.

Again, I thank you for the opportunity and, of course, I am open to questions whenever this committee is ready. Thank you very much.

[The prepared statement of Mr. Csiszar can be found on page 44 of the appendix.]

Chairman NEUGEBAUER. Thank you.

Dr. Seo?

STATEMENT OF JOHN S. SEO, CO-FOUNDER AND MANAGING PRINCIPAL, FERMAT CAPITAL MANAGEMENT, LLC

Mr. SEO. Thank you, Mr. Chairman. Good morning.

My name is John Seo. I am a co-founder and managing principal, along with my brother, Nelson Seo, of Fermat Capital Management, which is believed to be the largest investment manager of catastrophe bonds, or so-called cat bonds, worldwide.

Hurricane Andrew in 1992 and the Northridge Earthquake in 1994 caused many insurers to realize that they were sitting on top of a risk of ruin they didn't realize they had before. It was judged that the capital market, with its much bigger capital base, could safely remove this risk of ruin from insurers and so the cat bond market was invented in the mid to late 1990s.

To investors, cat bonds operate just like corporate bonds, depending on your point of view. Corporate bonds are effectively cat bonds that happen to cover credit risk and cat bonds are just corporate bonds that cover insurance risk.

Over the years, the reinsurance equivalent of cat bonds, collateralized reinsurance, as paralleled the development of the cat bond market virtually dollar for dollar. Together, cat bonds and collateralized reinsurance are called insurance-linked securities or just ILS. Today, I will speak to the ILS market as it relates to terrorism insurance.

The ILS market currently stands at $45 billion. Risk coverage has gone beyond hurricane and earthquake to include such things as tornado, hail, wildfire, disease, flood, and of course, terrorism.

The ILS investor base is distinctly global in nature and enjoys significant participation from all investor categories.

Innovation remains a hallmark of ILS markets. For example, a flood bond covering the New York Metropolitan Transportation Authority was issued this year in July.

It is generally accepted that we are at the beginning of a burgeoning market for flood bonds. Only a few years ago, most market observers would have considered such a thing as nearly impossible.

Regarding terrorism specifically, the cat bond side of the ILS market covers only $1.4 billion in terrorism risk. If we extrapolate that to the other half of the ILS market we can reasonably estimate that capital markets cover roughly $3 billion of terrorism risk today in total.

At current rates of growth, the ILS market is expected to be in the range of $150 billion to $200 billion by 2020. By mere extrapolation from our current condition, this would put ILS terrorism capacity at $9 billion to $12 billion by the end of this decade.

Now, I know some market observers have questioned whether or not capital markets are fundamentally cut out for terrorism risk. In particular, a common misunderstanding is that investors strictly avoid ILS investments that cover events which may also cause temporary drops in the stock market.

I say plainly, this is not true. If it were, we would have no earthquake bonds.

I explain all of this in excruciating detail in my written testimony so let me summarize my view on this matter as follows: ILS investors care mainly about fair compensation for the risk and everything else is secondary to that.

I now end my testimony by briefly touching on two ways to increase capital markets efficiency for terrorism risk. Cat bond coverage for terrorism risk is typically bundled with life and health risks. Of course, that is not surprising, but additional bundling could increase efficiency of coverage, for example, bundling terrorism, life, and earthquake risk in one transaction.

The main intuition here is simple: Risk bundling reduces frictional cost.

Finally, coverage for terrorism risk in the cat bond market currently includes NBCR. There is no doubt in my mind that NBCR coverage is holding back market capacity.

If NBCR were more commonly excluded from coverage, capital markets' capacity for terrorism risk would increase significantly from current levels.

Thank for this opportunity to testify before the Subcommittee on Housing and Insurance today. I look forward to answering any questions you may have.

[The prepared statement of Dr. Seo can be found on page 100 of the appendix.]

Chairman NEUGEBAUER. Dr. Hartwig, you are recognized for 5 minutes.

STATEMENT OF ROBERT P. HARTWIG, PRESIDENT AND ECONOMIST, THE INSURANCE INFORMATION INSTITUTE

Mr. HARTWIG. Thank you, Chairman Neugebauer, Ranking Member Capuano, and members of the subcommittee. My name is Robert Hartwig and I am president and economist for the Insurance Information Institute, an international property-casualty insurance trade association.

I appreciate the opportunity to have been asked by the committee to provide testimony on TRIA and the market for terrorism insurance in the United States.

The terrorist attacks of September 11, 2001, produced insured losses larger than any natural or manmade event in history. Claims paid by insurers to their policyholders eventually totaled $42 billion in today's terms.

Exclusions proliferated, prices soared, and very little private sector capacity for terrorism entered the market as the general consensus emerged that terrorism risk is fundamentally not insurable.

Only when TRIA was enacted by Congress in late 2002 did stability finally return to the market and coverage for terrorist attacks resume.

Eleven years later, the war on terror is far from over, as April's Boston Marathon bombings attest. But TRIA by all objective measures is now an unqualified success.

The program not only succeeded in restoring stability to the country's vital insurance and reinsurance markets, but it has done so at effectively no cost to taxpayers.

Indeed, TRIA as currently structured provides at least eight levels of protection to taxpayers while fostering competition among insurers of all sizes. And I document those in my written testimony.

The unambiguous success of TRIA demonstrates that the Act has become an indispensable component of the country's national security infrastructure. Under TRIA, private insurance, not government aid, is the principal funding and delivering mechanism that will drive rebuilding efforts and economic recovery after any future attack.

One hundred percent of the losses up to $100 billion will be financed directly by private insurers or can be recouped in full through assessments on the private sector. In the event TRIA is allowed to expire or its structure significantly altered, the preponderance of the burden for funding post-attack recovery efforts could well shift to the Federal taxpayer.

While there is no question that private insurers and reinsurers would continue to offer limited amounts of terrorism coverage, there is also no question that in the absence of TRIA, private insurance and reinsurance market capacity, for several reasons, will be diminished relative to what is currently available and purchased today.

Primary insurers, for example, may be forced to scale back their sale of terrorism insurance due to rating agency and regulatory pressure. Already, the leading insurance rating agency, A.M. Best Company, has subjected insurers to stress tests involving simulated terrorist attack scenarios.

Those insurers that failed the stress test are required to present an action plan detailing the steps that they will take to "reduce concentration of exposure to terrorism risk, should TRIA protection change materially."

In the event the insurer's action plan is deemed to be insufficient, "the rating unit will face negative rating pressure."

A.M. Best concerns run deeper still, adding that while private reinsurance is currently available in the market, future availability and affordability of this coverage is "uncertain in the event TRIA is not renewed or if the program changes significantly."

The same stress test analysis shows that smaller insurers would be disproportionately impacted by major changes in TRIA. Preserving a TRIA structure that encourages market participation among insurers of all sizes is critical.

More than 90 percent of small- and medium-sized insurers write TRIA coverage today. An Insurance Information Institute analysis of market shares indicates that insurers with less than $1 billion in surplus provided nearly a quarter of the U.S. TRIA capacity in 2012.

One corollary to this finding is that many insurers, particularly small- and medium-sized insurers, are already at or near their maximum exposure to terrorism risk. This means that changes to the program that would increase their exposure would not motivate them to write more coverage.

Indeed, the opposite is likely to happen. The bottom line is that any dramatic changes to the program are likely to be highly disruptive to a large share of the market, potentially reducing competition.

Expiration of TRIA or a major restructuring of its key provision threatens to turn the market, in effect, into Swiss cheese. By that, I mean a market that on its surface may give the appearance of being solid but which, in reality, is riddled with holes.

These holes are coverage gaps and shortfalls that could leave millions of American businesses and workers as well as taxpayers needlessly vulnerable. These holes and gaps will impact every industry in every region of the country, and the Federal Government will be called upon to fill these gaps in the event of future attacks.

In conclusion, a purely objective assessment of TRIA in its current form is very encouraging from a cost-benefit perspective. TRIA has brought much needed stability and capacity to the market, benefiting the entire U.S. economy, and it has done so within a fiscally responsible framework.

The program has no major structural defects. Moreover, there is no evidence that the existence of TRIA crowds out capacity or stifles innovation in traditional or ILS markets. In the 11 years since TRIA was enacted, private sector capacity has gradually expanded in the market not in spite of TRIA but because of it.

Thank you for the opportunity to testify before the committee today. I would be happy to respond to your questions.

[The statement of Dr. Hartwig can be found on page 66 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman, and I thank the panel.

And we will now go to a question-and-answer period. Each Member will be recognized for 5 minutes.

And I will recognize myself for 5 minutes.

Mr. Driscoll, since 9/11 the global insurance and reinsurance industry has shown remarkable resilience. They have taken, I think—for example, in 5 of the last 11 years since 9/11, insurers and reinsurers have absorbed catastrophic losses greater than $47 billion.

Despite these losses, the industry capital has hit near-record highs and the reinsurance capital particularly is over $500 billion. With these strong capital positions in both the insurance industry and the reinsurance, coupled with the modeling efforts that have moved forward on terrorism insurance, it appears to me that the industry is ripe to have more private sector participation. Would you agree with that?

Mr. DRISCOLL. Absolutely. We have grown the capital base of our industry over 300 percent since 2001. We responded to Hurricanes Katrina, Rita, and Wilma in 2005, the four storms that impacted Florida in 2004 to the financial crisis in 2008, and to over $100 billion in natural cat losses in 2011 on a global basis. And our industry collective balance sheet has never been stronger.

Further to that, I think the willingness and ability to both price and manage conventional terrorism risk is at an all-time high. So, I absolutely agree with your comments.

Chairman NEUGEBAUER. Thank you.

Mr. Csiszar, insured losses from the 9/11 attacks in today's dollars I think is estimated to be over $40 billion. The industry was able to absorb that, with some difficulty.

So 12 years removed from that, we have not seen any attacks. But there have been major efforts in modeling terrorism.

You mentioned in your testimony that the current $100 million trigger is probably too low, and that there is capacity in the industry to take on more of that risk. And so would the fact that the industry has, over the last few years, absorbed fairly major events in the $25 billion, $30 billion, $40 billion range, what would be your suggestion as an appropriate trigger if we were to change that?

Mr. CSISZAR. I look at two things, Mr. Chairman. First of all, if you were to withdraw the entire backstop you are looking at creating a crater of 20 percent, basically. That is huge. They can't handle that.

So what could we put in place to make it palatable? One thing I looked at, for instance, was we have these ILS, they are called, industry loss warranties. And these are in the private markets.

What is the trigger in the private market? In the private market, ironically, the most typical trigger for an ILW, industry loss warranty, is $20 billion. Now, you can purchase $10 billion or $15 billion, but it is a lot more expensive to purchase that.

So my thought, in looking at what the industry loses on an annual basis, as I said earlier, almost ritualistically paid out in catastrophes, is somewhere between $15 billion and $25 billion. Then, you have this industry loss warranty trigger at $20 billion. Somewhere in that range is what I would suggest.

Chairman NEUGEBAUER. Thank you.

Mr. McGovern, recently some insurers have expressed their willingness to underwrite terrorism risk for commercial property even if the current program were to expire. For example, John Doyle, AIG CEO of Global Commercial Insurance, said he could see a market emerging fairly quickly for property risk absent a backstop.

The CEO global corporate at Zurich also said his company would continue to offer property coverage to his clients without a backstop. Mr. Greenberg, CEO of CBR, has also made similar comments.

Since Lloyd's is one of the industry's leaders in providing standalone terrorism insurance, at a minimum do you feel that the current program is too generous for property coverage?

Mr. MCGOVERN. Lloyd's is a major leader in the standalone market but I think we need to keep the level of capacity in perspective. We calculate that our standalone terrorism market in premium terms at Lloyd's for U.S. risks amounts to $460 million of premium for U.S. standalone terrorism.

Put that in the context of our overall premium income from the United States at $12 billion. I think that tells you something about the capacity of the market to allocate capacity to major U.S. terrorism risks.

I think the other point that—and it is clear that capacity is growing. I think what we worry about is the aggregation of risk in key urban centers where asset values mean the ability of the industry to absorb major exposures is always going to be somewhat limited.

Chairman NEUGEBAUER. My time has expired.

And now the gentlewoman from California, the ranking member of the full Financial Services Committee, Ms. Waters, is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Neugebauer.

And I would like to thank all of our panelists who are here today.

Of course, we all think about TRIA in relationship to 9/11. And as it was said by perhaps more than one of the panelists today, there is nothing to compare with what took place on 9/11—the destruction, the loss of life and property, et cetera.

And so I am somewhat baffled by any resistance to making sure that we have the kind of coverage that TRIA would provide in the event of another terrorist attack. Those of us who—I guess all of us are concerned about terrorism. All of us are concerned about the ability for our country to not only prohibit these kinds of acts but about restoration in the event of such catastrophe.

Now, we have a lot of information. I am told that reinsurance is a vital component of terrorism insurance coverage; in the aftermath of September 11th, the reinsurance industry fled the market.

Can you discuss the extent to which the reinsurance industry has re-entered the market, if at all? How limited is current insurance capacity?

And I guess I would like to start with Mr. Sean McGovern, the director of risk management and general counsel at Lloyd's of London. Would you respond to that?

Mr. MCGOVERN. Thank you for the question. It is clear that the reinsurance market overall has grown, the global market has grown, the North American reinsurance market has grown. And indeed, the reinsurance market for terrorism risk has grown.

And the estimates I have heard is that the terrorism reinsurance market in the United States is about $6 billion to $10 billion. Compare that to the industry retentions, which are currently estimated to be about $35 billion. There is clearly somewhat of a gap there.

Now, it is clear that the reinsurance market could grow further. I think the challenge we all have is that clearly, thankfully, we have not had an event for many, many years. And that inevitably has an impact on availability and price.

It is true to say that when events occur, people take different view of risk and people price risk differently. And that inevitably has an impact on capacity and price.

Ms. WATERS. So what you are telling me in essence is that if an event such as 9/11 occurred today, that the reinsurance market, even with its growth, would not be able to handle it. Is that correct?

Mr. MCGOVERN. No. That is not what I am saying. I am saying that actually the reinsurance industry could handle that because of TRIA. The TRIA program actually gives the insurance and the reinsurance industry the confidence to offer and make available coverage.

Ms. WATERS. Thank you very much.

Mr. Hartwig, you gave very powerful testimony. And I learned something about the stress tests that you described.

Could you tell us how those stress tests are being carried out? Who is being identified as the companies that have capacity, stress tests? And how is it going?

Mr. HARTWIG. Right. So it is the best known of the rating agencies, insurance rating agencies, A.M. Best, which has carried out these tests. They have looked at nearly 900 so-called rating units, and they have looked at several hundred that have significant terrorism exposure.

And the test that they basically run them through at this point is actually a very, very modest test, something like a 5- to 6-ton truck bomb, okay? That doesn't even come close to approaching a 9/11-type event.

And so what they have found is that in the absence of TRIA or a major restructuring of TRIA that would require insurers to take on much more risk, they found that some insurers are, in effect, overexposed today under that scenario in the absence of TRIA or a TRIA that is significantly restructured.

Obviously, the larger the event that you would have, you would expect to see more of this experience. So each and every one of these insurers are going to be required to put together a plan, and if that plan is inadequate they potentially face downgrade action.

That raises their cost of capital, could cause the cost of their reinsurance to rise, and many customers may not do business with them, and those kinds of scenarios.

So it is an environment in which it is possible where, under these stress tests, the available capacity winds up being reduced in the marketplace, reducing competition.

The point I wanted to make there is that small insurers may be small, but small- and medium-sized insurers as a group provide a quarter of the TRIA capacity in the market today.

Chairman NEUGEBAUER. The time of the gentlelady has expired.

Ms. WATERS. Thank you very much.

Chairman NEUGEBAUER. The vice chairman of the subcommittee, Mr. Luetkemeyer, the gentleman from Missouri, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. McGovern, as someone who is from another country who insures risks around the world, you indicated that there are other countries that have terrorism insurance coverage for their properties in those countries and you participate in those.

Can you explain or give us an idea of some of the backstops that other governments have? And are there any governments that do not provide this backstop, so that the businesses within those countries are totally insured by the private sector or take the risk themselves?

Mr. MCGOVERN. There are a variety of programs around the world. Some countries don't have programs. But in the major European economies like the U.K., France, and Germany, for example, there are programs that have existed for some considerable time.

Perhaps focus on the U.K. The U.K. program is a pooling program with the industry, so there is an industry pool. The backstop that the government provides is unlimited for all types of terrorism cover. The industry pays a premium for that coverage.

Pool Re, which is the company that operates the pool, is sitting on 5 billion pounds worth of assets. So it can be made to work, to have a mechanism whereby the industry pays for the government backstop. Arrangements in other countries are different.

Mr. LUETKEMEYER. Okay. You indicated that you apparently had insured or provided terrorism risk insurance here in this country before 9/11. Is that correct?

Mr. MCGOVERN. Terrorism insurance was generally just folded into all risk policies, so it wasn't—

Mr. LUETKEMEYER. Okay. My question is, if you were here before 9/11, how did you model it?

Mr. MCGOVERN. Interestingly, before 9/11 no one really modeled terrorism risk in the United States. We modeled terrorism risk in the U.K.

Mr. LUETKEMEYER. So it was just a throw-in coverage at that point.

Mr. MCGOVERN. It was not excluded from the policy.

Mr. LUETKEMEYER. Since then you do model, I take it?

Mr. MCGOVERN. We do model, and there have been developments in modeling terrorism risk. But those models are limited by the quality of real event information.

Mr. LUETKEMEYER. Okay. One of the things that has been discussed a couple different times already—and Mr. Hartwig brought it up—is the problem with if we change the structure of our system right now we may squeeze out some of the small or midsize guys.

Mr. Driscoll's testimony indicates that there continues to be an influx of cash into this industry, into the reinsurance industry, so that there is capacity to take on more risk.

Mr. Driscoll, how do you respond to Mr. Hartwig's comment about the risk to the small or midsize folks? Are they growing enough to accept some more additional risk themselves, to be a continued participant if we make changes? Or do you think that if we make some significant changes they may be out in the cold, they won't be able to participate in this?

Mr. DRISCOLL. Yes. The smaller insurance companies are a critically vital, important component of the overall industry, but a very important part of our portfolio.

And we are sensitive, I think, to the needs of smaller insurance companies. They tend to be much more reliant on purchasing reinsurance protection for really any perils, whether it be natural catastrophes or terrorism.

So from our perspective as a reinsurance capacity provider, we are raising our hands saying we are willing to support the smaller segments of the insurance industry.

The challenge that the smaller insurance companies have is the inability to effectively recoup terrorism rate. And this is really a function of the fact that TRIA is a subsidized program. It inhibits the natural process of charging an appropriate risk premium.

At the State level, a lot of these companies are inhibited with how much terrorism premium they are able to recoup. So there is a natural mechanism by modifying TRIA and opening up the amount of risk that the private industry is willing to take that should feed through into the ability for insurance companies, particularly smaller ones, to charge more premium and thus be able to purchase more reinsurance. So there is really a natural environment that exists.

Mr. LUETKEMEYER. One last question before I run out of time here along the same line. It would seem to me that as you sort of transition away from the government backstop, larger—a much more large—a larger portion being taken over by the private sector, is there—do you think the reaction by the private sector would be to be able to cap themselves with their own risk?

In other words, if you are a small company, you would only take a certain portion. You wouldn't have an unlimited backstop on the upper end. You would only take on so much risk and then you would partner with somebody else to be able to take on a large risk? Or is that a viable option?

Mr. DRISCOLL. Yes. I think that it is a viable option. A central tenet of any well-run and well-managed insurance company is to balance the amount of risk you take against your capital base. So that process occurs every day.

And there are financial mechanisms, particularly within the reinsurance industry, that will help facilitate the capital construct of smaller insurance companies, whether it be proportional or excess protections.

Mr. LUETKEMEYER. Thank you.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Missouri, Mr. Cleaver, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

I am going to be a little parochial in presenting my questions. I am from Missouri, and you have a problem if you live in Missouri because if you come to Kansas, people say they land—"I have just landed here in Kansas."

And of course if you land in Kansas, you die, because there is no airport. Some sports person just wrote a deal last week about the 9-0 Chiefs saying, "We are going to play descendants of Dorothy." And of course, I don't think a woman in Missouri is named Dorothy.

But one of the things that we have to deal with is we have—the Missouri River is the longest river in North America. It is the longest tributary in the United States.

Well, 54 bridges, all of which are insured by TRIA, or that is a part of the insurance. Most people when they think about terrorism, they are thinking of New York, the East Coast, Los Angeles, or maybe Chicago.

But we have serious targets, or what we think would be targets. So this is not, for me, just a committee exercise. It is very real. Our power and light company is insured through TRIA.

I guess one of the questions I am interested in—maybe just hearing any of you—and I try to avoid volatile words, but how many of you believe that TRIA is corporate welfare? Is there anybody who believes that?

Mr. DRISCOLL. I will answer that question. I wouldn't use the phrase "corporate welfare," but there is an unnatural element to

TRIA in the sense that it is free and you are trying to transfer risk for free. And so in that respect it creates unintended consequences that in some cases are beneficial, but more often than not are problematic.

Mr. CLEAVER. Anyone else?

Mr. Hartwig?

Mr. HARTWIG. Again, as has been alluded to a number of times, I think, on this panel and on the committee, I think that we have to look at the unique nature of terrorism risk, that ultimately the bearer of that risk should be the entity that possesses the greatest information associated with that risk.

And that is certainly not anybody at this table. In fact, that is the Federal Government.

And so when you are in a position like that, I think we have to rethink the particular issue here, that it is absolutely appropriate, in a circumstance such as this, that some of the risk be shared in a public-private sector manner.

Mr. CLEAVER. Does TRIA replace what would be significant government exposure, Mr. Seo?

Mr. SEO. I'm sorry. Would you repeat the question. Does it replace—

Mr. CLEAVER. Yes.

Mr. SEO. —what would be—

Mr. CLEAVER. Significant exposure by the Federal Government.

Mr. SEO. I see.

Mr. CLEAVER. By the taxpayers.

Mr. SEO. Right. Potentially, it does. There is a delicate balance in the industry around a risk like this.

So I think there is some credence to the notion that by taking on the risk in a controlled manner through TRIA, the government is potentially reducing its long-term liability.

And actually to answer your question about the welfare, I think initially not, but of course, the question is when does it cross over and become that way? And that is an over-time issue, not necessarily by-design issue.

Mr. CLEAVER. Yes.

Mr. HARTWIG. Sir?

Could I—just very quickly, it absolutely—TRIA does insulate the taxpayer, again, to the tune of many, many tens of billions of dollars. But you are also, in effect, you are buying the delivery mechanism.

The reality is that the Federal Government has no effective means for delivering the benefits in the absence of a TRIA-like structure where it utilizes or piggybacks, in effect, on insurers.

In the absence of a TRIA situation, you wind up with a post-Sandy, FEMA-type scenario where people are still waiting for their Federal Government aid.

Mr. CLEAVER. Yes.

Mr. McGovern, what do you think would happen to the uninsured losses if there is a terrorist event? Who do you think will be approached to deal with uninsured losses?

Mr. MCGOVERN. The insurance industry will deal with the insured losses as it has always done—

Mr. CLEAVER. No, but the uninsured?

Mr. McGOVERN. The uninsured losses?

Mr. CLEAVER. Yes.

Mr. McGOVERN. That is a matter for Congress and the Federal Government.

Mr. CLEAVER. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Now, the gentleman from New Jersey, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. Again, thank you, Mr. Chairman, for holding this hearing. I just have a couple of questions.

Mr. McGovern, I will start with you, I guess. The CEO of one of the world's larger terrorism insurers was recently asked about the modelability of conventional terrorism risk, and that CEO stated that the insurance industry "doesn't service itself well by claiming that terrorism risk can't be modeled effectively," and "The argument that the industry cannot underwrite conventional terrorism was a classic example of driving business out of the market and into the government solutions."

Would you like to comment? Do you disagree with the statement of I guess one of your competitors out there?

Mr. McGOVERN. It is true to say that terrorism risk modeling does exist. But, as I said in my testimony, it is in its infancy. At the end of the day, models are just models. They should inform your decision; they shouldn't drive your decision.

Models are at their most reliable when they have lots of real-life world events inputted, which is why catastrophe risk modeling is so much more advanced than terrorism risk modeling, because we have had a lot of natural catastrophe events, which makes models more reliable.

Mr. GARRETT. Okay.

Mr. McGOVERN. Terrorism risk models are there, but I think people have a cautious approach to value of those risk models—

Mr. GARRETT. How long have you been doing it in Europe, modeling it?

Mr. McGOVERN. I wouldn't want to put a year on it, but clearly—

Mr. GARRETT. Ballpark, like 5 years, 6 years?

Mr. McGOVERN. Probably 20 years.

Mr. GARRETT. Yes, because it goes back quite a ways, I thought. Yes.

Mr. McGOVERN. Yes.

Mr. GARRETT. How many years is an appropriate amount of time to say we actually have a model there?

Mr. McGOVERN. Thankfully, the frequency of these events is very low—

Mr. GARRETT. Right.

Mr. McGOVERN. And that has an impact on the validity of models.

Mr. GARRETT. Right.

Dr. Hartwig, you said there are no major structural defects in the law right now. Let's look at Boston. Can you or anybody else tell me, was Boston a terrorist attack event? Has that decision been made yet?

Mr. HARTWIG. As defined under TRIA, there has been no certification associated with that. In my testimony, and I think in the testimony of others, I think that there has been a call for a clarification of the certification process.

Mr. GARRETT. That is a pretty big major structural—if we don't—after an event which, if you recall, was—

Mr. HARTWIG. I think it is generally agreed that there needs to be some tightening of that certification process, and I and others have called for that.

Mr. GARRETT. Okay.

Mr. Driscoll, in order to not establish, but to grow the market into these areas, if we were to modify TRIA as it stands right now—raise the caps, do some other structural changes, what have you—is there an appropriate length of time that we should do so in legislation?

In other words, you have two ends of any spectrum, right? One is to say, "We are going to do this—the next TRIA bill is only going to be for 12 months, so the next one is going to be a permanent temporary program."

So what would the industry be looking at in order to be responsive?

Mr. DRISCOLL. I can only speak for Validus Re rather than the industry, but—

Mr. GARRETT. Okay.

Mr. DRISCOLL. —from our perspective, the changes to the program that we think would be most beneficial should be largely nuanced.

One, there is a permanence that could be considered in context of nuclear, chemical, biological, and radiological. From our perspective, we feel strongly that those are uninsurable risks, not in the determination of frequency, but the severity and potential to bankrupt the industry. And so, a government backstop with respect to that element or that type of terrorism is vitally important.

With respect to conventional, the industry capital base is growing. It continues to grow. We are highly confident in its permanence and reliability.

We would expect that any changes to avoid dislocation in the market, whether it to be to workers' comp insurers or smaller insurers or the largest insurers, should be done gradually over time.

And so whether that is 2 years or 5 years, there ought to be a glide path that would help the industry capital flow in, and respond to the additional demand.

Mr. GARRETT. Okay.

And I guess I will just make a comment on a question—that is to a question on the other side. At the end of the day, anything that we do here is not eliminating the risk. Is that correct?

Mr. DRISCOLL. Absolutely.

Mr. GARRETT. And so all we are really doing is deciding who pays, whether it is the person who—the individual, the entity who has the beneficial use of the asset—

Mr. DRISCOLL. Yes.

Mr. GARRETT. —whether that person pays for the fact or the privilege or the right of having that asset, or whether it is the American taxpayer who is actually footing the bill.

That is ultimately what we are deciding. Who pays? The person who benefits or the taxpayer?

Mr. DRISCOLL. Absolutely. The strength of our industry is the capital construct that helps facilitate fund inflows after disruptive events to help rebuild our infrastructure and get our citizens back on their feet.

Mr. GARRETT. Thanks a lot. I appreciate it.

Chairman NEUGEBAUER. I thank the gentleman.

The gentlewoman from Arizona, Ms. Sinema, is recognized for 5 minutes.

Ms. SINEMA. Thank you, Mr. Chairman.

My question is directed to any of the gentlemen who are on the panel. And thank you all so much for being here today.

My district in Arizona is home to the largest public university in the country, Arizona State University. There is significant concern at home that with a possible elimination of TRIA coverage or without the opportunity to get TRIA coverage that ASU may not be able to afford terrorism coverage on its own.

I am wondering if any of you could expand on the impact that the expiration or adjustment of TRIA would have on our Nation's public universities such as mine.

Mr. MCGOVERN. I can't comment specifically on universities, but I think if we felt—if Lloyd's felt that TRIA was crowding out the private market, our testimony would be different today.

Second, and as I have said before and as other panelists have said, capacity is in the market because TRIA exists. Without TRIA, I think there would be uncertainty for policyholders around the country as to whether or not they would be able to get adequate coverage for terrorism risk.

Mr. HARTWIG. And if I could add on specifically to your question about universities, when you think about the diversity of the exposures of property, liability, workers' compensation, exposures that exist on a campus like ASU, you are talking about scientific facilities, you are talking about sports stadiums, you are talking about dormitories with thousands of students, classrooms with thousands of students. You are talking about many other types of—you are talking about infrastructure associated with the university.

You are talking about a type of risk that can only be insured today really because of the existence of TRIA, just to echo what Mr. McGovern said. It is a very diverse risk and I think one that is particularly dependent on TRIA.

Ms. SINEMA. Thank you, Mr. Chairman.

And, Dr. Hartwig, a follow-up question: I remember in the immediate aftermath of September 11th, the commercial property and casualty insurance market for terrorism coverage basically evaporated. And then again in 2005 and 2007, when expiration of the program was looming in Congress, a majority of insurance companies in our country moved to file conditional exclusions, indicating that they wouldn't be interested in offering terrorism coverage absent TRIA.

Has anything changed in the market since 2007 that would give this panel or this body cause for optimism that the private market is willing to accept significantly more terrorism risk than we have seen in the past?

Mr. HARTWIG. Incrementally, over the last 6 or 7 years, we have seen some capacity come into the market, and, as I said, incrementally. And as I said in my testimony, the reason that capacity came in is not in spite of TRIA; it is because of it.

It is also because of the fact that we have not had a major successful terrorist attack on U.S. soil. Again, if we had had one—and there have been dozens of attempts on U.S. soil, thankfully, all but one of which has been thwarted—I think we would be having a very different conversation here today.

So at the end of the day, it is likely that these conditional exclusions are going to come back into the market as we move into 2014 and markets begin to look ahead to the 01/01/2015 period, a period in which TRIA might not be in place without a reauthorization.

Ms. SINEMA. Thank you.

And Mr. Chairman and panel, one final question.

Dr. Hartwig, you briefly mentioned the issue of workers' compensation insurance. Businesses in Arizona are required to purchase workers' compensation insurance. They don't have the option to exclude coverage for acts of terrorism in the context of workers' comp. So for those that provide workers' comp coverage, it is mandatory to include this terrorism coverage.

What would be the impact of this body not reauthorizing TRIA or significantly changing the structure of TRIA to individuals who are purchasing workers' compensation for their employees?

Mr. HARTWIG. Basically, every employer in America has to buy workers' compensation coverage. It is required by law in all 50 States, not just in Arizona. And it is also the case that under law, insurers cannot exclude terrorism coverage under a workers' compensation policy.

So I think we have heard several times on the panel already that is a particular area of concern that really if there is a bottleneck in terms of capacity, it exists in a number of places, but it is particularly explicit or particularly strong in the area of workers' compensation.

Ms. SINEMA. Thank you, Mr. Chairman.

And thank you, Dr. Hartwig.

Mr. Chairman, this is a growing concern for employers in my district so thank you for allowing me the opportunity to speak.

Mr. DRISCOLL. Mr. Chairman, may I have a moment just to respond to one of the earlier questions, with respect to post-event and the industry response?

I think it is important to understand that the perception around transnational terrorism risk prior to 2011 within the insurance industry was that it was not a major risk. And so I think it is reasonable post-event for there to be a natural reassessment of risk. We see that with any unique event that occurs in our industry.

Since that time, the market has responded with significant additional capacity and additional capital for terrorism risk.

Ms. SINEMA. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Florida, Mr. Ross, is recognized for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

As I mentioned in my opening statement, I very much believe in market-based solutions for risk problems, and I see TRIA as being a necessary evil at the time that we created it. Based on the testimony today, I understand the significance of maintaining TRIA in place, but I also understand that it is very important that we have to make a transition.

And hearing from the panel today that we have a significant amount of private capital and capacity in the private markets out there is very encouraging. Now, how do we make that transition to provide more incentives and less impediments, is an issue that we have to face.

Dr. Seo, one of the things that has intrigued me ever since I read your article several years ago about the Nation's casino has been the use of ILSs. These cat bonds—we have used them in Florida for our Florida Hurricane Catastrophe Fund—seem to be an opportunity for diversification and growth, in terms of market share, that may offer us an opportunity to make available more capacity in the private sector.

You mention in your testimony that if terrorism risk were bundled with natural catastrophe risk, such as hurricane and earthquake, the efficiency of ILS coverage for terrorism risk could potentially be improved. Would you elaborate how this would benefit all types of coverage, not only terrorism, but maybe also natural catastrophe coverage?

Mr. SEO. In this case, actually, the benefit was to the terrorism risk.

Mr. ROSS. Right.

Mr. SEO. And I would say that the impact on the natural catastrophe coverage is relatively neutral.

Mr. ROSS. But it wouldn't—would you consider there would be an increase or a decrease, or would it just remain stable?

Mr. SEO. Overall efficiency in the system would be increased for sure—

Mr. ROSS. Good.

Mr. SEO. —by doing this type of bundling arrangement. See, that is the difficulty when you isolate risk too much on a standalone basis—any risk—it becomes very expensive to cover.

Mr. ROSS. So you combine the risks?

Mr. SEO. Correct.

Mr. ROSS. Let me ask you this question: Could we—and I hate to digress on this, but I have to ask this question because the NFIP is an issue that we have to face, but could the use of these insurance-linked securities assist us in diluting and reducing the amount of premiums in the flood insurance program?

Mr. SEO. Yes, absolutely.

Mr. ROSS. Good.

Mr. Driscoll, one of the things that I am concerned about is not only incentives, but impediments to private capital. And I am sure you are familiar with the Obama-Neal reinsurance tax that is out there, which concerns me greatly.

Do you feel that this tax would limit the capacity or the capability of insurers and reinsurers to take on more risk from terrorism or flooding and thus be counterproductive to our long-term plan to try to bring back or at least create a private market and reduce the size of government involvement?

Mr. DRISCOLL. Yes. Whether it is flooding, terrorism, or any other natural peril, reinsurers need to be able to pool risk to gain diversification. And any limits on affiliated reinsurance would impede global risk-pooling—

Mr. ROSS. Significantly.

Mr. DRISCOLL. —and that, in essence, fragments group capital and would impede market development, and I think ultimately it increases consumer price.

Mr. ROSS. Dr. Hartwig, it has been talked about, in fact by Mr. Csiszar, with regard to workers' compensation insurance. Look, it is as strict liability statute. It requires that every employer provide it. We understand that it is backed predominantly by reinsurance and reinsurance instruments.

And I think that the impact financially doesn't come initially from the occurrence of an event as to the availability and affordability of workers' comp insurance. It has to do with whether there is a market that allows for affordable and available workers' compensation insurance.

So I guess my question is—and I will go to you, Dr. Hartwig—TRIA expires December in 2014. If it expires, what impact would there be on the workers' compensation market for availability and affordability of insurance?

Mr. HARTWIG. For workers' compensation, I think there would be a pretty swift and a pretty significant impact. It would begin well before the end of next year, as again, we are looking forward into 2015. But some carriers might even position themselves ahead of time.

Under the expectation of a lack of TRIA protection beginning in 2015 you would expect insurers, because of this aggregation issue that they have with respect to workers' comp risk, property risk, liability risk, and everything that they are exposed to, they would need to pare that back in some way.

They are also very concerned about workers' comp because the potential liability under a workers' comp claim is effectively unlimited. A building has a certain value; for a human life, someone who may be a quadriplegic, it is unbounded.

Mr. ROSS. Quickly, Mr. Driscoll, I have 10 seconds—you talked about risk mitigation. I think risk management is absolutely important. What do you consider to be risk mitigation in terrorism insurance?

Mr. DRISCOLL. I think, very quickly in context of property, because it is a huge topic—

Mr. ROSS. Structural.

Mr. DRISCOLL. Structurally, I think there are boundaries that could be put in place. There are security measures that are put in place. There are a variety of factors.

All of these things are methods to not only improve the risk but to actually reduce the premium associated with the terrorism surcharge.

Mr. ROSS. Thank you.

My time has expired. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentlewoman from Ohio, Mrs. Beatty, is recognized for 5 minutes.

Mrs. BEATTY. Thank you so much, Mr. Chairman, and Ranking Member Capuano.

And again, to all of our panelists, let me just repeat what I said in my opening remarks, and thank you for being here and for your testimony.

As you can probably imagine, it is just amazing for me to be a freshman serving here in Congress and to be able to go back and say to my constituents that I have had the opportunity to address such scholarly individuals as you.

It is also equally amazing to be sitting here and talking about all of the issues with TRIA that we are talking about today in this wonderful America that we live in. It is very difficult for me to even believe that I would be sitting in a hearing where people would be against TRIA, against anything that would be protecting us and insuring us from terrorism.

I want to start by also thanking you, because I used to represent one of the largest single campus universities in the United States and worked there as a senior vice president. So when you think about not only universities but K–12 institutions, I want my constituents to see that we are putting a face on what we are doing. And I appreciated your answers and responses to that as well as to the workers' compensation question that my colleague asked of you.

Let me switch and ask you, as we think about policy price sensitivities and government support, has anyone examined the price sensitivities of changes in the trigger value, deductible amount, or co-sharing percentages?

And I can start with you, Mr. McGovern.

Mr. MCGOVERN. We haven't done any of that analysis. And that clearly is the balancing act that Congress is going to need to grapple with as it looks at whether it wants to make changes to the TRIA program.

On the one hand, how do you make changes to the program to introduce more private capacity into the market without, on the other hand, reducing take-up rates in the market or increasing price? Take-up rates generally seem to be around 60 percent nationwide. That is regarded as a success.

If you are changing the program in the name of increasing taxpayer protection, if those changes result in higher prices and lower take-up rates, I would just ask you whether you have achieved what you set out to achieve in making those changes.

Mrs. BEATTY. Any other comments on that?

Mr. CSISZAR. If I could add to that, again, if I look at all the natural catastrophes, and if I look at an event like Hurricane Sandy, in the aftermath of every event, reinsurance prices actually drop, because new capacity comes into the industry in the expectation of making a greater profit. And the next thing you know, they are all going after market share and the profitability that they expected evaporates rather quickly and prices drop.

Mrs. BEATTY. Let me also ask you, what sort of contingency planning has any of your industries undertaken to ensure continuity of coverages for businesses that have secured terrorism risk coverage in the event that there, God forbid, would be a terrorist attack which results in damages that are in excess of the $100 billion cap?

Mr. MCGOVERN. As I mentioned in my testimony, I think Lloyd's has a reputation for continuing to provide coverage when other people don't. And certainly that was the case after 9/11, as was noted by Congresswoman Maloney.

Lloyd's takes its commitments to its policyholders extremely seriously, and whether it is after a natural catastrophe event or after a terrorism event, we will continue to provide as much capacity as we are able to. But as I said in my testimony, we always have to be very mindful of how we are managing our aggregate exposures.

Mrs. BEATTY. And lastly, as we approach the 2014 date, as we look at reauthorization, we have proposals before us with a 5-year reauthorization and a 10-year reauthorization. Do you have any opinions on that, assuming you would be favorable to a 5- or 10-year reauthorization?

Mr. MCGOVERN. Lloyd's is in favor of a long-term extension to TRIA. Whether or not Congress wishes to make any changes to the TRIA program, our belief is that those should be made in the context of maintaining the stability that the TRIA program has already provided, so basically keeping the structure of TRIA as is.

If there are going to be changes, bearing in mind the balancing act that I mentioned earlier, those should be small, incremental changes over a long period of time, which would allow the industry to adapt.

Mr. HARTWIG. And if I could echo that, again, I think what makes the most sense from an economic stability standpoint, from a stability standpoint within the insurance business in general, is a long-term extension. And I should add that when we look abroad at many of the terrorism insurance programs that are abroad, these are long-term permanent programs in effect. They are permanent.

Mrs. BEATTY. Thank you. That sounds like a 10-year extension to me.

Chairman NEUGEBAUER. I thank the gentlewoman.

And now the gentleman from Wisconsin, Mr. Duffy, is recognized for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman.

I appreciate the panel appearing today. I just want to be clear on a couple of facts. In the private market policyholders actually pay a premium for the coverage that they receive. Is that correct? Does anybody disagree with that?

And the way that the current TRIA legislation works is that the taxpayer does not collect a premium for the coverage that they provide. Is that also correct? Do we all agree with that?

Does that provide a competitive advantage when you look at the private market getting involved in terrorism insurance, Mr. Csiszar?

Mr. CSISZAR. Clearly, it is a subsidy.

Mr. DUFFY. Thank you. I would agree.

Mr. CSISZAR. And to the extent that it is a subsidy, I think my friend, Mr. Driscoll, put it well before. The price signals disappear. This is is not a natural market, whereas if you were to charge a price—and I would suggest we don't make the same mistake as we did with the flood insurance, which we underpriced, which made things worse, actually, in a way—but there is certainly that if you can have an actuarially sound premium and that would send the appropriate price signals to the market, not just in terms of capacity but also mitigation efforts.

Mr. DUFFY. Does anybody disagree with that on the panel?

Mr. DRISCOLL. I am a little dubious about the ability of the Federal Government to set a well-established and sound actuarial price, and I say that with the utmost passion—utmost respect. I think the private market can effectively do that, but I am concerned about—

Mr. DUFFY. But if people—

Mr. DRISCOLL. I am concerned that if you establish a premium rate within TRIA, it truly does become a permanent vehicle.

Mr. DUFFY. And I share that concern as well, but to think that we provide reinsurance and don't collect a premium, though, I don't—I share your concern, too, about the government being able to price that.

Mr. DRISCOLL. There is a post-event recoupment mechanism, so there should be, it is never net neutral, but it is designed to be net neutral in terms of the impact on the taxpayer. But it is—again, it is—there are challenges there.

Mr. DUFFY. I agree. My concern is that no market works like that, though, that we are going to try to recoup the cost at some later point from people who may be in the space or not be in the space. It doesn't make a lot of sense for me when I try to protect the taxpayer, but I do get the recoupment.

Mr. McGovern, would you like to respond?

Mr. MCGOVERN. I was just going to add that our experience in the U.K. with Pool Re, where the industry does pay for the government backstop, that is not an actuarial-based pricing; it is a pricing based off your relevant premium. So it is not actuarially sound as a pricing mechanism. It effectively amounts to a tax, and clearly what you have is then you create an infrastructure and bureaucracy around the management of the collection and distribution of those funds.

Mr. DUFFY. But it is actually—it is not a tax because they are providing a product, right? You are actually getting a product, which is reinsurance for terrorism. So the tax argument doesn't really work, does it?

Mr. MCGOVERN. It creates a fund. That is the first fund available for losses outside of people's limits.

Mr. DUFFY. But one would argue that you tax to then redistribute. You are actually paying a fee for a service, which is reinsurance, correct?

Mr. MCGOVERN. Yes, that is right.

Mr. DUFFY. And so I want to make sure that—I don't think the argument that this is a tax holds water.

Mr. Csiszar as well, is it your testimony that you believe that the $100 million trigger is too low and it could actually go up to $20 billion? Is that your testimony?

Mr. CSISZAR. Yes.

Mr. DUFFY. Okay. Does anyone disagree that the $100 million trigger is too low, or does everyone—does the panel think—Mr. Hartwig, do you think the $100 million trigger is about right?

Mr. HARTWIG. I think the programs work very well with the current $100 million trigger, and when we look at the fact that the industry overall is retaining somewhere in the $35 billion range in aggregate, we can see that, in fact, within that space, there has been plenty of participation by private insurers, by private reinsurers, and there is the ability to expand.

As we have already heard, there is only maybe $7 billion, $8 billion, $9 billion dollars of private reinsurance cover for the terrorism market in place today. So there is plenty of gap, there is plenty of room in here to expand.

Mr. DRISCOLL. Just to clarify, on that $7 billion, $8 billion dollars, that is standalone terrorism treaty reinsurance sold in the United States. There are many, many billions of dollars of other terrorism limit sold in the reinsurance market that is bundled together with property and/or casualty. So the market is substantially bigger than—I just want to be crystal clear on that.

Mr. DUFFY. Mr. Driscoll, do you agree that we could increase the $100 million trigger?

Mr. DRISCOLL. I think with respect to conventional terrorism—with nuclear, chemical, biological, and radiological, it is a different dynamic. It is a different type of peril.

But I think with conventional terrorism, the single risk market right now has been estimated by third parties as $2 billion to $2.5 billion. That is one single location. These are large commercial locations, typically in metropolitan areas.

I think if you view the $100 million trigger in the context of a single risk, undoubtedly the market has much more capacity for that. So yes, I would agree.

Mr. DUFFY. My time has expired. I yield back.

I would have liked to have gotten to you, Mr. Csiszar.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. I understand the desire to try to protect the taxpayer and the Treasury, but as we have seen with flood insurance, but even more here with terrorism insurance, if the event occurs Congress is going to pass the supplemental appropriations bill. We can come into this room and be as stingy as Ayn Rand might inspire us to be, but if there is an actual terrorist instance and we are on the Floor, we will be as generous as Monty Hall.

There is no way to protect the Treasury, especially when we are in here. If a hurricane hits, it is not the fault of the Federal Government. And I realize there are environmentalists and climate change and whatever, but certainly the hurricanes that have hit so far. If a terrorist attack occurs on U.S. soil, that will be regarded as a failure of American antiterrorism policy directed by the Federal Government.

So I think our effort here is to develop a system by which the Federal Government will either get premiums in advance or a recruitment process, encourage people to have insurance, and know that we will be providing aid to those who suffer uninsured losses from a terrorist act.

Now, Dr. Hartwig, there have been some who maintain that there have been major improvements in the capital sector's ability to model and price for terrorism risk. Are you aware of such improvements?

Mr. Royce and I just got out of the Foreign Affairs Committee. I don't think there is anyone involved in foreign policy who could give you an actuarially reasonable estimate of what the risk is of a major terrorist act here in the United States. Do you have any—could anybody in your world know how to do this?

Mr. HARTWIG. I think nobody at this table has accurately predicted a terrorist attack before it happened, and I don't think we are about to. And we have heard several times that our ability to model terrorism is very crude and in early stages relative to natural disaster risks such as hurricanes, where we have thousands and thousands of actual data points to run in the system. We have absolutely nothing close to that when it comes to terrorism.

Mr. SHERMAN. And the very fact that we have different rates in different areas—I represent a desert; flood insurance is cheap or unnecessary in most areas. Earthquake insurance is more expensive in Los Angeles than it is in Kansas. That is because you actually know what might happen.

I can't tell you that the Rose Bowl has less or more risk of a terrorist attack than some stadium in another part of the country.

Mr. Csiszar, you said that yield may drive or is driving capital flows into the private reinsurance market. We are seeing yields on bonds and other safer instruments going up. Wouldn't that leave the need for government to continue to act in this capacity, at least for several more years as we see yields on more traditional investments growing?

Mr. CSISZAR. This sector, I think it is fair to say, attracts investors that have a taste for higher risk. And I don't think that doesn't change. That risk premium keeps moving up with the yield on Treasuries and so on. You will always have that spread.

So my sense of it is that it is probably more permanent capital, but on the other hand, the jury is still out because this is a phenomenon that we have only seen in the last 3 or 4 or 5 years since the financial crisis.

Mr. SHERMAN. Okay, but it is—the additional advantage this market has due to the low risks—low yields prevailing in the economy will probably evaporate before Congress acts on the legislation that we are considering.

Mr. CSISZAR. It depends on what the Federal Reserve does, I guess.

Mr. SHERMAN. We will have another hearing on that.

Let's see—my time has virtually expired. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And Mr. Royce from California is recognized for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

As chairman of the House Foreign Affairs Committee, it is clear to me that the threat of global terrorism has not dissipated since 2001. So the question before us today is not whether terrorism insurance is needed for commercial policyholders; the question is what role the Federal Government should play, and will play going forward in the marketplace.

And I was going to ask Mr. Driscoll, in your opening statement you state that there is adequate reinsurance capacity to cover the insurance industry's current $27.5 billion retention under TRIA, and that capacity could grow over time.

How do we gauge this capacity? What sources and numbers should we be looking to as policymakers? How do we maximize the capital stock there, the private capital stock?

And then I was going to ask Mr. McGovern for his comments on this as well. If this committee does adopt a policy of changing the industry retention level, what numbers should we look to? Should it be flexible? Should it be based on market conditions?

And so let's hear from you gentlemen, if I could.

Mr. DRISCOLL. Sure. I think it is probably helpful to think about that $27.5 billion in the context of a few other figures.

The notional limit purchased on a global basis for natural catastrophe is over $300 billion currently. The capital base of the industry is close to half a trillion dollars.

Terrorism within the United States on a standalone basis, as I noted earlier, is $7 billion to $8 billion, but a number substantially larger than that if you include terrorism that is purchased on a bundled basis with other traditional insurance coverages.

And so I think that the best way to source that information, the best way to collect a view on industry capital is probably work with trade bodies like the Reinsurance Association of America (RAA) or Avier, which represents Bermuda insurance and reinsurance carriers, and clearly working with Lloyd's of London, which is not only one of the largest global writers of insurance terrorism but also reinsurance terrorism.

Mr. ROYCE. Let's hear what Lloyd's of London has to say about it.

Mr. MCGOVERN. Congressman, it is very difficult to predict, and you are probably sensing that there are some differences of opinion about what we think the reinsurance industry could cope with. And I think the problem is that I think the reinsurance industry is very well-capitalized, unquestionably, but that doesn't necessarily lead to a very dramatic increase in the reinsurer's ability to provide reinsurance capacity, particularly in major urban areas with large accumulations of asset values, when the decisions about the deployment of reinsurance capacity will come down to an assessment about how individual reinsurers are managing their aggregate exposures.

So it is a complex issue. It is not my place to sort of throw out numbers without understanding what the implications would be.

Because as I have said before, the balancing act for Congress in looking at TRIA renewal is if step changes are made with the intention of increasing private market participation, but that doesn't—that leads to a reduction in take-up rates among commercial policyholders, which are currently pretty good, then actually you have reduced the amount of the insurance capital at risk rather than increased it.

Mr. ROYCE. Let me ask another question, and it goes back to something we did in 2005 in the House. It never made it into final law, but in our version of TRIA reauthorization at that time there was a mechanism allowing direct writers to establish TRIA capital reserve funds, and these funds gave the option to set aside premiums collected under TRIA to help ensure that taxpayers are repaid for government outlays in the event of an attack. Insurer obligations under the program, including deductibles and including the co-share requirements, could also be met with these funds.

And I would ask Mr. Hartwig and Mr. Csiszar, do you support looking at similar reserve mechanisms as we look towards TRIA reauthorization?

Mr. HARTWIG. If you are talking about reserving in advance types of situations, and I think maybe that is what you are discussing there, I think that there has historically been an issue with that, and the issue with that is these typically wouldn't be recognized for tax purposes. And so, these become extraordinarily expensive.

Mr. ROYCE. We had believed at the time that we had worked out something with the Ways and Means Committee that would guarantee that we had avoided that pitfall, but—

Mr. HARTWIG. That is the principal objection I have heard in the past, so I am not sure it is mine to render a final opinion on that. I certainly would defer to the advocacy trades in the organization who would be in contact with their members on that.

Mr. CSISZAR. Congressman, I didn't mention it in my verbal summary, but in my written testimony it is pretty clear that I would support that kind of a reserve mechanism.

The reality of it is that European companies—the U.K., France, Italy, Germany, Spain, you name it, the OECD, European OECD countries—do, in fact, have what they call equalization reserves. And not just for terrorism, but for catastrophes in general.

Mr. ROYCE. I think we should rename them, Mr. Chairman.

Thank you, Mr. Csiszar. I appreciate it.

My time has expired. Thank you, sir.

Chairman NEUGEBAUER. I thank the gentleman.

The ranking member of the subcommittee, Mr. Capuano, is recognized for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

I want to thank the members of the panel for being here again for another TRIA hearing.

I just want to be clear: There is no one on this panel who actually believes that if, God forbid, there was another significant terrorist attack in a downtown metropolitan area or in a cornfield in the middle of the Breadbasket that the American people should not respond to that immediately and do whatever it took to deal with the issues. Does anybody here think that we should not respond?

I knew the answer is no. I presume the answer is no. But if you have the coverage to say we shouldn't, please do.

So that being the case, oh, go ahead?

Mr. SEO. I'm sorry. I am not sure what you mean by respond. Respond—

Mr. CAPUANO. Respond to whatever it took to deal with the issue, with or without TRIA or anything else. Do you think that the U.S. Government, the people of America, should allow their fellow citizens to suffer a nuclear or biological attack without action?

I didn't think so. So now, all we are talking about is when do we step in. We are not talking about whether we will.

There is nothing that anybody here has suggested nor has suggested to me ever that the American people shouldn't step in at some point. The question is when? What is the degree? That is the argument from day one.

And here is the question—the question that I thought Mrs. Beatty asked very clearly that did not get a response. It is my understanding that when any business—not just insurance—when they have a larger risk of loss, that is a major factor in determining the cost of the item.

When risk of loss goes up, cost goes up. That is natural. Commercial enterprise. That is the way it should be.

So therefore, Mr. McGovern, if I told you your company now would be exposed to something more than $100 million, now you are going to be potentially exposed to $500 million, pick a number, would that not play a factor in your determining rates to be charged?

Mr. MCGOVERN. It certainly would. The risk profile changes and the costs associated—

Mr. CAPUANO. Mr. Driscoll, would you take that into consideration in determining rates?

Mr. DRISCOLL. We manage risk concurrent with the size of our capital base, so yes. I think the—

Mr. CAPUANO. So risk doesn't matter? Potential loss doesn't matter?

Mr. DRISCOLL. —size of the industry, loss potential is important.

Mr. CAPUANO. No, no, I am asking for your company. Your company—

Mr. DRISCOLL. We take as much risk on as we think is prudent with respect to managing for our shareholders and—

Mr. CAPUANO. And risk doesn't play a factor in determining rates?

Mr. DRISCOLL. No, risk, absolutely does. That is what I—

Mr. CAPUANO. So it does?

Mr. DRISCOLL. Yes.

Mr. CAPUANO. So if your risk is exposed to a higher number, your rates will go up. It is natural. I don't think it is a complicated question.

Mr. DRISCOLL. Sure, yes.

Mr. CAPUANO. So if we change these triggers, it is unequivocal, it is indebatable that rates will go up. Now, how much? Nobody seems to know or seem to care, but they go up.

When rates go up, what happens when things get more expensive? People don't buy it. Therefore the take-up rate goes down.

That 62 percent or whatever it is we are hitting now goes down. Does anyone here think that the take-up rate should go down?

See, here we are again. We have a system with all of its problems. And again, I have said from day one—I was here every time we have had a TRIA hearing—I don't like the program. I would like to come up with a better program. But it seems to be working.

We have a great take-up rate that the industry told us a long time ago that 60 percent take-up rate is reasonable. It is normal. It is the target. We are there. I don't get any complaints from people buying the insurance that it is too expensive.

Mr. DUFFY. Would the gentleman yield?

Mr. CAPUANO. No, not at the moment.

Mr. DUFFY. Okay.

Mr. CAPUANO. I didn't interrupt you, so but what you have—go right ahead.

Mr. DUFFY. I was going to ask you, are we talking about TRIA or Obamacare? I am—

Mr. CAPUANO. That is exactly why I didn't yield.

Mr. DRISCOLL. Congressman, can I—

Mr. CAPUANO. I have just spent an hour-and-a-half listening to your nonsense, and you can't listen for 5 minutes to mine.

Mr. DRISCOLL. Congressman, can I just with respect to the evolution of TRIA, to your point on rates, I think we would all agree that since 2001, the average per unit cost for terrorism has gone down pretty consistently, whether it be metropolitan or rural areas. We have seen an expansion of the private market—

Mr. CAPUANO. My time is limited. This is not a new issue to me.

I just look at a program that is working, that I am not getting any complaints about except by a few idealistic ivory tower types, but I am not getting complaints about from anybody in the business, and I am being asked to fix something that doesn't seem to be broken. It seems to be working.

And that kind of concerns me, particularly when I am also told that—we are told we are interested in small businesses coming in, yet I am also told—tell me if I am wrong—that 67 percent of the companies writing TRIA insurance right now are valued at less than $100 million. If we change that trigger, we would probably push a whole bunch of them out.

How is that good for competition and pricing? Now, I am not opposed—I am not sitting here philosophically telling you TRIA is wonderful. I am actually agreeing, it is not.

But unless I hear a specific proposal with specific consequences from those proposals so they have some idea what we are doing, it is awfully difficult to argue that we should mess with something that is working, that has worked reasonably well, that no one is complaining about.

And so therefore, if you have concerns about the program, I share them, but I think you have an obligation to give us specific proposals with specific consequences of those proposals as you see them. And then, we can have a discussion.

Other than that, this is a very nice and interesting philosophical discussion that doesn't amount to a hill of beans when everything is said and done because I still need things built, I still need people employed, and I still use up more of my time than I should.

Thank you, Mr. Chairman, for your indulgence.

Chairman NEUGEBAUER. I thank the gentlemen.

And now the gentleman from Ohio, Mr. Stivers, is recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman. I appreciate you having this hearing.

The benefit of going last is all the stupid questions have already been asked, and if you are smart, you know what to stay away from. I want to try to use my time as a summary.

You all agree that TRIA should be authorized, correct? Could we just go down the line?

Mr. MCGOVERN. Agreed.

Mr. DRISCOLL. Yes. We are proposing modifications, but overall agreed.

Mr. STIVERS. Yes. I understand.

Mr. CSISZAR. Yes.

Mr. SEO. Yes.

Mr. STIVERS. All right, so the panel all agreed that TRIA should be reauthorized.

And, Dr. Hartwig, I want to focus—I want to correct the record on something. A few of our committee members have said something that is incorrect in this hearing and your testimony helped bear it out, but is recoupment limited to only $27.5 billion under TRIA or can it go up?

Mr. HARTWIG. No. The $27.5 billion is basically the industry's retention. Above that, there are a couple of recoupment mechanisms. One is mandatory—

Mr. STIVERS. The Treasury Secretary can allow recoupment to go above that amount, correct? Yes or no? That is all I need. Thank you.

Mr. HARTWIG. Yes. Exactly, yes, to the top.

Mr. STIVERS. Thank you so much.

So let's talk about some changes you all agree on, I believe, from listening to your testimony. You all agree that we need a certification timeline, correct? Is there anybody who disagrees with that?

Okay. And I have heard most of you say, and I think there is—Mr. Csiszar is maybe a holdout, that changes in the program on an incremental basis, on a threshold trigger, on an aggregate retention, and a copay of excess retention, as long as it is incremental, I think four of the five of you agree with that. Let's—hold on, let's make sure that that is correct. Is that correct?

Mr. CSISZAR. Make it five out of five—

Mr. STIVERS. Okay, five out of five agree that incremental changes—but $20 billion is a little bit more than incremental, sir.

Okay. So you all agree, five out of five, that some incremental changes make some sense, and I think that is really important to note.

And I want to take off on something that Mr. Capuano just asked. I want to think through some of the risks as we make changes. I happen to represent a district that has grange insurance, motorists' insurance, State auto insurance, some small P&C and workers' comp carriers that, if the changes are too big, too quick, the result will be that those smaller companies will exit the marketplace, and it will actually concentrate the risk in fewer companies, and will there or will there not be fewer private dollars at risk in the marketplace because it will be concentrated in fewer companies?

Would everybody agree with that statement? Would anybody disagree with that statement? Let me—nobody disagreed. Okay.

So I think that it is really important that we pay attention and only make incremental changes so as not to push the small insurers out of the marketplace. And, I think that you all agreed that there is more private capital in the marketplace now that is competing for market share and actually resulting in lower prices for P&C and workers' comp with regard to the terrorism risk out there. As long as we make those incremental changes, is it true to say that the private capital and the increase of private capital will be deployed in a way as to continue to decrease the prices for ultimate customers over the time period?

Isn't that where the private capital will deploy, Mr. Hartwig? Do you want to—

Mr. HARTWIG. Assuming no major event or sequence of events.

Mr. STIVERS. Correct. Right. Okay. Well, we also haven't had a major event since 2001.

Mr. HARTWIG. I think it is easy to underplay the importance of that.

Mr. STIVERS. Yes. And that is why we are here in a time in 2013 when the program has actually never been used, so—and I do want to just engage in a conversation with Mr. Csiszar, because you have—I think you are the—are you the only one on the panel who wants to charge an up-front premium?

Because I actually think that the current mechanism works pretty well. There is a recoupment on the back end and I believe it will happen. I believe it is set in such a way that it can happen. We can change and play with the numbers in a way, but I am frankly worried because the Federal Government has such a horrendous record, whether it is FHA, flood insurance—any time the Federal Government actually tries to price risk, it is a horrendous disaster, and I guess I am just curious why you would want to do that in this case?

Mr. CSISZAR. Better to have something than nothing—

Mr. STIVERS. Okay. I understand, better to have something than nothing. However, the recoupment at 133 percent is something, and it is a mechanism that I believe will work. It is currently guaranteed on the first $27.5 billion, but I think there is a way to change some of those things in an incremental way over time.

In fact, every time we have reauthorized TRIA, we have messed around or moved around the aggregate retention, the copay for excessive reserves, and also the trigger. So it is logical to see that we can move those things, but I think in an incremental way.

So, thank you for your testimony. I think you have given us great perspective on the fact that we need to reauthorize TRIA and we need to do it pretty soon because there are people who are writing policies starting in January that actually will go past the expiration date, and so that creates some real uncertainty in the marketplace.

Again, thank you for your testimony. I'm sorry I have gone over my time, but I look forward to working constructively with Republicans and Democrats to get TRIA reauthorized. Thank you all.

I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And I would like to thank each of our witnesses today. I think we have had a productive session today.

I thank my colleagues for participating in a very productive dialogue. As I said at the beginning, I think it is important now that the committee have a swift and deliberative process here to bring some certainty to the market.

While this program expires in 13 months, many of these policies will begin to be written here right after the first of the year, and so it is my intention to move forward in a way to bring as much certainty to the marketplace as we can.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 12:06 p.m., the hearing was adjourned.]

APPENDIX

November 13, 2013

TESTIMONY OF ERNEST N. CSISZAR

Associate Fellow

R Street Institute

"The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure"

House Financial Services Subcommittee on Housing and Insurance

November 13, 2013

My name is Ernest N. Csiszar and I am a former insurance commissioner from the State of South Carolina and former President of the National Association of Insurance Commissioners ("NAIC"). I am currently a Clinical Professor of Insurance at the University of South Carolina's Darla Moore School of Business and I am an Associate Fellow of the R Street Institute, a public policy think tank devoted to a free market economy. I also serve as a Director on the Boards of a number of property and casualty insurance companies, including a specialty company that underwrites Workers' Compensation coverage. I am also a member of the Board of Directors of a large infrastructure development company that purchases significant amounts of terrorism insurance coverage for its projects.

I am pleased to appear before you today so as to share my perspective on two different, albeit related, matters:

(1) Whether or not the Terrorism Risk Insurance Act ("TRIA"), as amended and currently scheduled to sunset at year-end 2014, should be extended or renewed; and

(2) Whether there are any legislative or regulatory measures that could be implemented to make the market for private terrorism insurance more attractive and enhance the growth of insurance-linked securities ("ILS").

I thank and commend Chairman Neugebauer for holding this important hearing and I welcome the privilege to address the Subcommittee on Housing and Insurance.

(1) THE RENEWAL OR EXTENSION OF TRIA

Let me state at the very outset that I favor the renewal of TRIA, albeit with some significant amendments. There are times when, even as a committed opponent of government intrusion, I must admit that a private market may have failed or may not become fully functional without some intervention by government. Terrorism insurance happens to fall into that category. I do not believe that the insurance and reinsurance industries are ready to bear the entire burden of losses from one or more major terrorism events, particularly those committed by nuclear, biological, chemical, or radioactive means ("NBCR"), or some form of cyber-assault. Nor for that matter are the capital markets immediately ready to stand in place of TRIA for those types of risk. Terrorism continues to provide the most devastating, expensive, and disruptive loss scenarios imaginable and matters such as the current unrest in the Middle East and North Africa have only exacerbated the concerns with underwriting terrorism insurance within the insurance and reinsurance industries.

Nonetheless, genuine progress is being made in developing the private terrorism insurance market. Modeling has improved, underwriting is more nuanced, and there has been an influx of new private capital into the market. Capacity in the private market is up, competition is fierce and prices are down, and a sizable market for private standalone global coverage has developed. I am convinced however that a failure to renew TRIA in the face of the continuing unabated threat of terrorism – thereby eliminating the $100 billion federal backstop as well as the mandate to offer coverage – would lead to severe disruptions in availability, exclusion, and pricing. The risk of that occurring is simply too high. Reinsurers, in particular, can enter and exit a market freely as relatively unregulated entities. The industry tends to react to a shock by withdrawing capacity, exiting entirely from the impacted market, making prices unattractive to buyers, or excluding coverage. Dramatic price increases sometimes follow for other lines of business. And since there is no upper bound for terrorism risk losses[1], one could expect these price increases to be enormous.

Let me provide some additional perspective. TRIA was first put in place in 2002, and then amended in 2005 and extended in 2007. Post September 11, 2001, TRIA succeeded in preventing what would have been a prolonged and wholesale disruption in the market as many insurers and reinsurers were

[1] As noted later in this testimony, Workers' Compensation insurance must be offered under State law without limits. Furthermore, some potential terrorist threats, such as the explosion of a nuclear device in the midst of Manhattan, are estimated to cost over $1 trillion.

prepared to either withdraw from coverage, exclude coverage or invoke the war exclusion that most policies contained. Other lines of business would also have been impacted via price increases. That did not happen substantially because of TRIA which encouraged reinsurers to continue to back their insurer clients with the risk transfer mechanism needed to make TRIA work. For an insurer to be forced to offer terrorism coverage to its customers – as TRIA requires – the purchase of reinsurance is not an option. It is a necessity. It protects the company from insolvency and allows the company to continue to ply its trade post-event. Without reinsurance, there is no insurance! And it is not just any reinsurance that will do. Insurers need reinsurers who are committed to providing terrorism coverage – reinsurers that are well-capitalized, pay their claims quickly, and stand by their insurer clients without hesitation after a large catastrophic event.

Hence, the issue of whether or not to renew TRIA is first and foremost an issue that impacts reinsurers the most and it is to their potential reaction that this Committee must look if it were to take as dramatic a step as to recommend non-renewal.

So let's focus on reinsurance for a moment. Today, the threat of another major terrorism attack involving NBCR or some forms of cyber-attack continues to be among the most feared and potentially the most costly and devastating disasters faced by reinsurers. I think that I can fairly say that the industry does not treat terrorism as a matter of "if" – rather, a "when" and "how severe" and "how often" and "in how many places". Despite the continuing threat however, reinsurers have succeeded in attracting significant new capital since 2002, and particularly since 2007. And, as is the case after every catastrophic event, the industry has managed time and again to find the capital lost due to catastrophes. The industry now has roughly $510 billion in total capital available and that capital has been increasing at the rate of 1% to 5% each year since 2006. $100 billion in new capital is expected over the next ten years. This, of course, is capital that must support many uses besides terrorism – and in many places other than United States. Terrorism is not the only line of business sustained by that capital. Reinsurers allocate capital to other lines as well whether it is auto, homeowners', liability and commercial. Nor is the United States the only place in which they do business. Reinsurance is a global industry, largely located off-shore. Thus, reinsurance capital allocations tend to move quickly to whatever lines or locations offer the most favorable conditions for returns on capital.

As a result, the reinsurance industry has been able to absorb the huge losses from September 11 and from many a natural catastrophe since then, and yet recapitalize lost capital quickly after an event. New capacity[2] seems to move in quickly after an event supported by expectations of improved pricing and higher profits. Interestingly however, to the benefit of consumers, these expectations rarely seem to materialize for very long as new capital flows in and competition for market share takes its toll. As a result, the industry has evolved to the point where paying for yearly catastrophic losses of as much as \$20 billion to \$25 billion seems to have become routine. Whether it is catastrophic fires and earthquakes in California and the American West, sinkholes and hurricanes in the Southeast or tornadoes, hail, and winter storms in the Midwest and the Northeast – these catastrophes have become a repetitive, predictable, annual ritual for the industry: it responds by paying for these losses without much of a blip in either availability or pricing. Losses of this size have come to be expected it seems. Specifically, even in the immediate aftermath of Hurricane Sandy, the second most expensive storm in U.S. history, property catastrophe reinsurance costs continued to decrease as a whole and for most reinsurance programs.

[2] New reinsurers tend to enter the market with new capital. Within less than three months after Hurricane Katrina in 2005, for instance, eight new reinsurers with \$8 billion in new capital had entered the cat market. Also, reinsurers formed sidecar facilities. \$4 billion or more came in through these sidecars. Sidecars are capital facilities that are sponsored by reinsurers. Much like a quota-share reinsurance arrangement, an investor in a sidecar takes on a proportion of the risks for a limited category of policies, typically catastrophe exposures, for a limited period of time.

As for TRIA, the federal backstop continues to be the mainstay for domestic terrorism coverage in the United States. A sizable market for stand-alone commercial coverage has developed. That market tends to serve clients with broader global needs for terrorism coverage, self-insuring captive company clients, and clients interested in coverage up to the $100 million trigger. Since TRIA covers United States territory only, the commercial market also tends to cater to clients interested in both domestic and international coverage, frequently on a "difference in conditions/difference in limits" ("DIC/DIL") basis[3] grounded in a TRIA-based master policy.

In developing these stand-alone terrorism facilities, reinsurers are benefiting from the currently depressed global yields environment by being able to offer higher yields derived from terrorism coverage. It is worth a reminder though that the higher yields are also a reflection of higher risk for those institutional investors like pension funds, hedge funds, private equity, and specialist funds who invest in these facilities. Nonetheless, it has been reported that as much as $2 billion and more of terrorism coverage per client may be available in the private market, depending on location, accumulation, and concentration. Moreover, such new terrorism facilities in the billions of dollars are also being set up by others including brokers, and, hence not surprisingly, prices for customers with more than $1 billion of total insured value have dropped to median rates of $19 per $1 million, down from double and triple that rate in earlier years[4].

For those of us who ultimately favor private markets, these are clear signs of progress in the private market. Nonetheless, some words of caution are in order:

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[3] DIC refers to a policy designed to broaden coverage by providing coverage for perils that are excluded on standard coverage forms or supplementing international policies that are written by admitted insurers in the applicable foreign countries. DIC policies are often used to fill the gaps between the coverage provided by a multinational organization's master insurance policies and coverage provided by policies purchased locally in accordance with each country's insurance requirements so that the organization has uniformity of coverage regardless of location. DIL, on the other hand, refers to a provision contained in a master international insurance program that provides coverage for the difference in limits between the limits of local underlying policies and the limits of the master international policy.

[4] See Marsh's "2013 Terrorism Risk Insurance Report".

1. Not renewing TRIA would open $100 billion crater in the industry's capital structure. That's roughly a 20% hit to the industry's entire capital[5] – by any measure, a huge loss of capital that would have to be filled – and filled quickly at a time when forecasts for new capital over the next 10 years indicate $100 billion level.
2. Some potential - and almost unthinkably probable - terrorist attacks could be of such a substantial magnitude as to be beyond the pale of even as significant amount of capital as is currently available to the industry. Think of that nuclear device in the center of Manhattan. This is a particular problem for Workers' Compensation insurance which prevents the exclusion of terrorism coverage, mandates unlimited coverage, and prohibits the exclusion of nuclear, chemical, biological, and radiation ("NCBR") related coverage. This has broader economic implications regarding employment, jobs, and economic development, given that no business can operate without Workers' Compensation insurance.
3. It is difficult to tell whether the new capital that has come into the business is of a long-term nature or whether it is of the "quick in and quick out hot money" type driven by investors out for yield in an otherwise zero interest and nominal yield environment. With competitive forces at work, as new capital has come into the business, reinsurers have had a difficult time maintaining rates while protecting their individual market share and, as another sign, yields on cat bonds, for instance, have been plunging and only time will tell how much of this capital is of a more permanent nature. Will the new capital will "stick" or exit in the face of ever-diminishing returns? That remains an open question.
4. It has also been suggested that a good proportion of this new capital comes from naïve investors who have yet to be tested by any significant losses. Cat bonds, for instance, have only been

[5] The ratio of cat losses to gross surplus is a good indicator of the ability to absorb losses from terrorism.

triggered three times out of 200 issues within that last fifteen years. Investors may lose interest if their capital were to be wiped out by a sufficiently large event.

5. Availability and pricing of insurance and reinsurance for catastrophic events depends heavily on modeling the frequency and severity of potential losses. The severity of terrorist events can be modeled reasonably well. The problem lies with frequency. Mother Nature is reasonably predictable. Human beings are not. The intervention of human agency in terrorist events makes frequency essentially unpredictable[6]. Moreover, it leaves little room for ex ante mitigation measures, given that an event could occur anywhere. The problem is further complicated by the fact that models without good data fall into the category of "garbage in, garbage out". Clearly for good reasons, the best data and information regarding the likelihood and impact of a potential terrorist event lies with the intelligence and law enforcement agencies and is unavailable to reinsurers[7]. Unfortunately, that only complicates the modeling process so vital to providing terrorism insurance coverage.

6. Natural catastrophes are "low probability – high severity" events, the proverbial fat-tail events or "black swans". Terrorism is not like other tail risk. It is arguable that terrorism presents the industry with "high probability – high severity" events perhaps on a multiple venue and sequential basis, events that are ultimately uninsurable without some form of government program of last resort. Indeed, most other OECD states have had government-backed terrorism insurance pools for twenty years or more, though with a wide variety of intervention mechanisms.

Based on these thoughts, I make the following suggestions to this Committee:

[6] Although some experts believe that human behavior can eventually be modeled via game theory, mathematical power laws and chaos theory, these scientific efforts remain in their infancy.

[7] The types of attacks that do occur, or are aborted or interdicted, would provide good information pertaining to vulnerability of targets, target selection and potential multiple target attacks, and generally speaking, to the terrorists' modi operandi.

1. Renew TRIA – renew it for a long enough period to avoid uncertainty in the near-term and long enough for some of these issues to play themselves out, 5 to 10 years perhaps. Private markets, as history has proven, sometimes take as much as a generation or two to develop. But raise the $100 million loss trigger significantly - perhaps to as much as $20 billion or $25 billion– in line with the routine payouts for other types of catastrophic losses. This would also bring the TRIA program in line with loss triggers in the private markets for industry loss warranties ("ILW") [8]. There is simply no good reason to keep the trigger at its current low level.
2. Raise the horizontal deductible from its current 20% to 40% of the past year's direct earned premium for the commercial lines subject to TRIA and raise the quota share cost-sharing arrangement for insurers from 15% to 25% of losses that exceed an insurer's deductible, in recognition of the increase in capacity in the industry since 2002 and in the evolution of a private stand-alone market since then. This might also stimulate additional private mitigation efforts.
3. Charge a risk-based price for providing the backstop. There is no reason for not collecting an actuarially sound premium for the government's willingness to continue to provide the $100 billion federal backstop. Government – taxpayers, that is - should be compensated for the service.
4. Use a portion of the industry's premiums, or other funds available to Treasury, to invest in risk transfer, including reinsurance, catastrophe bonds or other vehicles. This initiative would

[8] As an indicator of a more realistic trigger, in the private market, for instance, a typical ILW usually triggers at $20 billion in industry-wide losses. Industry loss warranties (ILW) are financial instruments which pay off when the industry-wide losses from a catastrophe exceed a certain industry loss index. While lower triggers of $10 billion and $15 billion are available for purchase, they can be very costly. Hurricane Sandy provides a good example. On March 22, 2013, Property Claim Services (PCS) issued its loss estimate for Sandy, falling just short of the typical ILW trigger of $20 billion in estimated insured losses. The storm was a close call for many ILW with $20 billion triggers. Sandy has actually set in motion a rethink of the entire ILW trigger structure, given that it was no more than a Category 1 storm and, upon reaching land, more like a tropical depression.

protect taxpayers and support the growth of the terrorism risk market, encouraging private investment in models, data sets and other capabilities. Also by accessing the private market, the program would facilitate risk validation and third-party views of exposure, the efficacy of mitigation initiatives and the effectiveness of prevention regimes.

5. Each of these suggestions could of course be introduced on staggered basis over all or part of the renewal period.

(2) IMPROVING THE ATTRACTIVENESS OF TERRORISM INSURANCE MARKETS AND ENHANCING GROWTH IN THE ILS MARKETS

Reinsurance is but one market for the transfer of risk for an insurer. Another option lies in the capital markets, with investors assuming the risk via ILS. The two transfer mechanisms operate alongside and complement and supplement each other. Given the liquidity, depth, and resilience of global capital markets, they are by far the most effective means for pooling, transferring and diversifying risks of all kinds, including insurance risks. In the past 25 years, they have played an increasingly more prominent role by innovating new ways to transfer risks.

ILS either securitize insurance risks [9] or transform such risks into derivatives. They are ideally suited for catastrophe financing. ILS include catastrophe bonds, exchange-traded catastrophe futures and options, catastrophe swaps, non-indemnity types of derivatives such as industry loss warranties as well as collateralized reinsurance products written on an indemnity basis and transformed into securities. Some of these instruments are liquid and some are not. Some are private and over the counter, others are exchange-traded. Some ILS provide for up front funding while others pay ex-post with no up front

[9] Typically, a sponsoring insurance or reinsurance company – or it could be a corporation (e.g., Disneyland and Universal Studios transactions) or a state (e.g., Mexico's earthquake issue) – enters into a financial arrangement with a Special Purpose Vehicle (SPV) and, in exchange for a transfer of premiums to the SPV, the SPV assumes the payment of claims. The SPV invests these premiums in high quality instruments and, in turn, issues notes to investors who receive a stream of payments based on risk and use of funds.

funding. While no ILS specific to terrorism coverage have been issued, increased capacity in the ILS catastrophe market would likely generate a flow-over of additional capital allocations to terrorism insurance.

ILS now make up over 15% of the property catastrophe reinsurance market[10]. From a risk standpoint, the capital markets and rating agencies typically treat them akin to high-yield corporate bonds (e.g., junk bonds). By far the most common and liquid ILS is the catastrophe bond. $40 billion in cat bonds have been issued in the last ten years with about $19 billion currently outstanding. That may not seem like much when you consider the industry's total cat exposure of about $300 billion in potential catastrophe-related claims. Nonetheless, the numbers reflect impressive growth, given that ten years ago that figure was a mere $4 billion. Indeed, a small niche market has become a major supplier of capacity to insurers and reinsurers alike. And if forecasts are correct, today's amount is expected to quadruple again within the next decade. There is also evidence that substantial additional risk is being funded through ILS instruments other than cat bonds[11].

While equity and hedge funds were among the early movers into the ILS market, there has been a recent surge of interest from investors with longer-term time horizons such as pension funds, mutual funds, and wealth managers. Some of these entrants are much larger than reinsurers are and, hence, have a much greater ability to absorb greater volatility and more severe losses. Apart from increased yields derived from larger risk premiums, ILS offers investors access to a largely uncorrelated asset class[12], thereby enhancing the potential for diversification. There is also a relatively healthy secondary market. Reinsurers both participate and compete with ILS. Not surprisingly, between new reinsurance capital and ILS, reinsurance premiums have been forced down by 15% this year alone.

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[10] See PwC's 2013 "Expanding the potential of ILS" report.
[11] Given that most of these are private, over the counter transactions, the evidence is anecdotal.
[12] Unrelated to the more traditional fixed income and equity instruments that is.

Each ILS requires a bankruptcy-remote Special Purpose Vehicle ("SPV") and, while sponsors and investors are mostly from the United States and Europe, the Cayman Islands have become the domicile of choice for these SPVs[13]. In recent years, the Caymans have passed legislation that makes them more attractive for both SPVs and investors. They have also developed a regulatory environment specific to these types of transactions which recognizes the sophistication and higher risk appetite of customers that operate in these markets. Moreover, these types of transactions are often fully collateralized, and hence the fees are high and the capital requirements are usually low[14]. From a fiscal standpoint, SPVs typically receive pass-through treatment as the investment income accumulated within an SPV is intended to be paid out to future claimants.

The use of off-shore SPVs by U.S. entities can be explained by a number of reasons: (1) restrictive GAAP and statutory accounting treatment, resulting in disparate treatment between ILS and reinsurance; (2) taxation issues; (3) uneven and inhibitive state insurance regulations, especially regarding credit for reinsurance provisions; and (4) reserve treatment. For instance, the NAIC model legislation permits an insurance company to set up an on-shore SPV for an ILS but then, unlike the case for traditional reinsurance, prevents a credit to capital until the bond is triggered and the sponsor is indemnified by the SPV. Traditional indemnity-based reinsurance, on the other hand, reflects the transfer of risk as credit to capital immediately upon signing of a reinsurance contract. To add a further complication, a NAIC model law is nothing more than a recommended law – not every state adopts these models, either uniformly or in their entirety. Hence, regulation from state to state is uneven, a very costly and inefficient route for what is in essence a one-time event for each SPV.

The NAIC has also adopted a Special Purpose Reinsurance Vehicle (SPRV) model law, allowing on-shore special purpose reinsurers to issue insurance-linked debt to back up a reinsurance program. The model law however only applies to cases that employ an indemnity-based trigger. Unfortunately, many

[13] Cayman is the domicile of choice for over 90% of all catastrophe bond related SPVs.

[14] Capital can be as low as $500, though regulators typically adjust that based on the specifics of the bond issue.

transactions employ non-indemnity triggers and these are treated purely as additional debt, without any credit to capital whatsoever.

Regulatory certainty in the U.S. is even more opaque when exchange-traded insurance derivatives are involved where many State regulators have not even addressed to issue. Not surprisingly – and to the detriment of the U.S. -the popularity of going off-shore!

In light of the above, I would suggest the following with a view to facilitating the development of the ILS market:

1. Initiate a review[15] of all legal, regulatory, accounting and fiscal treatment of insurance-linked securities and derivatives with a dual aim to develop a soup-to-nuts platform for issuing ILS on-shore and provide for appropriate accounting, regulatory, and fiscal treatment based on the risks inherent in the various types of instruments. Issues to be addressed could include a separate licensing facility for SPVs, equal accounting and regulatory treatment between reinsurance and ILS where warranted based on risk characteristics, exemptions from the Frank-Dodd legislation and the Federal Reserve systemic risk provisions; clarifying bankruptcy remoteness; exemptions from consumer protections which are not relevant in this context, and so on.
2. Overall, ILS would also benefit from a uniform, a sensible regulatory framework. NAIC model laws, of course, do not have the force of law in any U.S. jurisdiction. Although many states adopt laws following NAIC models in whole or in part, it always remains to be seen how many states will adopt them eventually and at what pace. Reports at the Spring National Meeting 2013 indicate, for instance, that 11 states have adopted revisions to their credit for reinsurance statutes and/or regulations to implement reduced collateral requirements mandated by the

[15] See the GAO's 2002 report entitled "Catastrophe Insurance Risks: The role of risk-linked securities and factors affecting their use" and subsequent GAO 2003 report "Catastrophe Insurance Risks: Status of efforts to securitize natural catastrophe and terrorism risk".

Dodd-Frank legislation and modeled in the NAIC's amendments to its Credit for Reinsurance Model Law and Regulations ("Amended Credit for Reinsurance Model Act"). Twelve (12) others have indicated their intention to do so, leaving the remainder of the states without any position on the matter at this time. As regards full implementation, only Florida and New York have actually approved any reinsurers for collateral reduction at this time. Moreover, even when the NAIC passes a model law of regulation, states are at liberty to make changes at the local level, thereby replacing intended uniformity with a "hodge podge" of local variations. Some argue that the situation would change if the NAIC were to make model laws a condition of state accreditation, in which case all states almost certainly would adopt them in full and without change. But then again, changes to NAIC accreditation standards generally take four or more years to become effective. Real change in a timely manner at the State level to develop attractive ILS markets is therefore unlikely. Given that ILS are in the nature of capital market instruments, federal legislation may well be appropriate.

3. Pass through taxation treatment[16] - which eliminates taxation at the SPV level and thus avoids double taxation—with favorable implementing requirements could facilitate expanded use of ILS and, as a by-product, increase the flow of private capital into the terrorism market.

As for making reinsurance more attractive:

1. Allow for the use of reserves for catastrophic events. For insurers and reinsurers, a more favorable fiscal treatment of catastrophe (including terrorism) or equalization reserves[17] may increase the availability of traditional insurance/reinsurance. In its 2005 report, the GAO noted

[16] Much like the mortgage industry is permitted to do through the use of Real Estate Mortgage Investment Conduits ("REMICs).

[17] These are long-term reserves kept for the purpose of preventing cash-flow depletion in the event of significant unforeseen catastrophes, including terrorism events.

some discrepancies between the U.S. and European fiscal treatment of catastrophe reserves[18]. A number of European countries allow insurance companies to establish tax-deductible reserves for potential losses associated with catastrophic events, although each country differs in the way it allows reserves to be set-up and used[19]. In the U.S., on the other hand, catastrophe reserves are not tax-deductible. Tax-deductible reserves would offer several potential benefits: they would provide insurers and reinsurers with financial incentives to increase their capital and expand capacity without endangering solvency or contractual commitments. They would also lower the costs of catastrophic coverage, including terrorism in all likelihood. Opponents have noted that permitting insurers to take *ex ante* tax-free reserves may open the door to deceptive or even fraudulent accounting. At the very least, the issue warrants serious study.

To conclude, I wish to thank Chairman Neugebauer for this opportunity to comment at this hearing and I look forward to working with the members of this Subcommittee towards a resolution of these issues. Thank you!

[18] See GAO 2005 report entitled "Catastrophe risk: U.S. and European approaches to insure natural catastrophe and terrorism Risks".
[19] Germany, France, Italy, Spain, Switzerland, and the United Kingdom all allow tax-deductible reserves.

Testimony of Kean Driscoll

Chief Executive Officer

Validus Re

House Financial Services Subcommittee

on

Housing and Insurance

Hearing on

"The Future of Terrorism Insurance:

Fostering Private Market Innovation to Limit Taxpayer Exposure"

November 13, 2013

My name is Kean Driscoll and I am the Chief Executive Officer of Validus Re. I am pleased to appear before you today to provide my company's perspective on possible changes to the Terrorism Risk Insurance Program ("TRIP" or the "Program") that would incent more private market involvement. I commend Chairman Neugebauer for holding this important hearing and welcome the opportunity to address the Subcommittee on Insurance, Housing, and Community Opportunity.

Validus Group ("Validus") is a leader in the global insurance and reinsurance markets, operating principally through Talbot Syndicate 1183 at Lloyd's of London, and Validus Re. Talbot has written direct and facultative terrorism business at Lloyd's for more than 12 years and it is now the largest writer of that business by income. Validus Re is one of the largest stand-alone property terrorism treaty coverage providers in the world, with an estimated 10% market share, and it evaluates business opportunities on approximately 90% of all direct and facultative terrorism business written throughout the world. Validus' guiding objective, through its operating subsidiaries, is to maximize its return on equity subject to prudent risk constraints on the amount of capital its exposes to any single loss event.

Background on Reinsurance

Reinsurance is commonly referred to as the insurance of insurance companies. The reinsurance market is global and plays an important role in maintaining the financial health of the insurance marketplace and ensuring the availability of property and casualty insurance in the United States. Reinsurance may be used by insurers for several reasons. One of the most common purposes is to transfer risk from the primary insurer for catastrophic events, including hurricanes, earthquakes, and conventional acts of terrorism. Reinsurers have responded financially to virtually every major U.S. catastrophe over the past century. By way of example, 60% of the losses related to the events of September 11th were absorbed by the global reinsurance industry, and in 2005, 61% of Hurricanes Katrina, Rita and Wilma losses were ultimately borne by reinsurers.

Background of the Terrorism Risk Insurance Program

TRIP was enacted in response to the September 11, 2001 terrorist attacks, which 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 in an unwavering manner, the events changed the way the industry views the terrorism risk.

TRIP was created to provide a federal backstop, which allowed the insurance industry to provide terrorism coverage to U.S. businesses. By limiting insurers' exposure to catastrophic terrorism losses, TRIP improved the private market for such coverage. The reinsurance industry strongly supported adoption of the Terrorism Risk Insurance Act in 2002, the 2005 Terrorism Risk Insurance Extension Act (TRIEA) and the 2007 Terrorism Risk Insurance Program Reauthorization Act (TRIPRA).

Reinsurers' Role Under TRIP

TRIP provides a large amount of reinsurance-like protection for commercial insurance exposures. Individual insurers retain a significant amount of terrorism risk losses through both a company deductible and a co-pay requirement for losses above the retention before TRIP funding is available. The insurance industry has significant financial risk and exposure to acts of terrorism because of the significant retentions under TRIP, the mandatory offer of coverage required under TRIP, state regulatory action related to rates and exclusions, and rating agency scrutiny.

Insurers may seek reinsurance from the private market to reduce the conventional terrorism exposure they face for potential losses between the deductible and loss-sharing provisions of TRIP. A reinsurer's ability to provide this coverage is limited by the amount of conventional terrorism risk it is willing and able to supply based on the amount of capital it allocates to terrorism coverage and its own specific risk evaluation. Because reinsurers are not covered by TRIP, reinsurers view TRIP in the context of the benefits provided to the broader industry as a whole.

The Current Reinsurance Market

Since 2001, insurers and reinsurers have worked hard to develop a better understanding of conventional terrorism risk. Reinsurers have created task forces, consulted military and intelligence experts, hired specialty risk modeling firms, invested in research and development, and implemented new underwriting standards all with the intention of offering private market solutions for the transfer of conventional terrorism risk. Conventional terrorism can be modeled, priced, and managed on a portfolio basis. The probability or frequency of an event can be estimated, albeit with less certainty than risk classes with a more robust historical record; however, the insurance and reinsurance industries have pioneered risk transfer solutions for many other classes of business that suffer the same shortcomings. To supplement the lack of a rich data set on frequency, we use open source intelligence that helps us estimate both the intent and capability of terror threat agents. This information is consolidated into an event set that helps us estimate the probability of various attack types at different targets.

Once we have established a perspective on frequency, we use well established modeling techniques to quantify hazard severity, vulnerability and financial loss. There is very good data on damageability from various blast sizes with secondary effects.

The question is not whether conventional terrorism risk can be priced, but rather, the precision of the parameters in a pricing model. We can and do currently price conventional terrorism risk, and estimate that approximately $7-8 billion of reinsurance coverage is purchased annually on a stand-alone basis for conventional U.S. terrorism. This excludes coverage that is included as part of general property/casualty, worker's compensation and other specialty lines coverages. We believe presently there is adequate reinsurance capacity to cover the insurance industry's current $27.5 billion retention under TRIP, and if the industry retention for conventional terrorism exposure grew over time, so to would the capacity of the reinsurance industry for conventional terrorism risk.

TRIP Renewal

TRIP is valuable to the insurance industry in underwriting conventional terrorism risk but it takes a "one size fits all" approach that could be modified to encourage more private market insurance and reinsurance participation. If the Committee is inclined to make changes to the Program, Validus encourages you to tailor the Program in accordance with the following comments.

1. The Program should continue to cover catastrophic terrorism loss scenarios related to nuclear, biological, chemical and radiological ("NBCR") attacks. The broader industry cannot effectively address these perils as the breadth of potential events is either unknowable or could potentially bankrupt the industry.

2. Cyber terrorism, a peril distinct from cyber liability, should be clearly covered by the Program. The scope, duration, potential damage and economic losses from this risk are also unknowable, and therefore, uninsurable.

3. The Program should clarify the process for certifying a terrorism event, including a defined time for making the certification

4. Validus has the ability and willingness to assume more conventional terrorism risk exposure, and I believe the reinsurance industry also has the ability and willingness to meaningfully expand its capacity for conventional terrorism risk. To reflect the fact that the industry's appetite for writing conventional terrorism risk has grown since the last extension, the Program could be modified through a variety of ways, including:

    a. Gradually increasing the insurance industry retention and the size of a qualifying terrorism loss under the Program. This reduces the likelihood of having to fund a loss through taxpayer funds and it avoids short-term price and capacity dislocation in the broader industry.

    b. An expansion of the co-participation which would better align the insurance industry with the Program.

5. The insurance industry is a critical facilitator of effective risk management in virtually every industry, and every facet of life. Risky behavior, or highly exposed assets typically result in a higher premium charge. Policyholders can reduce higher premiums through effective risk mitigation techniques. Currently, the Program impedes the ability of the insurance industry to properly price its products, by shifting the risk of a conventional terror attack from the policyholder to the taxpayer. The improper allocation of a risk premium facilitates unintended outcomes. We see this phenomenon playing out in the flood market, as the heavily subsidized National Flood Insurance Program ("NFIP") has produced significant deficits. Congress should encourage a greater private sector risk bearing role and appropriate risk pricing. Insureds and insurers will then have an incentive to mitigate risk and price it

appropriately, and Congress can focus on genuinely becoming a "reinsurer" of last resort for conventional terrorism risk.

6. Finally, special consideration should be made for smaller insurers, as well as for the insurance industry generally with respect to workers compensation exposure accumulations in metropolitan areas, which could be disproportionately impacted in the near term by any of the changes to the Program.

Thank you for the opportunity to testify. We look forward to continuing this dialogue as the renewal process moves forward.

The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure

United States House of Representatives
Financial Services Subcommittee
on Housing and Insurance

Testimony of
Robert P. Hartwig, Ph.D., CPCU
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Insurance Information Institute
New York, NY

November 13, 2013

Washington, DC

Thank you, Representative Neugebauer, Ranking Member Capuano and members of the Committee.

Good morning. My name is Robert Hartwig and I am President and Economist for the Insurance Information Institute, an international property/casualty insurance trade association based in New York City.[1] I am also a Chartered Property Casualty Underwriter (CPCU) and have worked on a wide variety of insurance issues during my 20 years in the property/casualty insurance and reinsurance industries, including many related to the industry's exposure to catastrophic loss, including acts or terrorism.[2] The Institute's members account for nearly 70 percent of all property/casualty insurance premiums written in the United States. Its primary mission is to improve understanding of the insurance industry and the key role it plays in the U.S. and global economy.

I have been asked by the Committee to provide testimony on the current state the Terrorism Risk Insurance Program and the market for terrorism insurance in the United States. For the purposes of my testimony, I will address the following issues:

(i) The immediate impacts of the September 11, 2001 attacks on insurance and reinsurance markets;
(ii) The essential role that TRIA plays with the nation's national security infrastructure and its benefits to consumers, businesses and communities;
(iii) Taxpayer protection features of TRIA;
(iv) Private sector insurer and reinsurer involvement in terrorism insurance markets since 9/11;
(v) The unique nature of terrorism risk and the limits of private sector involvement in terrorism insurance markets;
(vi) Changes in the terrorism threat landscape since the enactment of the original TRIA legislation in 2002 and the impacts on terrorism insurance;
(vii) Potential economic, ratings agency and insurance market impacts if TRIA is not extended;
(viii) Obstacles to insuring and reinsuring losses arising from acts of terrorism;
(ix) Cyber terrorism and certification timelines.

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[1] Contact information: Tel: (212) 346-5520; Email: bobh@iii.org.

[2] See *Terrorism Risk: A Constant Threat,* Robert P. Hartwig and Claire Wilkinson, Insurance Information Institute, June 2013: http://www.iii.org/white_papers/terrorism-risk-a-constant-threat-2013.html.

Impacts of the September 11, 2001 Terrorist Attack on Insurance Markets

The terrorist attacks of September 11, 2001, produced insured losses larger than any natural or man-made event in history. Claims paid by insurers to their policyholders eventually totaled some \$32.5 billion dollars—\$42.1 billion in 2012 dollars (Exhibit 1) and to this day remains the second most costly insurance event in United States history (Exhibit 2).[3] The insured losses arising from the events of that fateful day were unprecedented in virtually every respect, producing catastrophic losses not only in property coverages, but also for the first time in the workers compensation line. The sheer enormity of the loss—coming from an entirely unforeseen peril for which no premium had been collected—combined with the possibility of future attacks, produced financial shockwaves that shook insurance markets worldwide and provoked an extraordinarily swift and severe underwriting and pricing reaction by insurers and reinsurers.

Terrorism Exclusions and Price Shocks in the Wake of the 9/11 Attack

The shock of the September 11 attack led insurers and reinsurers to exclude coverage arising from acts of terrorism from virtually all commercial property and liability policies. Before 9/11 terrorism exclusions were virtually nonexistent in commercial insurance contracts sold in the United States. The economic consequences of such exclusions were quick to manifest themselves. Major commercial property construction projects around the country, unable to secure coverage against the now very real risk of terrorist attack, were in jeopardy of being tabled, hurting job growth at a time of rapidly rising unemployment and when much of the country was in recession. Banks, in turn, threatened to choke off lending to businesses if borrowers failed to secure coverage against terrorist acts. The problem was not confined to high profile "trophy" properties located in major metropolitan areas. Shopping malls, office complexes, factories, sports stadiums, hotels, utilities, airports, port facilities and other critical infrastructure all across the United States were impacted. In short, the macroeconomic consequences associated with the lack of terrorism coverage were beginning to exact a severe toll on businesses

[3] The loss totals do not include the March 2010 settlement of up to \$657.5 million announced by New York City officials and plaintiffs' lawyers to compensate about 10,000 workers whose health was damaged during the rescue and cleanup at the World Trade Center.

and workers alike. *[Note: The potential macroeconomic implications of allowing TRIA to expire in 2014 are discussed in greater detail in the next section of this paper].*

Even as exclusions proliferated, prices soared. The average rate increase for a business seeking to renew coverage in the fourth quarter of 2001 was nearly 30 percent. Reinsurance prices rose sharply as well. Very little private sector coverage for terrorism entered the market as a general consensus emerged that terrorism risk is fundamentally not insurable. Insurers, who are regulated by the states, therefore took the unprecedented step of seeking to establish a risk sharing plan with the federal government in the event of future attacks. Only when the Terrorism Risk Insurance Act (TRIA) was enacted by Congress in November 2002—fourteen months after the attack—did stability finally return to the market and coverage for terrorist attacks resume. In the eleven years since enactment, stability remains a hallmark of this market primarily due to the continued existence of TRIA. That said, the market for terrorism insurance today—in late 2013—is already showing signs of stress associated with uncertainty over the future of TRIA. Already a number of major commercial insurers have stated that policyholders will soon be notified that coverage for certain terrorist acts could be altered or discontinued if TRIA is allowed to expire.[4]

TRIA, National Security and Protection of the Nation's Critical Financial Infrastructure

The war on terror is far from over, as the recent Boston Marathon bombings attest, but TRIA by all objective measures is now a proven and unqualified success. The program not only succeeded in restoring stability to the country's vital insurance and reinsurance markets in the years immediately following 9/11, but it continues more than a decade later to deliver substantive, direct benefits to millions of businesses, workers, consumers and the overall economy—all at essentially no cost to taxpayers.

Upwards of 60 percent of businesses purchased terrorism coverage nationally in 2012, up from 27 percent in 2003, the first full year of the program (Exhibit 3). Industries responsible for much of the country's critical infrastructure such as power and utilities,

[4] "Unease Over Terrorism Insurance Rattles Market," *Commercial Mortgage Alert*, November 1, 2013.

telecommunications and health care, along with financial institutions and local government have take-up rates that approach or exceed 70 percent. Moreover, the take-up rate for workers compensation is effectively 100 percent, meaning that every worker in America is protected against injuries suffered as the result of a terrorist attack.

The unambiguous success of TRIA demonstrates that the Act has become an invaluable component of the country's national security infrastructure. The continued operation of the nation's financial institutions—including its insurers—during and throughout the aftermath of a major terrorist attack—is absolutely essential to ensure a smooth and expedited recovery from the massive economic and operational shocks of the sort that occurred after the 9/11 attacks and that are certain to accompany future such events, irrespective of where in the country they occur. Failure to institutionalize a permanent plan to protect the nation's financial infrastructure leaves the country unnecessarily vulnerable to economic instability and risk of recession.

Macroeconomic Impacts of the TRIA Expiration

A 2004 study co-authored by R. Glenn Hubbard, Columbia University's Business School Dean and a former chairman of the U.S. Council of Economic Advisors, quantified the potential macroeconomic impacts of a failure to extend TRIA.[5] The study concluded that within three years of the expiration of TRIA (in the absence of a major terrorist attack), GDP could fall by 0.4 percent, household net worth by 0.9 percent and employment by 0.2 percent. Applying the findings of that study to the current period suggests that expiration of the current Act could lead to a meaningful drag on economic growth, reducing real GDP by an estimated $69 billion by 2017, depressing household net worth by an estimated $798 billion and remove 290,000 jobs from the economy.[6]

[5] R. Glenn Hubbard and Bruce Deal, *The Economic Effects of Federal Participation in Terrorism Risk*, Analysis Group, September 14, 2004.

[6] Figures cited in Table 1 are Insurance Information Institute estimates based on findings of the study referenced in footnote 3.

Table 1

POTENTIAL MACROECONOMIC IMPACTS ASSOCIATED WITH THE EXPIRATION OF TRIA

Macroeconomic Factor	Estimated Impact Within 3 Years of Terrorism Program Expiration
Real GDP	-$69 Billion
Household Net Worth	-$798 Billion
Jobs	-290,000

As Table 1 demonstrates, terrorism remains a threat to the country's national economic security, especially in the context of the still fragile economic recovery. Consequently, maintaining a Terrorism Risk Insurance Program as a component of the country's comprehensive national security plan and infrastructure is both reasonable and prudent. It is also imminently affordable. Indeed, the cost to American taxpayers is effectively zero.

Taxpayer Protection Features of the Terrorism Risk Insurance Act

TRIA from its inception was designed as a terrorism risk sharing mechanism between the public and private sector—with an overwhelming share of the risk being borne by private insurers, a share which has increased steadily over time. Today, all but the very largest (and least likely) terrorist attacks would be financed entirely within the private sector. In the event of a truly catastrophic attack, TRIA provides the government with the ability to fully recoup any and all federal monies paid. In other words, there would be *no* cost to the taxpayer.

As a point of fact, from the date of TRIA's enactment in November 2002 through today, a span of almost exactly 11 years, the federal government and therefore taxpayers have paid nothing (apart from negligible administrative expenses) under the program. The recent Boston Marathon bombings provide an illustrative example. All of the 207 property/casualty claims filed in the wake of that event were handled by private insurers who have made payments to policyholders totaling at least $1.18 million.[7] Not one taxpayer dollar was used to pay any of these claims.

TRIA's structure actually provides at least eight distinct layers of taxpayer protection as displayed schematically in Exhibit 4's Pyramid of Taxpayer Protection. Each of those layers is discussed in turn below.

SUMMARY OF 8 KEY TAXPAYER PROTECTION FEATURES UNDER TRIA

1. **CERTIFICATION DEFINITION:** ***Criteria Must Be Met***[8]
   - **Definition of a Certified Act of Terrorism:** The 2007 extension of TRIA, likes its predecessors, requires that a detailed set of criteria be met before an act of terror can be "certified." Specifically, the term "act of terrorism" refers only to an act that is certified by the [Treasury] Secretary, in concurrence with the Secretary of State and the Attorney General of the United States:
     i. to be an act of terrorism;
     ii. to be a violent act or an act that is dangerous to human life, property or infrastructure;
     iii. to have resulted in damage within the United States, or outside of the United States in the case US air carriers, vessels and/or missions;
     iv. to have been committed by and individuals as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the US government by coercion.

[7] As of July 26 (latest available). P/C insurers also held $1.41 million in reserves for claims associated with the bombings. Figures are from the Massachusetts Division of Insurance as reported in BestWire Services, *P/C Insurers Have Paid $1.18 Million in Boston Marathon Bombing Related Claims,* September 3, 2013.
[8] United States Treasury accessed as of 9/22/13 at http://www.treasury.gov/resource-center/fin-mkts/Documents/TRIAasamended-CompositeTextPost.pdf.

2. **CERTIFICATION THRESHOLD (TRIGGER):** ***$5 Million***
   - **$5 Million Minimum:** Under the 2007 reauthorization of TRIA, no act shall be certified by the Secretary as an act of terrorism if property and casualty losses, in the aggregate, do not exceed $5 million.
   - **Acts of War Exclusion:** TRIA further stipulates that no act may be certified as an act of terrorism if the act is committed as part of the course of a war declared by Congress (this provision does not apply to workers compensation).

3. **TRIGGERING EVENT THRESHOLD:** ***$100 Million***
   - Under the 2007 reauthorization of TRIA the triggering event threshold was set at $100 million, up from $5 million in the original act and $50 million in 2006. This means that Federal funds will be paid out *only* in the event of a terrorist act that produces total insurance industry losses above this threshold (even if the event is certified by the Treasury Secretary as a terrorist act).

4. **INDIVIDUAL INSURER DEDUCTIBLES:** ***20% of Premiums***
   - The amount of terrorism losses that an individual insurer must pay before federal assistance becomes available. The level rose to 20 percent of an insurer's direct earned premiums for commercial property/casualty insurance in 2007 where it currently remains (up from 17.5% in 2006, 15 percent in 2005, 10% in 2004 and 7% in 2003).

5. **INSURER CO-PAYMENT IN EXCESS OF RETENTION:** ***15% of Loss***
   - The share of losses that insurers pay above their individual retentions rose to 15 percent in 2007 where it remains today, up from 10 percent in 2006 and prior years.

6. **INDUSTRY AGGREGATE RETENTION:** ***$27.5 Billion***
   - Under the 2007 reauthorization, the industry as a whole must ultimately cover a total of $27.5 billion of the losses through deductibles and copayments (assuming an event of $27.5 billion or greater). This amount was increased to $27.5 billion in 2007, up from $25 billion in 2006, $15 billion in 2005, $12.5 billion 2004 and $10 billion in 2003 ***(Figure 7)***. Government expenditure above this amount can be recouped.

7. **GOVERNMENT RECOUPMENT:** ***Full Taxpayer Protection***
   - **Mandatory Recoupment:** TRIA mandates that the government recoup *133 percent* of the difference between the actual amount it has paid and the required retention. This recoupment comes via a surcharge on

commercial insurance policyholders not to exceed 3 percent of premium for insurance coverages that fall under the program.

- **Discretionary Recoupment:** If the insured loss exceeds the $27.5 billion threshold, federal expenditures may be recouped for amounts in excess of the threshold at the discretion of the Secretary of the Treasury.

8. **HARD CAP:** ***$100 Billion***
   - **Program Limit:** Losses within a program year are capped at $100 billion, inclusive of both insurer and government participation. Neither the government nor insurers would be required to pay losses for certified acts beyond this amount.

Additional Taxpayer Protection Features of TRIA

Several other features of TRIA serve as additional protections to taxpayers.

Commercial Lines Only: Only claims occurring in certain property/casualty commercial lines of insurance are included in the calculations of insured losses under TRIA (auto and homeowners insurance, life insurance and health insurance have always been excluded). In addition, the number of lines covered under TRIA has been narrowed over time. At TRIA's inception in 2002 approximately 44 percent of property/casualty insurance industry premiums were covered under the Act. By 2012 that figure had dropped to approximately 35 percent. Excluded commercial lines of coverage under the Act today include: mortgage and title insurance, financial guaranty, medical malpractice, reinsurance, commercial auto, burglary and theft, surety, professional liability (except directors and officers coverage) and farmowners multiperil.

State Guaranty Funds: In the unlikely event that an insurer becomes severely impaired or insolvent as a consequence of a terrorist attack, state insurance regulators will take corrective action. If the insurer's assets are insufficient to meet its liabilities, the resources of the appropriate state guaranty fund(s) could be called upon to satisfy those liabilities. Guaranty associations obtain funds for their operations and payment of claims through assessments against the solvent insurance companies licensed to do business in the state and from the recovery of amounts paid on claims from the insolvent estate.[9] All guaranty fund resources are therefore ultimately derived from the industry itself. *No taxpayer dollars are ever involved.*

Make Available Requirement (Mandatory Offer of Coverage): Commercial insurers are required to offer coverage against terrorist acts and by law, workers compensation must include coverage against such acts. These requirements have led to widespread participation in the program. The take-up rate for terrorism coverage in 2012 was 62 percent according to a recent study by insurance broker Marsh.[10] The take-up rate for workers compensation is effectively 100 percent, meaning that every worker in America is protected against injuries suffered as the result of a terrorist attack.

TRIA Will Reduce Taxpayer Funded Post-Attack Disaster Aid Costs

The very fact that terrorism coverage is so widely purchased today and that coverage already extends to every American worker through the workers compensation system means that fewer government (taxpayer) resources will be called upon in the wake of any future terrorist attack. Allowing TRIA to expire will reduce the market penetration of terrorism coverage as prices rise and insurers limit their exposure across all lines of coverage, including workers compensation. Consequently, the uninsured share of losses will rise, increasing the pressure on the government to compensate victims for their uninsured losses. This will impair the ability of individual businesses, affected communities and the overall economy's ability to recover. A sharp spike in business failures, higher unemployment and reduced GDP growth are just a few of the adverse consequences that are certain to follow in the event of a major terrorist attack in the absence of TRIA. In summary, government will be called upon to act in the aftermath of a major terrorist attack. TRIA provides an efficient means for ensuring that most of the costs are financed and administered by the private sector rather than the taxpayer.

[9] National Conference of Insurance Guaranty Funds accessed September 22, 2013 at: http://www.ncigf.org/media/files/Primer-2012.pdf

[10] Marsh, *2013 Terrorism Risk Insurance Report*, May 2013.

Use of Insurer Claim Management Infrastructure Will Save Taxpayer Money, Improve Post-Attack Response

Private insurers are today the principal source and conduit for the rapid and direct delivery of recovery funds to victims of terrorist attacks. In the event that TRIA is allowed to expire, the government lacks any formal structure or experience for adjusting, managing and delivering benefits to victims of complex commercial property and liability claims, nor does it have any formal fraud monitoring capability. Maintaining TRIA not only ensures that the costs of future terrorist attacks will be borne primarily by the private sector, it enhances the quality of the outcome. Again, in the absence of TRIA there is no question that the federal government will be called upon to act. TRIA ensures that that much of those costs will be borne and administered by the private insurers.

Private Insurer and Reinsurance Participation in the Market for Terrorism Insurance Today

One primary goal of TRIA and it successors has been to encourage private sector capacity to enter (and remain) in the marketplace so that an increasing share of losses from future terrorist attacks could be borne in the private sector.

There is no question that billions of dollars in capacity has been attracted to the terrorism risk insurance market. Evidence of the program's success in this respect has been documented by a number of government entities and other organizations. In its latest report on terrorism risk insurance market conditions, the President's Working Group on Financial Markets noted that the program provides an incentive to property/casualty insurers and reinsurers who might not otherwise provide terrorism insurance at current capacity levels or prices.[11] The U.S. Government Accountability Office (GAO), commenting on the availability and affordability of terrorism coverage in large metropolitan areas, reported that with a few exceptions, commercial property terrorism insurance appears to be available nationwide at rates policyholders believe is reasonable, suggesting ample capacity.[12]

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[11] *Market Conditions for Terrorism Risk Insurance 2010*, Report of the President's Working Group on Financial Markets.

[12] *Initial Results on Availability of Terrorism Insurance in Specific Geographic Markets*, GAO-08-919R, July 2008.

Note that this statement is very different from an assessment that such capacity would exist in the absence of a terrorism backstop. Again, it is important to emphasize that the majority of the coverage that exists in the market today exists because of the continued existence of the Terrorism Risk Insurance Program. Insurance broker Aon estimates that 70% to 80% of the market would encounter terrorism exclusions if the program were discontinued. Thus capacity in the market is largely contingent upon the continuation of the program. As detailed earlier in this testimony, policy language that would exclude coverage against terrorist attacks returned to the market each time the expiration of TRIA has loomed.

The so-called market for "standalone" terrorism coverage also provides evidence that in the absence of a Terrorism Risk Insurance Program, coverage capacity (supply) will fall well short of demand. Insurance brokers Marsh and Aon both report that the "theoretical" maximum amount of coverage available per risk in the "standalone" market is approximately $2 billion with larger sums available under some circumstances. This is in contrast with limits of just $150 million or less available in early 2002 before TRIA was enacted. At the time, such coverage also was subject to high deductibles equal to 7 to 10 percent of the stated value of the coverage.[13] While the sums available in the market today may seem large, especially in comparison to 2002, there are many risks for which the coverage is inadequate. Consider, for example, that back in 2001 (prior to the introduction of terrorism exclusions) the twin towers at the World Trade Center site were insured for $3.55 billion—more than what is generally available in the market today. Multibillion dollars risks are now quite common in the United States, from office and shopping complexes to large manufacturing facilities, sports stadiums, transportation hubs and energy infrastructure not to mention infrastructure such as bridges, tunnels and dams. These exposures exist in every state.

Reinsurance capacity, which was extremely limited in the aftermath of 9/11, is up as well. A 2011 report from reinsurance broker Guy Carpenter noted that there is between

[13] *September 11, 2001: One Hundred Minutes of Terror that Changed the Global Insurance Industry Forever*, Robert P. Hartwig, John Liner Review, January 2002.

$6 billion and $8 billion of terrorism reinsurance capacity available in the U.S. market, but cautions that the market remains vulnerable to a major terrorism loss. The $6 billion to $8 billion in terrorism reinsurance capacity stands in stark contrast to approximately $100 billion in reinsurance capacity available in the market today against traditional risks (mostly property catastrophe risks). A continued cautious approach is clearly required. Indeed, many modeled terrorism loss scenarios result in insured losses in the tens or even hundreds of billions of dollars—some even exceeding the claims paying capital of the entire industry. As noted previously, much of the capacity in the market today is predicated on the existence of the Terrorism Risk Insurance Program. In the absence of the program, reinsurance capacity would be greatly reduced.

Capital Markets and Terrorism Risk

Capital markets are playing an increasingly important role in providing capacity against losses arising from large natural disaster events which are becoming increasingly frequent in the United States and around the world. Capital market reinsurance capacity for U.S. natural catastrophe risks is estimated at $30 billion to $40 billion. However, investor appetite for catastrophe risk is so far limited to natural catastrophes such as hurricanes and earthquakes. Investors are attracted to investments in backing natural disasters risks in part because the performance of these assets is entirely uncorrelated with the performance of traditional financial market instruments such as stocks and bonds. A recession, for example, will impact the value of stocks and corporate bond prices but will have no impact on the likelihood of sustaining a loss on a catastrophe bond.

Investors to date have shown no appetite for terrorism risk because in the event of a major terrorist attack the performance of securitized terrorism risk instruments (such as catastrophe bonds) and tradition equity market and fixed income investment vehicles are likely to be *highly correlated.* For example, a large-scale terrorist attack could cause bonds exposed to the event to lose all or part of their value, leading to large losses for investors while stock markets plunge (as they did in the wake of the September 11, 2001 attack). Investor disinterest in terrorism risk is also a function of the inability to model and therefore price) such risks with anything close to the same degree of precision as tradition natural disaster risk.

Changes in the Terrorism Threat Landscape and Impacts on Terrorism Insurance Markets

In the immediate aftermath of 9/11 the ability of commercial policyholders to purchase adequate limits of terrorism coverage at affordable prices was severely constrained. Commercial property owners and businesses were faced with substantially reduced protection for terrorism-related risks, in addition to higher property/casualty rates overall. As a result, many were forced to go without coverage or only partly insure their assets.

Today, reports of property owners having problems securing terrorism coverage due to a lack of capacity in the market are no longer making headline news. Indeed, it is therefore tempting to conclude that in the eleven years since TRIA was first implemented that insurance markets have fully adjusted to the post-9/11 environment and that insurers and reinsurers have concluded that terrorism is a fully insurance risk.

The reality is quite different. The fact of the matter is that terrorism risk today is almost every bit as uninsurable as it was a decade ago. Recent major successes in the war on terror, including the killing of al-Qaida leader Osama bin Laden in 2011, do not alter this conclusion. This is because the current stability in the terrorism insurance market in the United States is due almost entirely to two factors:

(i) There has been no successful large-scale terrorist attack on U.S. soil since 2001, and

(ii) TRIA remains in place.

The influence of both of these factors is discussed in the sections that follow.

Absence of Successful Attacks Does Not Imply Terrorism Risk is Inconsequential

The fact that there has been no successful large-scale terrorist attack in the United States in eleven years is a remarkable achievement. It is a testimony to the hard work and dedication of this nation's counterterrorism agencies and the bravery of the men and women in uniform who fought and continue to fight battles abroad to keep us safe here at home.

Unfortunately, the threat from terrorist attack in the United States is both real and substantial and will remain as such for the foreseeable future. Indeed, the U.S. State Department warned in a recent report that despite the death of bin Laden and other key al-Qaeda figures, the terrorist network's affiliates and adherents remain adaptable and resilient, and constitute "an enduring and serious threat to our national security."[14]

Table 2 below shows that interest in attacking targets within the United States remains undiminished—with four terrorist plots executed or interdicted within the past year alone. Indeed, it is clear from Table 2 that in addition to an ongoing threat from foreign terrorist networks, the United States also faces homegrown (domestic) terrorist threats from radical individuals, who may be inspired by al-Qaida and others, but may have little or no actual connection to militant groups.

Catastrophe modeler Risk Management Solutions (RMS) points to an increase in the number of homegrown plots in the U.S. in recent years.[15] Many of these have been thwarted, such as the 2012 attempt by Quazi Ahsam Nafis to blow up the Federal Reserve Bank of New York and Mohamed Osman Mohamud who targeted a Portland, Oregon, Christmas tree lighting ceremony. Also among the more notable unsuccessful attacks was an April 2013 attempt to blow up an Amtrak train en route between New York and Toronto. Other thwarted attacks against passenger and cargo aircraft, including the Christmas Day 2009 attempt to blow-up a jet over Detroit, are indicative of an ongoing risk to aviation infrastructure.

[14] *Country Reports on Terrorism 2011*, U.S. Department of State, July 31, 2012.
[15] RMS Terrorism Risk Briefing, July 2012.

Table 2 also shows that terrorists are interesting in attacking targets across the United States, not just in large urban areas. Cities such as Springfield, Illinois and Lubbock, Texas, have also been targeted. It also important to note that the largest act of domestic terrorism in United States history was the truck bombing of the Alfred P. Murrah Federal Building in Oklahoma City in April 1995, which killed 166 people and produced insured property losses totaling $189 million (in 2012 dollars).

Another evolving threat is cyber-terrorism. Recent high profile attacks, such as the sabotaging of Iran's nuclear program via the Stuxnet computer worm and malicious infiltration attempts here in the U.S. by foreign entities, underscore the growing threat to both national security and the economy.

All these factors suggest that terrorism risk will be a constant and evolving threat for the foreseeable future.

Table 2

RECENT TERRORIST ATTACKS AND ATTEMPTS IN THE UNITED STATES

Date	Location	Event
April 15, 2013	Boston, MA	Brothers Tamerlan and Dzhokhar Tsarnaev detonate two pressure cooker bombs near the finish line of the Boston Marathon, killing 3 and injuring 264
April, 2013	New York City, NY-Toronto	Two suspects with al-Qaida links arrested in Toronto, Canada for alleged plot to blow up Amtrak passenger train en route from New York City to Toronto
November, 2012	New York City, NY	Brothers Raees Alam Qazi and Sheheryar Alam Qazi arrested and charged with conspiring to detonate a weapon of mass destruction targeting a New York City landmark
October, 2012	New York City, NY	Quazi Mohammad Rezwanul Ahsan Nafis arrested in plot to blow up Federal Reserve Bank in New York City
August, 2012	Ludowici, GA	Four U.S. soldiers charged in connection with murder and illegal gang activity, linked to foiled plot to commit domestic acts of terrorism, including overthrowing the government and assassinating the President
May, 2012	TBD	Foiled underwear bomb plot to bring down U.S.-bound commercial airliner around the anniversary of bin Laden's death
July 27, 2011	Fort Hood, TX	U.S. Army Pfc Naser Jason Abdo arrested and charged with plotting bomb attack on fellow soldiers at Fort Hood
June 22, 2011	Seattle, WA	Two men arrested in plot to attack military recruiting station in Seattle
May 11, 2011	New York City, NY	Ahmed Ferhani and Mohamed Mamdouh arrested in plot to attack Manhattan synagogue.
February 23, 2011	Lubbock, TX	Foiled plot to bomb military and political targets, including former President George W. Bush in New York, Colorado and California
December 8, 2010	Baltimore, MD	Attempted bombing of Armed Forces recruiting center by U.S. citizen Antonio Martinez, aka Muhammad Hussain
November 26, 2010	Portland, OR	Attempted bombing at Christmas tree lighting ceremony in downtown Portland by naturalized U.S. citizen Mohamed Osman Mohamud
October, 2010	Washington, D.C.	Attempted plot to bomb D.C.-area metro stations
May 1, 2010	New York City, NY	Attempted SUV bombing in Times Square, New York City, by naturalized U.S. citizen Faisal Shahzad
December 25, 2009	Over Detroit, MI	Attempted bombing of Northwest Airlines passenger jet over Detroit by underwear bomber Umar Farouk Abdulmutallab
September, 2009	New York City, NY	U.S. resident Najibullah Zazi and others charged with conspiracy to use weapons of mass destruction in New York City
September, 2009	Springfield, IL	Attempted plot to detonate a vehicle bomb at the federal building in Springfield
September, 2009	Dallas, TX	Attempted bombing of skyscraper in Dallas
May, 2009	New York City, NY	Foiled plot to bomb Jewish synagogue and shoot down military planes in New York City
May, 2009	Various U.S. targets	Conviction of Liberty City six for conspiring to plan attacks on U.S. targets, including Sears Tower, Chicago

Source: Federal Bureau of Investigation (FBI); various news reports; Insurance Information Institute.

Potential Impacts If TRIA Is Not Extended

Without question, TRIA and its successors are the principal reason for the continued stability in the insurance and reinsurance market for terrorism insurance today. As discussed previously, TRIA is credited with restoring terrorism coverage in commercial insurance policies upon its enactment in late 2002.

Potential macroeconomic effects of allowing TRIA to expire—reduced economic growth and fewer jobs—were discussed earlier. In terms of impacts on insurance markets there is no question that coverage will become more expensive and less available—and in many cases unavailable. The question is not a theoretical one. In 2004, more than a year before the original Act's expiration at year-end 2005, terrorism exclusions once again emerged for policies with exposure extending into 2006. This was an unmistakable indication that insurance and reinsurance markets felt that terrorism risk, at least for larger scale attacks, remained uninsurable in the private sector. After Congress agreed to extend the program for another two years under the Terrorism Risk Insurance Extension Act of 2005 (TRIEA), terrorism coverage remained available and affordable in the market. However, with TRIEA's looming expiration in year-end 2006, terrorism exclusions once again appeared in the market, signaling the market's assessment that terrorism risk remained fundamentally uninsurable. These exclusions largely disappeared following passage of a 7-year extension of the program under the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). With TRIPRA's expiration now a little more than one year away (year-end 2014), it is virtually certain that terrorism exclusions will soon reappear in the market. Indeed, insurance broker Aon estimates that at least 80 percent of the commercial property market will be impacted by these exclusions and other restrictions.

Studies by various organizations, including the University of Pennsylvania's Wharton School Risk Center, the RAND Corporation and the Organization for Economic Co-operation and Development (OECD), have supported the idea of a substantive federal role in terrorism insurance. In particular, the Wharton School found that TRIA has had a positive effect on availability of terrorism coverage and also has significantly contributed to reducing insurance premiums.[16] The OECD notes, however, that the financial (capital) markets have thus far shown little appetite for terrorism risk.

Ratings Implications

Although expiration of TRIA is currently more than a year away, insurance ratings agencies are compelled to take action today by subjecting insurers to "stress tests" to ascertain their ability to absorb losses in the event of a terrorist attack.[17] Ratings agency A.M. Best scenario recently employed in its stress test a deterministic scenario simulating a conventional weapon attack similar to a "five- or six- ton TNT truck bomb, with no restrictions placed on the radius and assuming the attack occurs when the buildings are at their highest occupancy." A.M. Best found that 226 of the 889 "ratings units" it examined had exposure to such a scenario and 34 (3.8%) of these ratings units failed the stress test. Consequently, the companies will be required to "present and action plan detailing the steps they will take to reduce concentration of exposure to terrorism risk, should TRIPRA protection change materially." In the event that the insurer's action plan is deemed to be "insufficient" then the "rating unit will face *negative rating pressure, likely in the form of assigning a negative outlook.*" [italics added]

A.M. Best's concerns run deeper still, adding that while private reinsurance is currently available in the market, future availability and affordability of this coverage is "uncertain" in the event TRIA is not renewed or if the program changes significantly.

It is also worth noting that the A.M. Best analysis shows that smaller insurers would be disproportionately impacted by the expiration of TRIA. For those rating units with terrorism exposure under the A.M. Best criteria and with surplus (i.e., effectively net worth) under $500 million, 19 percent failed the stress tests. For those with surplus between $500 million and $1 billion, 11 percent failed.

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[16] *Evaluating the Effectiveness of Terrorism Risk Financing Solutions*, Howard C. Kunreuther and Erwann O. Michel-Kerjan, September 2007, National Bureau of Economic Research.
[17] "The Future of TRIPRA Remains Uncertain, Ratings Pressure Intensifies," *Best's Briefing*, October 9, 2013.

This finding is notable. An Insurance Information Institute analysis of market share indicates that insurers with less than $500 million in surplus serviced approximately 16.8 percent of TRIA-backed coverages in 2012 while insurers with surplus of under $1 billion accounted for nearly a quarter of the market (23.6 percent). One corollary to this finding is that many insurers—particularly small and medium-size insurers—are already at or near their maximum exposure to terrorism risk. Changes to the program that would increase their exposure (or an outright end to the program) would not motivate them to write more coverage. Indeed, the opposite is likely to happen. The bottom line is that any dramatic changes to the program are likely to be highly disruptive to a large share of the market.

A.M. Best also found that rating units with large workers compensation exposures were the most vulnerable under the stress test scenario. Because terrorism protection is mandatory under workers compensation policies, "This leaves ratings units with large workers comp terrorism risks even less options when contemplating how to reduce exposure."

Finally, it is important to recognize that the five- to six-ton TNT truck bomb scenario employed in the A.M. Best stress test should by no means me construed as worst-case scenario. Much larger events are possible which would produce greater stress on rating units and likely increase failure rates.

Evidence from Other Countries: Terrorism Risk Insurance Programs Abroad

Additional evidence that terrorism risk is fundamentally uninsurable comes from abroad. A number of countries have established their own terrorism risk insurance programs and these have operated successfully, often for many years. Australia, Austria, Belgium, France, Germany, the Netherlands, Spain, Switzerland and the United Kingdom have all created programs to cover terrorism in the event of an attack on their own soil.[18] None of these countries is considering the discontinuation of its program.

[18] In 1993, the British government formed a mutual reinsurance pool for terrorist coverage following acts of terrorism by the Irish Republican Army. Insurance companies pay premiums at rates set by the pool. The primary insurer pays the entire claim for terrorist damage but is reimbursed by the pool for losses in excess of a certain amount per event and per year based on its share of the total market. Following 9/11, coverage

This begs the question as to why—twelve years after the 9/11 attack and a decade after the initial terrorism risk insurance program legislation was enacted—terrorism risk, particularly for large-scale attacks, is still viewed as uninsurable? The answer is surprisingly simple and explains why even the absence of a successful major attack on U.S. soil since 2001 does not alter this assessment.

Obstacles to Insuring Losses Arising from Acts of Terrorism

Simply put, acts of terror violate all four of the basic requirements traditionally associated with insurability of a risk. In situations where these requirements cannot be met, it is difficult or impossible to ascertain the premium to be charged and/or difficult or impossible to achieve the necessary spread of risk to avoid excessive exposure to catastrophic loss, thereby threatening the insurer's solvency. Consequently, such a risk would generally be deemed to be commercially *not* viable (i.e., insurable) in whole or in part.

The four basic requirements for insurability of a risk are detailed below (as well in Exhibits 4A and 4B), with a description of how terrorism risk violates each requirement:

1. **Estimable Frequency:** Insurers require a large number of observations to develop predictive, statistically sound rate-making models (an actuarial concept known as "credibility"). For example, insurers handle millions of auto, home, workers compensation and business property claims every year, providing them with vast amounts of data from which they can reliably estimate the frequency of such claims. For major catastrophic risks such as hurricanes and earthquakes that occur less frequently insurers still maintain databases with hundreds or even thousands of these events, supplemented by sophisticated catastrophe models, that help provide statistically reliable estimates of frequency. Terrorism risk is clearly different in this respect.

was extended to cover all risks, except war, including nuclear and biological contamination, aircraft impact and flooding, if caused by terrorist attacks. The British government acts as the reinsurer of last resort, guaranteeing payments above the industry retention.

Obstacle: There are very few data points on which to base frequency estimates for acts of terror in the United States, thus estimates lack any true actuarial credibility. The opinions of experts on the likelihood of terrorist attacks, which might be viewed by some as substitutes for actuarially credible data, are also highly subjective. At any given time, there is a wide range of viewpoints among national security experts on the likelihood, location and/or attack modality. Moreover, insurers have no access to data used internally by counterterrorism agencies. Given the paucity of historical data and diversity and shifting nature of expert opinions, catastrophe models used to estimate terrorism risk are relatively undeveloped compared to those used to assess natural hazard risks. The bottom line is that estimating the frequency of terror attacks with any degree of accuracy (credibility) is extraordinarily challenging, if not impossible in many circumstances.

2. **Estimable Severity:** Insurability requires that the maximum possible/probable loss be estimable in order to calculate the insurer's exposure (in dollar terms) and minimize its "probability of ruin." No insurer can expose itself to losses of a magnitude that present an unreasonable risk of insolvency.

Obstacle: Potential losses arising from terrorist attacks are virtually unbounded. In this sense terrorism risk is akin to war risk, which is almost universally excluded from commercial insurance policies worldwide. Consequently, losses arising from acts of terror can easily exceed an insurer's claims paying capital resources. Workers compensation coverage, which does not permit any exclusions or limitation if injuries or deaths arise from terrorist acts, can lead to extreme losses that on their own could potentially bankrupt an insurer under some attack scenarios. In addition, when it comes to estimating losses from potential terrorist attacks there also appears to be significant variability in outcomes (i.e., disagreement on estimated severity impacts), underscoring the degree of uncertainty associated with potential terrorist attacks.

3. **Diversifiable Risk:** Insurability requires that the losses can be spread across a large number of risks. This is an application of the "Law of Large Numbers" and helps makes losses more manageable and less volatile. Failure to achieve an adequate spread of risk increases the risk of insolvency in the same way that an undiversified portfolio of stocks (or any asset) is riskier than a well-diversified portfolio.

   Obstacle: Terrorism attacks are likely to be highly concentrated geographically (e.g., World Trade Center site), concentrated within an industry (e.g., power plants, airports) or within a certain span of time (e.g., coordinated attack).

4. **Random Loss Distribution/Fortuity:** Insurability requires that the probability of a loss occurring be random or fortuitous. This implies that individual events must be unpredictable in terms of timing, location and magnitude.

Obstacle: Terrorism attacks are planned, coordinated and deliberate acts of destruction. Again, they are likely to be highly concentrated geographically (e.g., World Trade Center site) or concentrated within an industry (e.g., power plants). Terrorists engage in "dynamic target shifting" whereby terrorists shift from "hardened targets" to "soft targets" which implies that losses are not random or fortuitous in nature. The April 2013 Boston Marathon bombing was an example of an attack on a soft target. It is also not difficult to imagine attacks occurring in the United States similar to the September 2013 attack on an upscale shopping mall (another soft target) in Nairobi, Kenya, by al-Shabaab, a Somali-based terrorist group with links to al-Qaeda.

Additional Issues for Consideration in Conjunction with TRIA Reauthorization

Certification Deadline: While TRIA spells out a highly detailed set of criteria that must be met for an event to be officially certified as a "terrorist act," TRIA offers no timeline or deadline by which such a certification must be made. Although the Boston Marathon bombings occurred more than five months ago (on April 15, 2013), there has to date been no certification by the Treasury Department nor has there been any statement by Treasury that the event would not be certified. Indeed, Treasury has offered no guidance as to whether any such determination is ever forthcoming. This situation has created some uncertainty and confusion for policyholders, insurers and other impacted parties. A simple and reasonable solution would be to require that a certification determination must be made within a specified number of days after the event.

Cyber Terrorism: The threat both to national security and the economy posed by cyber terrorism is a growing concern for governments and businesses around the world, with critical infrastructure, such as power plants, transportation, and communication infrastructure at risk.[19] The Department of Homeland Security received reports of some 198 attacks on critical infrastructure systems in the U.S. in 2012, a 52 percent increase on 2011.[20]

Former U.S. Homeland Security Secretary Janet Napolitano recently warned that a "cyber 9/11" could happen imminently and noted that critical infrastructure – including water, electricity and gas – is very vulnerable to such a strike.[21]

Earlier, in an October 2012 speech then U.S. Defense Secretary Leon Panetta warned that the United States was facing a possible "cyber Pearl Harbor" scenario, and increasingly vulnerable to foreign cyber attacks on its critical infrastructure networks. Such attacks are targeting the computer control systems that operate chemical, electricity and water plants and transportation networks, Panetta said.

Summary

In the twelve years since the tragedy of the September 11, 2001 terrorist attack on the United States, much has been learned about the nature of terrorism risk and its insurability. There is no question that the Terrorism Risk Insurance Act and its successors brought much needed stability to the market in the aftermath of the most costly insurance loss in global history. In the decade since, private sector insurers, reinsurers and the federal government have successfully partnered with one another in

[19] *Cyber Risks: The Growing Threat,* Robert P. Hartwig and Claire Wilkinson, Insurance Information Institute, April 2013.
[20] *As Hacking Against U.S. Rises, Experts Try to Pin Down Motive*, the New York Times, March 3, 2013
[21] *Napolitano warns of risk of major cyber attack*, Newsday, January 24, 2013.

order to maintain that stability, providing tangible benefits for businesses large and small—and their employees—all across America.

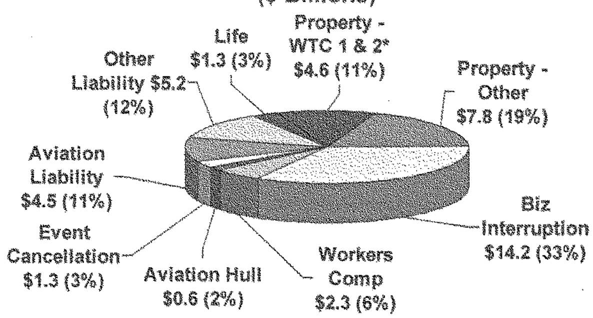
The looming expiration of the TRIA at the end of 2014 brings to a head the question of whether terrorism risk is now, or ever will be, a risk that can be managed entirely within the private sector. The evidence, both in the United States and from similar programs abroad, is that market stability in terms of both pricing and availability of terrorism coverage, as well as the ability to maintain adequate and expanding levels of capacity over time, are contingent on the continued existence of the Terrorism Risk Insurance Program. Moreover, based on recent ratings agency "stress test" analyses, significant changes to the program could prove to be very disruptive to markets.

Thank you for you for the opportunity to testify before the Committee today. I would be happy to respond to any questions you may have.

Exhibit 1

Loss Distribution by Type of Insurance from Sept. 11 Terrorist Attack ($ 2012)

($ Billions)



Total Insured Losses Estimate: $42.1B

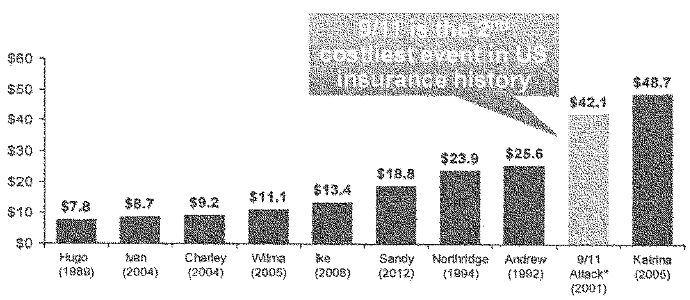
*Loss total does not include March 2010 New York City settlement of up to $657.5 million to compensate approximately 10,000 Ground Zero workers or any subsequent settlements.

Source: Insurance Information Institute.

Exhibit 2

Top 10 Most Costly Disasters in U.S. History

(Insured Losses, 2012 Dollars, $ Billions)



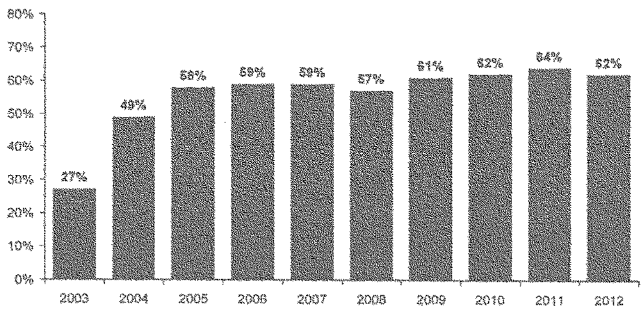
* Insured loss estimate for Sep. 11 terrorist attack includes property, business interruption, workers comp, aviation hull, liability, event cancellation and life insurance losses.

Sources: PCS; Insurance Information Institute inflation adjustments to 2012 dollars using the CPI.

11

Exhibit 3

Terrorism Insurance Take-up Rates, By Year, 2003-2012



In 2003, the first year TRIA was in effect, the terrorism take-up rate was 27 percent. Since then, it has increased steadily, remaining in the low 60 percent range since 2009.

Source: Marsh Global Analytics, *2013 Terrorism Risk Insurance Report*, May 2013.

12

Exhibit 4

Pyramid of Taxpayer Protection: Strong, Stable, Sound and Secure

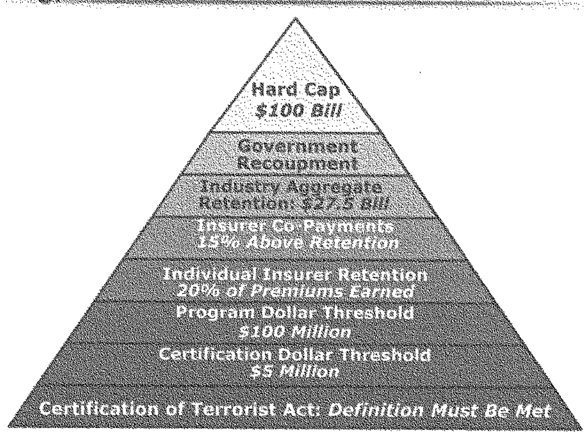


Exhibit 5A

Terrorism Violates Traditional Requirements for Insurability

Requirement	Definition	Violation
Estimable Frequency	•Insurance requires large number of observations to develop predictive rate-making models (an actuarial concept known as credibility)	•Very few data points •Terror modeling still in infancy, untested •Inconsistent assessment of threat
Estimable Severity	•Maximum possible/ probable loss must be at least estimable in order to minimize "risk of ruin" (insurer cannot run an unreasonable risk of insolvency though assumption of the risk)	•Potential loss is virtually unbounded. •Losses can easily exceed insurer capital resources for paying claims. •Extreme risk in workers compensation and statute forbids exclusions.

Source: Insurance Information Institute

Exhibit 5B

Terrorism Violates Traditional Requirements for Insurability (cont'd)

Requirement	Definition	Violation
Diversifiable Risk	•Must be able to spread/distribute risk across large number of risks •"Law of Large Numbers" helps makes losses manageable and less volatile	•Losses likely highly concentrated geographically or by industry (e.g., WTC, power plants)
Random Loss Distribution/ Fortuity	•Probability of loss occurring must be purely random and fortuitous •Events are individually unpredictable in terms of time, location and magnitude	•Terrorism attacks are planned, coordinated and deliberate acts of destruction •Dynamic target shifting from "hardened targets" to "soft targets" •Terrorist adjust tactics to circumvent new security measures •Actions of US and foreign govts may affect likelihood, nature and timing of attack

Source: Insurance Information Institute

LLOYD'S

Testimony of

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Lloyd's of London

Before the Subcommittee on Housing & Insurance
Of the United States House of Representatives
Committee on Financial Services

Hearing Entitled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure"

November 13, 2013

Introduction

Thank you Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee for the opportunity to testify today. My name is Sean McGovern. I have responsibility for Risk Management at Lloyd's and am also General Counsel. It is a privilege to share our views on the Terrorism Risk Insurance Act, which we believe has been an extremely successful program.

From its beginnings in Edward Lloyd's coffee house in the late 17th Century, Lloyd's has been at the forefront of insuring unusual and specialized risks.

Lloyd's has long been a large participant in the US insurance market, through both direct insurance and reinsurance. Our specialism is catastrophe coverage and we have been there to support the US economy in the face of many tragedies over hundreds of years, cementing our reputation with our response to the 1906 San Francisco earthquake and more recently in the very substantial claims arising from Katrina, Rita and Wilma in 2005. We know how to underwrite catastrophic risk and we have an appetite to take risk that others will not - it is our business.

I would like to begin by noting some of the experience on which our views on terrorism risk in general, and on TRIA in particular, are founded.

- Lloyd's paid more claims than any other insurer or reinsurer following the tragic events of September 11th – almost $8 billion.
- Lloyd's is a major provider of standalone terrorism coverage globally. We most recently incurred over $70 million of claims following the September 2013 Westgate Mall attack in Kenya.

- Lloyd's led the development of the standalone terrorism market in the US in the days following 9/11- a point acknowledged by Congresswoman Maloney at the full Committee hearing in September.[1]
- Lloyd's is generally wary of Government intervention and believes in free markets and private market solutions whenever possible.
- Lloyd's market has specialist providers of property and casualty insurance and reinsurance and also a growing standalone terrorism market.

Terrorism risk is different to other catastrophe risk

Notwithstanding all of the above, the nature of terrorism risk is simply different from other perils, even natural catastrophe perils. To name just a few of the differences:

- Risk assessment for terrorism is very difficult – frequency and severity are extremely hard to predict.
- Only the Government has access to intelligence information regarding terror threats and it cannot share that information with industry, nor should it.
- As the recent tragic events in Boston demonstrated, the likelihood and the mode of attack are highly variable – which adds to the uncertainty around the potential maximum size of an event.
- Although modeling exists, it has limitations – in particular, due to the infrequency of extreme terror events, there is much less historical data available to draw upon than exists for natural catastrophes.

None of this means that terrorism risk cannot ever be underwritten – we already do so after all. Nevertheless, all these factors act to substantially limit the appetite of the insurance and reinsurance industry to absorb this risk, particularly in major urban areas due to the density and accumulation of asset value.

TRIA is still necessary

Lloyd's supports the renewal of TRIA. The basic market conditions that necessitated TRIA still exist - commercial policyholders need insurance to protect the US economy against terrorism losses. But, as outlined above, the coverage of terrorism risk is different from other risks.

TRIA has been successful in giving the insurance industry the confidence to make terrorism coverage available. The availability and high take-up rates of terrorism risk insurance across all sectors of the economy are already well-documented in the record before the Committee. This availability has had a positive impact on pricing which has encouraged take-up and the result is that the Federal Government and ultimately the tax-payer are insulated from potential losses. Since TRIA, through the recoupment provisions, operates essentially as a post event cost-sharing mechanism, the high threshold for Federal involvement ensures that private capacity will absorb all but the most extreme losses.

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[1] From transcript of September 19 HCFS Hearing on TRIA: *"the only place some companies could get insurance was Lloyd's of London. Why was Lloyd's of London able, in very limited ways, to provide insurance, yet no insurance company in America was providing insurance to anyone -- any business in New York"*

Without TRIA however, the aggregation of risk would quickly lead the industry to exclude coverage or withdraw capacity from key economic centres in the US.

There is much talk about the excess capital in the insurance industry and its ability to take on more terrorism risk. Nonetheless, it would be wrong to assume that more capital leads to a dramatic increase in the overall appetite to write US terrorism. Reinsurers need to manage risk aggregation and seek diversification. It is important also to bear in mind that there has so far been no TRIA certified terrorist attack since the program began, let alone one that reached the trigger for Government support. Should such an event occur, it is likely that capacity and risk appetite would be affected – just as with other catastrophe perils.

Lloyd's is likewise skeptical of suggestions that the ILS market could provide sufficient capacity to meet demand for terrorism cover absent TRIA. With 9/11 as the precedent, terrorism correlates more closely with adverse market events than even severe natural catastrophes[2], which would limit appetite from ILS investors who are typically looking for risks that do not correlate with financial market risk. ILS investors also typically seek very tightly modeled risks. Modeling techniques have been developed for terrorism risks, but they are limited by the relative paucity of historical data available regarding extreme terrorism losses. While we do not doubt that there will be some appetite from the ILS market, it is no cure-all.

Further factors that need to be considered include the appetite of the cedents to write the original risks without TRIA's backstop and "make available" requirement. Moreover, total reinsurance capacity does not cater only for terrorism risk – and increasing demand outside the United States offers reinsurers opportunity for portfolio diversification.

More broadly, the United States is by no means the only country confronted with the challenge of ensuring the national economy is protected in the event of a failure of counter-terrorism measures. The UK has lived with the threat of domestic terrorism for many years. Whilst the structure of the co-operation between Government and industry to make terrorism cover available in the UK is different from TRIA, the program ("Pool Re") is covered by an unlimited Government backstop. Similar arrangements exist in the major European economies (see **Appendix A**), as well as many other industrialised nations – despite none having experienced a terrorist event of the magnitude of 9/11.

Looking Ahead to Future of TRIA

Lloyd's believes the current TRIA structure is the right framework within which to encourage greater private market innovation in meeting the demand for terrorism cover. It ensures private sector involvement from the first dollar. It allows the expertise and innovation that have been developed in the context of the TRIA backdrop to evolve, rather than be discarded.

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[2] The Dow had lost nearly 1400 points from its pre-September 11th close in the first week of trading after the markets reopened. By contrast, the Dow was generally stable following Hurricane Katrina; even gaining in the first week after the storm.

While current modeling methodologies do give some ability to individual insurers to manage their own exposure to terrorism risk, they do not offer any assurance that sufficient cover will be available to meet overall demand. In that scenario, the consequences can be dramatic – as demonstrated by the economic paralysis we saw in late 2001 and 2002.

We accept the need to assess whether or not TRIA should change – and it may well be that the balance between Government and private market involvement could tilt more towards the private market. But any changes to TRIA to facilitate greater private insurance and reinsurance capacity should not sacrifice the stability TRIA has already achieved.

How changes are made can be just as important as what changes are made. For example, sudden or drastic increases in the retentions or co-shares could prompt some insurers to concentrate their capacity elsewhere.

While Lloyd's recognises and supports the goal of reducing the Government's overall exposure to terrorism risk, the best way to increase private participation and benefit from the expertise that TRIA has enabled the industry to develop, would be through incremental changes over the course of a long-term extension of the program.

Hanging the sword of Damocles over the entire edifice every few years creates instability and damaging uncertainty – for industry (the insurance industry and other impacted industries, such as commercial real estate), policyholders and taxpayers alike. By contrast, well-defined incremental changes over the course of a long-term extension of the program may provide a transparent process of reductions in the risk borne by the taxpayer. This would also be consistent with supporting gradually increasing industry appetite and capacity to underwrite terrorism risk.

Making those step-changes contingent on regular, independent assessments of availability and capacity may give a means to safeguard the steady development of a stable private market for terrorism cover.

However it is important to note that Lloyd's does not envisage the end-point of such a transition being the complete removal of TRIA. For the reasons we have outlined, we believe that TRIA will continue to be needed in some form for the foreseeable future. This is not because of any particular failure of either industry or of government, but as a consequence of sociological and political changes both within and without the United States.

Increasing urbanization combined with growing geo-political tensions has created 'tinderbox' conditions both for the emergence of new terrorist threats and also their capacity to inflict concentrated destruction. While it may be possible to increase private participation in covering terrorism risk, we struggle with the notion that there could be no federal backstop.

Nevertheless, some improvements could also be made to the administrative aspects of TRIA. The Boston Marathon attack revealed a need to clarify the operation of the certification process, due to market effects even where federal compensation is not at issue.

Most commercial insurance policies in the U.S. market cover or exclude terrorism peril by reference to a certified "act of terrorism" under TRIA. The lack of guidance to date on whether the Boston attack constitutes an "act of terrorism" therefore continues to create significant uncertainty for claims adjusters, particularly in relation to various claims-handling obligations (and time lines) that insurers face under State laws.

Where exclusions in property policies turn on certification of an event, the decision of whether or not to certify an event must be made by an independent body not a political one, and either of the insurer or the insured should be able to request a determination.

Some aspects of the program, however, should not change. For example, the design of the program as a retrospective assessment is preferable to pre-event pooling, which is always complex for an extremely low-frequency, but potentially catastrophic loss risk.

Likewise the recoupment mechanism protects taxpayers and essentially means that federal support provides bridge liquidity for those insurers hardest hit by an event.

Conclusion

Whatever the future of TRIA, Lloyd's will remain committed to providing the fullest cover it can to its American customers – just as we did immediately after 9/11, before TRIA was enacted.

But our ability to do that will be limited by our need to manage our risk aggregation. The same issue will apply across the industry and we have no confidence that the private sector alone is capable of providing the entirety of the coverage that would be needed should TRIA not be renewed.

TRIA has been and continues to be an effective plan for stabilizing the economy in the wake of uncertain terrorism risk, while also ensuring a smooth economic recovery following a future attack. We believe that it should be renewed.

Avenues for increasing private involvement may exist, but must be explored in such a way that the market is protected should additional private market capacity fail to materialize. We look forward to working with the Subcommittee on finding ways to do this.

Thank you, and I am happy answer any questions.

Appendix A – European Government Terrorism Pools

Source: Willis European Terrorism Exposure Bulletin February 2011

COUNTRY	GOVERNMENT POOL	COMPULSORY/ OPTIONAL	LIMITATIONS
Austria	Österreichischer Versicherungspool zur Deckung von Terrorisiken	Optional	Limit €5 million per location
Belgium	No government pool is in place	Compulsory	Since May 2008 it has been mandatory for terrorism insurance to be provided by all Belgian insurers
Denmark	No government pool, however a fund established in June 2008 takes effect when insurers reserves have been exhausted	Optional	Most insurers now exclude terrorism cover from policies so cover has to be purchased separately if required
Finland	No government pool is in place	Optional	Two local insurers provide terrorism buy-back within their standard property policy
France	GAREAT	Compulsory	Terrorism exclusions apply for large risks above a stated limit, being €20 million or 20% of the sum insured, whichever is greater. Cover is 'bought back' via GAREAT
Germany	Extremus	Optional	Cover available via Extremus for risks exceeding €25 million. Terrorism buy-back for sums insured below this value is generally available via the primary Insurer
Italy	No government pool is in place	Optional	The majority of policies exclude terrorism cover where the sum insured exceeds €50 million
Netherlands	Nederlandse Herverzekeringsmaatschappijvoor Terrorismeschaden (NHT)	Optional	Government pool provides cover for risks up to €75 million per location per annum
Norway	No government pool is in place	Optional	Terrorism cover is generally excluded from commercial risks with a limited writeback. Cover is not readily available in the open market
Portugal	No government pool is in place	Optional	Cover is usually excluded from personal and commercial risks
Spain	Consorcio	Compulsory	Consorcio provides terrorism buy-back cover, subject to an appropriate premium
Sweden	No government pool is in place	Optional	Terrorism normally excluded from Property policies and is not readily available through the local market. Where required this has to be secured through the global insurance market
Switzerland	No government pool is in place	Optional	All primary property policies with a sum insured exceeding CHF 10 million exclude terrorism cover. Commercial and industrial risks also contain a terrorism exclusion for risks below CHF 10 million
United Kingdom	Pool Re	Not compulsory, however if cover is required it must be purchased for all properties of the Insured and the Insured may elect to purchase cover for property and business interruption or property only	Cover is subject to the same limits as the UK property damage/business interruption policy. The Pool Re programme provides for terrorism on an 'all risks' basis, but excludes acts of war

The Future of Terrorism Insurance:

Fostering Private Market Innovation

To

Limit Taxpayer Exposure

Subcommittee on Housing and Insurance,

Committee on Financial Services,

United States House of Representatives

Testimony of

Dr. John S. Seo

Co-founder & Managing Principal

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Westport, CT

Wednesday, November 13, 2013

Washington, DC

1. Introduction

I thank the Subcommittee on Housing and Insurance for inviting me to testify at this hearing on the potential role of the so-called Insurance-Linked Securities (ILS) market to privatize a greater part of the terrorism insurance market in the United States. The most commonly known part of the ILS market is the catastrophe bond (cat bond) market. The other, less-well known part of the ILS market is broadly termed collateralized reinsurance, which encompasses a broad array of reinsurance activity. What collateralized reinsurance has in common with cat bonds is that risk capital from outside the traditional insurance and reinsurance market are used to back up promises to pay for insured catastrophe losses. In my testimony today, I will speak broadly about the ILS market, with details and evidence taken largely from the cat bond market.

My name is John Seo. I am a co-founder and managing principal along with my brother, Nelson Seo, of Fermat Capital Management, LLC, which is believed to be the largest investment manager of cat bonds worldwide. Fermat Capital today has $4.5 billion of assets under management, all of it in ILS with a majority in cat bonds. Over the last 15 years, in addition to my "day job" of being a cat bond portfolio manager, I have also been privileged to serve as a state-appointed advisor to the Florida Hurricane Catastrophe Fund and as a bank-appointed advisor to The World Bank's Global Facility for Disaster Reduction and Recovery. In these additional roles, I was asked to help explore mechanisms to privatize catastrophe risks held directly or indirectly by the State of Florida and The World Bank.

I have been asked by the Subcommittee to testify on the current state and outlook of the ILS market, to discuss common misunderstandings about the ILS market appetite for terrorism risk, and to discuss ways to increase the efficiency of ILS coverage for terrorism risk. Before I get to that, I am afraid I must give a brief history of the ILS market because this market is still so new and its role in insurance markets is still not widely understood. I also think the Subcommittee will find the history of the ILS market relevant to the current situation in terrorism insurance.

2. A Brief History of the ILS Market

The ILS market had its beginning in the mid-to-late 1990s in the aftermath of Hurricane Andrew in 1992 and the Northridge Earthquake in 1994. These two events brought about insured losses of approximately $15 billion each. While such losses unto themselves were somewhat manageable by the insurance market, they were approximately 10 times larger than expected. This had two implications for the insurance market in the mid-1990s.

The first implication was that, as things stood, insurance companies were potentially "broke", in the sense that they likely did not have enough capital to weather worst-case loss scenarios — they were potentially under-reserved by up to 10 times for the "Big One" in hurricane and earthquake. The second implication was that insurance companies were potentially "blind", in the sense that their traditional actuarial methods provided no reasonable indication of worst-case loss scenarios. Not surprisingly, being potentially broke and blind in regard to hurricane and earthquake, the insurance market for these risks collapsed in the mid-to-late 1990s, and state governments had to step in. Although significant progress has been made since then to bring private markets back into the U.S. hurricane and earthquake insurance markets, that progress has been the greatest on the commercial side of the market. Even today, almost 20 years later, in Florida the state owns over 70 percent of homeowners' hurricane risk on the beach; and in California the state owns over 70 percent of homeowners' earthquake risk on the fault-line.

In response to this dire situation in the mid-to-late 1990s, a relative handful of enterprising professionals on Wall Street created the ILS market. Two key visions drove the early formation of the ILS market.

The first vision is the most well known: that capital markets had the potential to easily absorb the worst-case losses of hurricanes and earthquakes. Vast as it is, the insurance market only has a capital base that, depending on how you measure it, is 50 to 100 times smaller than the capital base that backs ILS markets. With an appropriately sized capital base, ILS markets were expected one day to restore the insurability condition to hurricane and earthquake risks and create a "win-win" situation, between insurers, on one hand, and reinsurers and ILS investors, on the other. Note ILS investors are alongside reinsurers because they both perform similar roles, each in a complementary way. ILS and traditional reinsurance help insurers shoulder their greatest risk burdens. ILS does this with global capital diversification; reinsurance, with global risk diversification.

The second vision driving the early formation of the ILS market is less well known: capital markets would make cutting-edge catastrophe models ("cat models") more mainstream in commercial usage. Though in much wider use today, cat models were only being used by a small handful of pioneering insurance and reinsurance companies 20 years ago. By putting the promise of vast amounts of risk capital behind the latest technologies for risk estimation, it was believed that ILS markets could accelerate insurance industry adoption of modern cat modeling techniques. This would eventually make catastrophe insurance markets more transparent, which would increase the efficiency of catastrophe risk financing in all forms.

These two elements, the promise of a huge capital base and the adoption of cutting-edge cat models, were together intended to solve the "broke and blind" problem that afflicted the insurance industry in the aftermath of Hurricane Andrew and the Northridge Earthquake. The jury is still out on whether these two visions of the ILS market will ultimately materialize, but progress to date has been excellent by most anyone's measure.

While investment activity on the non-cat bond side of the ILS market bears a close resemblance to traditional reinsurance activity, the cat bond side of the ILS market has become a distinct and well-accepted sub-sector of the corporate bond market. Just like corporate bonds, cat bonds are typically rated, listed with public exchanges, and are actively traded in the over-the-counter market. Unlike traditional corporate bonds, however, cat bonds collectively provide explicit coverage for hurricane, earthquake, tornado, hail, wildfire, disease, flood, terrorism risk and potentially any other quantifiable risks that would be called a catastrophe by the insurance market. In return for bearing these risks, cat bond investors receive a high coupon, higher typically than those of comparably rated corporate bonds. This high coupon acts as a kind of insurance premium for ILS investors.

3. Current state and outlook of the Insurance-Linked Securities (ILS) market

From its beginnings in the mid-to-late 1990s, the ILS market has grown to $45 billion this year, with $20 billion of that coming from the cat bond market. The non-cat bond side of the ILS market is typically a "buy and hold" market with annually renewed contracts, while the cat bond side of the ILS market is actively traded on a daily basis. The cat bond market is expected to see over $7 billion in secondary market trading volume this year. ILS investors are found on every habitable continent in the world and range from high net-worth individuals, family offices, foundations, endowments, insurance companies, private banks, hedge funds, specialty ILS managers, money managers, mutual funds, pension funds and sovereign wealth funds. Specialty ILS managers collectively have several hundred distinct investors from among all the investor classes just mentioned, who pool their money in ILS fund vehicles, some of which are onshore, listed, and regulated in the UK, Europe, or Australia. New ILS investment vehicles are announced every month now.

As has always been the case, high levels of innovation continue to characterize the ILS market. It is not unusual for a risk to be considered "a bridge too far" in one year, then commonplace a few years later. For example, a cat bond covering the New York Metropolitan Transportation Authority

(MTA) for flood risk was successfully placed in the market this year in July. ILS professionals now believe the MTA cat bond to be the first of many such flood bonds that will be issued in coming years; yet, even a few years ago, many of those same ILS professionals considered a burgeoning market for flood bonds to be improbable. This is not an unusual experience in the ILS market.

Regarding the coverage of terrorism risk specifically, I report to the Subcommittee that the cat bond market alone currently covers only $1.4 billion in terrorism risk. If we extrapolate that to the non-cat bond side of the ILS market, we could reasonably estimate that the ILS market in total covers roughly $3 billion in insured terrorism risk today.

From its current base, some market observers expect the ILS market to triple in size over the next five years and create $150 to 200 billion in total risk capacity before the end of this decade. Using only simple extrapolation from our current state, this expected growth trend would take ILS capacity for terrorism risk to $9 to $12 billion by the end of this decade. If the ILS market should more widely adopt coverage of terrorism risk, the ILS market capacity for terrorism risk could easily rise to $20 to $30 billion by the end of the decade. There are the usual caveats that must surround this rosier projection, but it is definitely not out of the realm of future possibility.

4. Common misunderstandings about the ILS market appetite for terrorism risk

Unless a particular part of the ILS market is growing by leaps and bounds, it is common for misunderstanding to arise around the market appetite for the risk or risks in question. Some of these misunderstandings stem from a lack of information, and some of these misunderstandings come from mixing and confusing the preferences expressed among different investor classes. I would like to address one of each kind of misunderstanding now.

The first common misunderstanding is that ILS markets have shown no appetite for terrorism risk to date. I assume that such a view is largely due to a lack of information, so I will simply lay out the numbers on this issue now. The ILS market for terrorism risk began with Golden Goal Finance, Ltd., a $250 million cat bond deal brought to market in October 2013. Golden Goal provided terrorism cancellation coverage to FIFA for the 2006 World Cup. At the time, merely two years after 9/11, Golden Goal was 7 percent of the outstanding cat bond market, quite large for a single cat bond issue. As such, Golden Goal at the time of issuance was the third largest cat bond issue in the market out of 25 outstanding issues. In the ten years since the issuance of Golden Goal, terrorism risk has remained at 7 percent of the cat bond market, growing from $250 million to $1.4 billion in cat bond coverage over the last 10 years, which comes out to a 19 percent compound annual growth rate. Admittedly, these figures do not indicate an overwhelming trend of historical growth, but they certainly do not support the conclusion that ILS markets have exhibited no appetite for terrorism risk to date. Given the proper information, it seems clear that ILS markets to date have kept an open mind on terrorism risk—nothing more and nothing less.

Another common misunderstanding is that ILS investors strictly avoid correlation risk. This very common misperception about ILS investors deserves careful discussion. Confusion around this issue is understandable.

Without getting into too much detail here, ILS markets are supported by a mixture of so-called fast and slow money. Fast money typically comes from hedge funds; slow money, from pension funds. According to the latest figures from Swiss Re Capital Markets, hedge funds make up less than 5 percent of the ILS market. Pension funds are more difficult to track directly because they tend to invest through specialty ILS managers. As one such manager myself, I would gauge pension fund participation in the ILS market to be 60 percent.

Fast money is the most vocal about correlation risk in ILS. Part of this concern is sincere. Fast money often runs highly leveraged positions, in long-short pairing as well. Even a relatively small and brief departure from correlation assumptions can cause big trouble for fast money. This makes fast money naturally sensitized to the possibility of minute flaws in correlation assumptions. Nonetheless, part of the concern expressed around ILS correlation by fast money is a codified way of asking for a higher yield. Fast money reasons that slow money, which I will discuss soon, keeps ILS yields low on the assumption of non-correlation. Fast money goes on to reason that any potential correlation is uncompensated; and, therefore, greater than normal yield is required for ILS with any potential correlation issues. By the way, this concern applies to most earthquake bonds as much as it would to terrorism bonds.

Armed with this kind of reasoning, which borders on militancy at times, fast money can stay on the sidelines for years at a time, waiting for what it perceives as distressed yields before entering a particular part of the ILS market. Perhaps the incorrect view that all ILS investors are hypersensitive to correlation risk comes from the fast money side of the market, but fast money, as already noted, is only a small part of the overall ILS market capacity.

Slow money is clearly enamored with the general low correlation of ILS to stocks and bonds. Perhaps this, too, could mislead a market observer. By incorrectly combining slow money declarations of love for the low correlation of ILS with the non-correlation militancy of fast money, it is possible to come up with the false, composite picture that all ILS investors are a tough bunch when it comes to ILS correlation risk. Yet, this is simply not true.

Slow money likes ILS and believes ILS offer returns that have a low correlation to stock and bond returns. There is no doubt about this, but the sentiment is more declarative than prescriptive. First of all, slow money defines correlation on a much longer time scale than does fast money—years as opposed to days, weeks or months. Does a prolonged economic recession increase the risk of an insured loss event? Does an insured loss event increase the risk of a prolonged recession? Measured on such long time scales, to my knowledge, no significant correlation between ILS and traditional markets has ever been found. Low correlation with traditional investments is desired by slow money, but the insistence is not so strict that zero correlation is required. Furthermore, the long time scale used to gauge correlation washes out most short-term effects usually associated with, or defined as, correlation.

Perhaps just as important as the long time scales on which slow money operates, slow money is also thoughtful about its approach to alternatives markets like ILS. Even if there were some possibility that an insured loss event might cause longer term damage to stock and bond returns, slow money would ask: is that risk, already borne by stock and bond investors, better compensated in ILS than in stocks and bonds? The answer to that question is almost universally: "ILS pays better for the risk." This is because stock and bond investors are almost never compensated for bearing extreme event risk, whereas ILS investors are almost always paid for the extreme event risks they cover. As you might hope and expect, with slow money, any lack of correlation with stock and bond returns is icing on the cake, but fair compensation for the risk is of the greatest importance in the end.

5. Ways to increase the efficiency of ILS coverage for terrorism risk

I would like to end my testimony by briefly describing two ways to increase the efficiency of ILS coverage for terrorism risk, which could help the ILS market get to a higher adoption of terrorism risk coverage than might be expected at the current pace of progress.

Greater efficiency of ILS coverage is generally achieved by bundling of coverage with risks that are better understood or exclusion of risks that are less well understood or both. Let me explain while being more specific.

ILS coverage for terrorism risk in the cat bond market has never occurred on a pure, standalone basis. ILS coverage for terrorism risk in the cat bond market is typically bundled with so-called extreme mortality risk, which includes mass threats to human life from disease and earthquake.

This bundling is natural and unsurprising, but the bundling of terrorism risk with other risks likely occurs because risk coverage generally becomes more efficient the more risks are put together in a single contract. I am leaving out a great deal of technical details, but the intuition here is simple: risk bundling reduces the negative effects of transaction costs and economic rents for capital. Ideally, the new risks that are being brought into the bundle are better understood, improving the average quality of the risk bundle. Sometimes, other competing market inefficiencies can come into play to counter the benefits of risk bundling, so this is not always a cure all. Nonetheless, if terrorism risk were bundled with natural catastrophe risks such as hurricane and earthquake, the efficiency of ILS coverage for terrorism risk could potentially be improved.

Finally, ILS coverage for terrorism risk in the cat bond market currently includes nuclear, biological, chemical, and radiological (NBCR) causes of loss. Cat models attempt to take into account both conventional and NBCR sources of terrorism losses, but the ILS market believes that NBCR risks are much less well understood than conventional terrorism risks. If NBCR were excluded from ILS coverage, the efficiency of ILS coverage for the remaining conventional terrorism risk would be improved greatly.

6. Closing

Thank you for this opportunity to testify to the Subcommittee today. I look forward to answering any questions you may have.

American Bankers Association

Building Success. Together.

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September 16, 2013

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President's Working Group on Financial Markets: Terrorism Risk Insurance Analysis
C/O Kevin Meehan
Federal Insurance Office
U.S. Department of the Treasury
Room 1319
MT, Department of the Treasury
1500 Pennsylvania Avenue NW.
Washington, DC 20220

Re: President's Working Group on Financial Markets: Terrorism Risk Insurance Analysis

Dear Mr. Meehan:

The American Bankers Association and its insurance and securities subsidiaries, the American Bankers Insurance Association (ABIA) and the ABA Securities Association (ABASA)[1], appreciate the opportunity to provide comments about the long-term availability and affordability of terrorism risk insurance.[2] We believe we are in a unique position to comment since a Financial Holding Company, of which ABA represents many, may act as a lender, insurance broker, and securities underwriter for a variety of large corporate customers. Because of our cumulative experience in these markets, we believe that TRIA is vital to the smooth operation of the capital markets and, therefore, the economy at large.

At the time Congress last considered and passed re-authorization of TRIA in 2007, we commented that TRIA "provides capacity and reliable pricing for terrorism risk insurance in a market that otherwise has been unable to accurately and efficiently price risks associated with terrorist events."

There have been no material changes to the insurance marketplace since then that would compel us to change our opinion. TRIA is necessary to help companies that need terrorism coverage solve the problem of being unable to obtain it.

[1] The American Bankers Insurance Association (ABIA) and the ABA Securities Association (ABASA) are separately chartered trade associations and subsidiaries of the American Bankers Association.
[2] See 78 Fed. Reg. 42588 (July 16, 2013).

Were TRIA to lapse, a variety of undesirable market conditions would result; lenders would not be able to underwrite or syndicate large commercial loans; companies would not be able to secure coverage for terrorism risk, a necessary precedent to securing real estate-related credit; and, existing loans made with the condition that terrorism risk coverage be continuous would be found in default.

Holders and issuers of Commercial Mortgage Backed Securities (CMBS) would also be negatively affected as rating agencies might judge these assets adversely. One rating agency, Fitch, said this:

"Fitch may decline to rate or cap its ratings on CMBS transactions with inadequate terrorism insurance."[3]

While lapse would be the worst possible condition, we also want to point out that market disruptions are being experienced currently due to contract terms extending beyond the expiration date of the program. For example, insurance policies with terrorism coverage for any term extending beyond 2014 can't be issued to commercial customers. Accordingly, multi-year commercial loan products, which require property insurance policies backing them, are at risk now; new loans and refinancing can only be issued on a short term basis or not at all.

We appreciated previous opportunities to provide information to the Treasury. Please find our comments addressing questions regarding coverage and expiration of the TRIA program below.

Coverage

Our members' experiences with terrorism risk insurance have indicated that absent TRIA, the availability of coverage would be minimal and the private insurance marketplace would function inefficiently at best. Previous reauthorizations of TRIA have expanded available coverage and allowed for the market to function in a more effective fashion.

The 2007 reauthorization covered domestic terror events in addition to those of a foreign nature, removing ambiguities about whether a particular event would be covered, or not. Given the events in Boston earlier this year, we find this provision highly relevant. We recommend that this provision remain. It has benefited both policyholders and insurers.

We also want to point out that the most valuable provision in the Act is the "make available" provision, where property and casualty insurers who offer property coverage to a commercial customer must make terrorism coverage available as well. It's critical this provision survive re-authorization too.

[3] "Fitch Ratings' Report: U.S. Terrorism Reinsurance: Looming Uncertainty of Program Renewal" July 31, 2013

Despite the increased clarity and efficiency afforded by TRIA, corporate insurance customers in high-risk urban areas still encounter difficulty obtaining coverage with sufficient limits. This is due in large part to the inability of the marketplace to ascertain the potential risks of a terrorist event in urban centers and, with confidence, provide the capacity needed to address those needs.

Without TRIA, it is our judgment that coverages for such high risks would be virtually unavailable.

Expiration

We believe it is important to address TRIA re-authorization now, before the program expires at the end of next year. We do not believe states would be able to mandate sufficient policy requirements to protect commercial consumers needing terrorism risk insurance coverage in the absence of this federal program.

In addition, the private sector has not demonstrated an ability to provide terrorism risk coverage at affordable prices, absent TRIA. Terrorism risk cannot be underwritten by traditional means since data on predicted frequency and severity in any given location is unobtainable. As a result, there is no reason to presume that coverage levels and prices would remain consistent if TRIA were allowed to expire.

Conversely, many observers suggest that TRIA inhibits the development of capacity in the traditional re-insurance marketplace. We believe this to be true in principle. Accordingly, to encourage private market development we urge the government to consider reducing the potential liability TRIA represents to the Treasury. Over time, more efficient markets may evolve to a point where TRIA may be discontinued.

We want to point out, however, that several large brokers like Marsh and Willis report that right now, affordable terrorism risk insurance only exists because TRIA does too. We believe them.

Legislative Vehicles

Several bills have been introduced in the House that propose to extend the TRIA program for at least 5 years. This seems to be the minimum practicable extension sufficient to allow insurance markets to respond. Other bills extend the program for 10 years. We are in favor of either approach.

Various enhancements to TRIA are also proposed;

- Changing the aggregate financial responsibility of the Treasury in the event of an attack;
- In addition to the Secretary of the Treasury, including the Secretary of the Department of Homeland Security in the certification process for acts of terrorism; and,
- Changing the "recoupment" provisions TRIA requires the Secretary of the Treasury to impose.

Each of these provisions would enhance the value of the program and we encourage the Administration to support them; however, the most important feature of the legislation is that it suggests the TRIA program be reauthorized promptly.

We strongly support that intent.

Should you have any questions regarding these comments or wish to obtain any further information from the ABA, please contact me at (202) 663-5172 or by email at kmkechn@aba.com.

Regards,

JKAMcKechnie

J. Kevin A. McKechnie
SVP & Director, Office of Insurance Advocacy

American Bankers Association

Building Success. Together.

J. Kevin A. McKechnie
Senior Vice President & Director
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202-663-5172
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March 19, 2013

The Honorable Michael Grimm
U. S. House of Representatives
Washington, D.C. 20515

The Honorable Carolyn Maloney
U. S. House of Representatives
Washington, D.C. 20515

RE: Support for H.R. 508, TRIA Re-authorization

Dear Representative Grimm and Representative Maloney:

The American Bankers Insurance Association (ABIA), the insurance subsidiary of the American Bankers Association (ABA), would like to thank you for introducing H.R. 508. We have long been advocates for the Terrorism Risk Insurance Act, supported its creation and re-authorization and now strongly support its extension for a further 5 years.

ABA, ABIA, and scores of other major industry trade groups are part of an industry coalition, the Coalition to Insure Against Terrorism (CIAT), that supports the continuation of the program. The Coalition maintains that terrorism risk remains effectively uninsurable without the government backstop, and the cost to our economy would be too great if such coverage was not available.

It is vital that the economy continue to rebuild and we see the availability of comprehensive commercial insurance, including coverage for terrorism risk, as an important component of recovery. We look forward to working with you and the bi-partisan group of sponsors already assembled to enact this legislation.

Sincerely,

JKAMcKechnie

J. Kevin A. McKechnie
SVP & Director
Office of Insurance Advocacy

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

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202/463-5310

November 12, 2013

The Honorable Randy Neugebauer
Chairman
Subcommittee on Housing and Insurance
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Michael E. Capuano
Ranking Member
Subcommittee on Housing and Insurance
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Neugebauer and Ranking Member Capuano:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, thanks you for holding the hearing entitled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure."

In the months following the 9/11 terrorist attacks, the inability for insurance policyholders to secure terrorism risk insurance contributed to a paralysis in the economy, especially in the construction, travel and tourism, and real estate finance sectors. Since its initial enactment in 2002, the Terrorism Risk Insurance Act (TRIA) has served as a vital public-private risk sharing mechanism, ensuring that private terrorism risk insurance coverage remains commercially available and that the U.S. economy could more swiftly recover in the event of a terrorist attack.

Catastrophic terrorism remains an uninsurable risk because its frequency and location cannot be accurately predicted, and its potential scale could be devastating. Without the backstop that TRIA provides, the private insurance market would be unable to provide adequate levels of terrorism risk insurance. TRIA continues to promote long-term availability of terrorism risk insurance for catastrophic terror events and provides a standard of stability for financial markets and recovery after such an attack.

In the absence of TRIA, the federal government would almost certainly be called upon to make significant expenditures after a large-scale attack on the United States. The Chamber strongly supports TRIA's current structure as it ensures the involvement of private sector capital from the outset while also protecting U.S. taxpayers. TRIA requires that individual insurance companies pay a deductible equivalent to one-fifth of their premiums for all TRIA-covered lines and then requires 15% copayment of all losses above their deductible, utilizing substantial private sector capital to pay losses from an attack before any involvement from the federal government. To further protect taxpayers, the program also mandates a recoupment mechanism to ensure that the federal government can be made whole after an attack.

While TRIA is currently set to expire at the end of 2014, the Chamber strongly urges Congress to reauthorize this program sooner rather than later. As the Chamber's member companies map out plans for the next 14 months and beyond, the ability to secure terrorism risk insurance is crucial to ensuring that the American business community has the certainty that it needs to continue to move forward with projects and create jobs.

The Chamber thanks you again for holding this hearing and looks forward to working with the Committee to secure swift reauthorization of this important program.

Sincerely,

R. Bruce Josten

R. Bruce Josten

cc: Members of the Subcommittee on Housing and Insurance

CIAT

COALITION TO INSURE AGAINST TERRORISM

www.insureagainstterrorism.org

American Bankers Association
American Bankers Insurance Association
ABA Securities Association
American Council of Engineering Companies
American Gaming Association
American Hotel and Lodging Association
American Land Title Association
American Public Gas Association
American Public Power Association
American Resort Development Association
American Society of Association Executives
Associated Builders and Contractors
Associated General Contractors of America
Association of American Railroads
Association of Art Museum Directors
Building Owners and Managers Association International
Boston Properties
CCMI Institute
Campbell Soup Company
Citigroup
CRE Finance Council
Cornerstone Real Estate Advisors, LLC
CSX Corporation
Emerson
Financial Services Roundtable
The Food Marketing Institute
Helicopter Associates International
Hilton Worldwide
Host Hotel & Resorts, Inc.
Institute of Real Estate Management
InterContinental Hotel Group
International Council of Shopping Centers
International Franchise Association
International Safety Equipment Association
International Speedway Corporation
Long Island Import Export Association (LIIEA)
Marriott International
Mortgage Bankers Association
National Apartment Association
National Association of Chain Drug Stores
National Association of Home Builders
NAIOP
NASCAR
National Association of Manufacturers
National Association of REALTORS
National Association of Real Estate Investment Trusts
National Association of Waterfront Employers
National Basketball Association
National Collegiate Athletic Association
National Council of Chain Restaurants
National Football League
National Hockey League
National Multi Housing Council
National Restaurant Association
National Retail Federation
National Roofing Contractors Association
National Rural Electric Cooperative Association
New England Council
Office of the Commissioner of Baseball
Public Utilities Risk Management Association
The Real Estate Board of New York
The Real Estate Roundtable
Securities Industries and Financial Market Association
Self Insurance Institute of America
Starwood Hotels and Resorts
Taxicab, Limousine & Paratransit Association
Union Pacific
University Risk Management and Insurance Association
U.S. Chamber of Commerce
U.S. Travel Association
UJA Federation of NYC

November 13, 2013

The Honorable Randy Neugebauer
Chairman
Subcommittee on Housing & Insurance
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Michael Capuano
Ranking Member
Subcommittee on Housing & Insurance
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Neugebauer and Ranking Member Capuano:

Thank you for convening this important hearing to further examine the Terrorism Risk Insurance Act (TRIA). CIAT is a broad coalition of commercial insurance consumers, formed immediately after 9/11 to seek a way to restore availability of commercial terrorism insurance for American businesses and the broader economy. CIAT's diverse membership represents, among others, commercial real estate, banking, energy, construction, hotel and hospitality, entertainment, manufacturing, transportation, the major league sports, as well as public sector buyers of insurance including colleges and universities. 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.

CIAT strongly supports the TRIA program. For more than a decade, TRIA has made it possible for businesses to purchase the terrorism risk coverage they need at almost no cost to the taxpayer. TRIA brought stability to a marketplace that was severely paralyzed following 9/11, and it remains a critical component of ensuring economic continuity following another large-scale terrorist attack. It is imperative that TRIA be extended beyond 2014. A recent study by Fitch Ratings concluded that it is "unlikely that substantial private market capacity would arise as a substitute" were TRIA to expire[1]. Bloomberg Government's analysis concurs, indicating "there is no reason to assume that reinsurers will re-enter the market if the TRIA program expires, and every reason to assume that the availability of coverage will fall."[2] We remember all too well what happens when terrorism coverage is not available: commercial borrowers lose their ability to get financing – or go into technical default on financing covenants, billions of dollars in real estate-related transactions stalled or cancelled, hundreds of thousands of jobs lost. Simply letting TRIA expire is not a realistic option.

Under TRIA, all insurance against terrorism risk is written in the private marketplace with no upfront federal liability. All losses recognized in the TRIA plan go first through the private insurance mechanism where much of the loss is retained by design. In the absence of TRIA, which ensures industry participation, the federal share of such a disaster could well be larger. TRIA replaces government exposure with private capital, since insurers retain the cost of all but the largest terror incidents.

♦ ♦ ♦

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As a coalition of primarily commercial entities, we instinctively prefer private market solutions. However, the unique characteristics of terrorism (*e.g.*, adaptive, intentionally driven to inflict catastrophic damage, can strike anytime/anywhere, etc.), significantly hampers the reliability of traditional actuarial risk models, thus necessitating a program like TRIA. To this end, we believe one of the strengths of TRIA is the manner in which it utilizes the private insurance marketplace to manage terrorism risk – indeed, as mentioned above all exposure under TRIA starts with private insurance contracts and, due to both significant retentions and the recoupment mechanism, the ultimate risk-bearers under TRIA are the policyholders and the private insurers. We are always willing, however, to consider ways to further limit taxpayer exposure under the program, as which we know is your focus as well.

Overall, we support the current structure of TRIA and are wary of major structural changes. We are open to modifications so long as they do not have the effect of restricting the availability of terrorism insurance. The current retrospective pooling arrangement, nevertheless, has advantages over various "pre-funding" mechanisms because:

- the retrospective pooling arrangement avoids the need to set contribution rates based on some guess as to how much in terrorism losses there will be
- a pre-funded pool poses temptation to spend the funds on other purposes
- the uncertain nature and timing of large terrorist attacks leads to the risk that a pre-funded pool could be either insufficient or over-capitalized

With respect to the various private sector retention levels under TRIA (*i.e.*, the program trigger, insurer deductibles, etc.), we remain concerned that increasing these levels too much too quickly could restrict the availability of terrorism insurance. We understand, after all, that reinsurance capacity for even the existing retention levels under TRIA is limited.[3] This fact alone demonstrates that TRIA is not "crowding out" the private sector.

Lastly, reasonable measures to attract greater reinsurance and other private sector capacity to the terrorism insurance marketplace are to be encouraged. To date, however, we see no evidence that creative private sector capital alternatives such as CAT Bonds and insurance link securities are sufficiently developed to inject meaningful private capital into the terrorism insurance marketplace. Ultimately, it is important that Congress find ways to incentivize this without impairing TRIA to ensure that terrorism insurance remains available in the event that private sector capacity does not develop to the degree assumed.

We are committed to working with you as you craft a solution to extend TRIA beyond 2014, and we again thank you on your leadership on this critical issue.

Sincerely,

The Coalition to Insure Against Terrorism

[1] Fitch Ratings *U.S. Terrorism Reinsurance: Looming Uncertainty of Program Renewal*, 1 (2013).
[2] Bloomberg Government, *Extending Terrorism Insurance: The case is strong for maintaining a federal backstop in a market too risky for private sector alone*, 5 (2013).
[3] According to Eric Smith of Swiss Re, "Based on the most recent estimate, the total amount of reinsurance capacity available for terrorism in the United States is approximately $6-10b -- well below the $27.5b insurance marketplace aggregate retention under TRIA and the $34-35b cumulative insurer loss retentions." *The Terrorism Risk Insurance Act of 2002; Hearing Before the H. Comm. on Financial Services*, 113th Cong. (2013) (statement of J. Eric Smith, President & CEO, Swiss Re Americas, at 4).

♦ ♦ ♦
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FINANCIAL SERVICES ROUNDTABLE

Committee on Financial Services

Subcommittee on Insurance and Housing
"The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure"

November 11, 2013

The Financial Services Roundtable ("FSR") thanks Chairman Neugebauer and Ranking Member Capuano for holding this important hearing entitled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure." We applaud your consideration of Terrorism Risk Insurance Act ("TRIA") and appreciate the opportunity to submit comments for the record.

FSR supports the long-term reauthorization of TRIA. TRIA establishes a public-private partnership that enables the private sector to offer terrorism risk insurance and absorb substantial property and casualty losses resulting from acts of terrorism. Under this framework, FSR believes TRIA achieves its public policy goals of supporting a private market for terrorism risk insurance, fostering economic resiliency before and after a terrorist attack, and limiting taxpayer losses following a terrorist attack against the nation.

This hearing is an important step in assessing the program and informing policymakers about this marketplace for terrorism insurance coverage. The last time Congress voted on TRIA was in 2007, and many of the Financial Services Committee members have never considered this program.

FSR represents 100 of the largest integrated financial services companies providing banking, insurance, investment products and services to the American consumer. FSR member companies fuel America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

Our diverse membership gives FSR a unique perspective on TRIA. FSR member companies not only include the insurers and reinsurers that offer terrorism coverage, but also banks and investors that must protect their investments from terrorism-related events, companies that need workers compensation protection for their employees and the very policyholders that must insure against terrorism loss. TRIA was not established for insurers, but rather for policyholders – investors, developers, lenders, and employers, all of whom drive economic growth and create jobs.

TRIA BACKGROUND

Congress approved the Terrorism Risk Insurance Act of 2002 on November 26, 2002, after private terrorism insurance constricted following the terrorist attacks of 2001. The September 11, 2001, attacks totaled approximately $31.6 billion (in 2001 dollars), and Congress enacted TRIA in response to widespread concern that the lack of terrorism insurance would have a tangible adverse impact on the U.S. economy.

TRIA was a three year program authorized through 2005 and then reauthorized again in 2005 and 2007 in recognition of the ongoing terrorist threat and the inability of insurers to underwrite the threat and make a sufficient private market for terrorism coverage. The existing law is set to expire on December 31, 2013.

TRIA'S FRAMEWORK

TRIA ensures that the private sector offers terrorism risk coverage and ultimately absorbs some if not all of the loss from an attack. Extraordinary losses that exceed substantial private funding levels will be shared between the private and public sector, as outlined below. The existing program's structure requires substantial private sector capital before any public money becomes involved, and that public money which may be called upon is subject to a meaningful recoupment formula.

TRIA only covers certified acts of terrorism (as determined by the U.S. Department of the Treasury), requiring, among other things, property and casualty losses that exceed $5 million. The current version of TRIA has a "program trigger" of $100 million, under which the private sector absorbs all loss. If losses exceed $100 million, each individual insurance company will realize the entire loss up to 20 percent of its previous year's annual direct written premiums from commercial and property lines (this is the program deductible). Though that deductible varies depending on the premiums written, it is currently estimated to be approximately $34 billion.[1]

If losses exceed this level, private insurers begin to share losses with the federal government; the government absorbs 85 percent of additional losses and the private sector absorbs the remaining 15 percent. In effect, this government participation is a liquidity mechanism, where the government payments, should there be any, provide immediate liquidity to the insurer, allowing policyholders and claimants to receive insurance claims payments quickly. The law requires that government will recoup from insurers 133 percent of public funds provided up to $27.5 billion; losses above that amount are subject to recoupment in the government's discretion. Government funding for events that occur after January 1, 2012, must be collected by September 30, 2017, under current law.

TERRORISM RISK CANNOT BE UNDERWRITTEN

Terrorism is a risk, particularly for major attacks that could lead to massive damages, that cannot be underwritten at the present time. Effective insurance underwriting requires the ability to predict the frequency, location, and severity of loss. Though the typical insurance risks can be unpredictable, when those events are pooled over a large enough area and timeline, the randomness of those events can provide a better understanding of the frequency and severity and location of events and inform underwriting, pooling and risk management decisions by insurers.

Terrorism, however, presents an additional complication because it is purposeful, and indeed, the very nature of terrorism is to evade prediction. Insurers continue to seek modeling methodologies; however, underwriters have yet to identify a proven model that can work with existing and available data to predict this risk in an accurate enough way with the erratic and purposeful behavior of terrorists. The industry, thankfully, lacks meaningful data regarding severity, nature, extent, impact or duration of Nuclear, Chemical Biological, and Radiological (NCBR) attacks. Neither the frequency nor severity of an attack can currently be accurately predicted or credibly modeled. A terrorist may not act for years and then strike multiple times in multiple different ways and locations, none of which is predictable. This lack of predictability is compounded by the fact that terrorism is a dynamic risk: "Terrorism involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and

[1] Webel, Baird. Congressional Research Service. Terrorism Risk Insurance: Issue Analysis and Overview of Current Program. April 26, 2013.

purposefully unpredictable."[2] To the extent that the terrorist threat is identified, the threat is likely to evolve and change to avoid being thwarted. This risk, perversely driven by human creativity and unlimited in scope, makes underwriting terrorist risk an impossibility. Furthermore, terrorists seek to disguise intent and their planned actions making it even more difficult to predict attacks or outcomes.

Without TRIA, the insurance industry's ability to insure property or absorb losses following a severe terrorist attack will be severely compromised. This is compounded by the state law requirement to cover workers compensation coverage. Regardless of whether TRIA is reauthorized, workers compensation must be covered. This leaves coverage providers vulnerable to substantial downside risk from terrorist attacks, including non-conventional NCBR attacks. Without TRIA in place, this downside risk related to workers compensation coverage jeopardizes the solvency of insurers, potentially leaving policyholders unprotected in the aftermath of a tragedy.

If TRIA expires, private sector capacity will diminish significantly, as exhibited in the months after September 11, prior to TRIA's enactment. The lack of market capacity will result in very limited and costly coverage options. This will impact the ability of entities to access coverage necessary to secure financing and investment, to proceed with development, to secure mandatory workers compensation coverage and to protect the businesses that are critical to our economy. It is, therefore, critical that the U.S. continues to partner with the insurance industry to assure policyholder access to critically important coverages.

TERRORISM RISK INSURANCE MARKETPLACE

The Financial Services Roundtable and its member companies share the Committee's goal of creating a robust private marketplace for terrorism risk insurance. The nature of terrorism risk, however, is unique and without TRIA no such marketplace would exist at this time.

Take-up Rates

The marketplace and take-up rate for terrorism risk insurance has evolved substantially since the inception of the program. According to Marsh's 2013 study, "In 2003, the first full year TRIA was in effect, the take-up rate was 27 percent but has since increased steadily, remaining in the low 60 percent range since 2009." Take-up rate varies between sectors and regions and company size.

Pricing for terrorism risk has also evolved over the life of the program. Initially, coverage was priced at approximately 7 percent of property premium during the third quarter of 2003. Over time, however, price levels declined, ultimately stabilizing between 3 – 5 percent of property premium range. Price levels, of course, vary according to the size location, and industry.

[2] Hubbard, Glenn and Bruce Deal. *The Economic Effects of Federal Participation in Terrorism Risk.* September 2004.

Capacity

Under TRIA, primary writers in the commercial space are mandated under the "make available" provision to offer terrorism risk coverage; policyholders, however, are not required to purchase the coverage (absent state requirements for coverages such as workers compensation or lender requirements as part of a commercial mortgage). Given the "make available" mandate, primary commercial writers provide the capacity or coverage that would not exist otherwise.

Reinsurance influences the availability of terrorism risk insurance because the transfer of risk from insurer to reinsurer allows the insurer to spread its risk and frees up capital, which allows insurers to provide additional capacity to the marketplace. According to the 2010 President's Working Group Report, reinsurance capacity ranges between $6 - $10 billion. Although capacity may have increased since the report was issued, the available reinsurance coverage does not appear to be sufficient at those or even moderately increased capacity levels.

The private sector continues to explore whether the capital markets could provide addition risk spreading mechanisms for terrorism insurance, thus increasing capacity for primary insurers. To date, however, there is not an active securitization market for terrorism risk. While our members are eager to identify stable sources of additional capital for the market place, there is no viable option to meet demand at this point.

Many risk professionals believe the termination of TRIA would reduce coverage and decrease the affordability and availability of terrorism coverage. According to a poll by the Risk and Insurance Management Society (RIMS), 45 percent of respondents expected a decrease in terrorism coverage limits while 24 percent believed coverage would no longer be offered by insurers upon expiration of TRIA.

The Committee is considering what adjustments should be made to the program to increase the marketplace for terrorism risk insurance, foster economic resiliency before and after a terrorist attack, and limit taxpayer losses following such a tragedy. These are important goals to have top of mind as changes to the program are contemplated. Although the question is not whether available terrorism risk insurance coverage would be sufficient should TRIA expire, any adjustments to the program should be closely scrutinized as to their impact on private sector participation in the market and supply of coverage.

As noted in the above description of TRIA's framework, there are key attachment points to determine when an attack is considered for certification and when public funds must be deployed and then recouped from the private sector. FSR believes that TRIA's current framework effectively accomplishes its public policy goals, but also understands the Committee's goal to increase private sector involvement. This goal, however, and the adjustments made to achieve it, should be weighed against potential harm they do to marketplace capacity and the functioning of the program.

As a result, FSR recommends that any adjustments to the program – whether new ideas or adjustments to existing attachment points – ensure the program is authorized on a long-term basis; continues to function effectively for all market participants; and provides an orderly mechanism to ensure economic resiliency before and after an attack.

Workers Compensation

Under state law, insurers cannot exclude workers compensation from coverage, whether or not TRIA is in place. This leaves insurers vulnerable to substantial downside risk from terrorist attacks, including non-conventional NCBR attacks. Without TRIA in place, this downside risk related to workers compensation coverage jeopardizes the solvency of insurers, potentially leaving policyholders unprotected in the aftermath of a tragedy. Consequently, the workers compensation market may experience a variance in pricing and capacity based on the framework and existence of the program.

Commercial Lending

The market for terrorism risk insurance and the take up rate has important implications for commercial lending because commercial lenders include terrorism risk insurance coverage requirements for loans over a certain size or where the project being financed is in proximity to areas identified as potential targets for terrorist attacks. Lenders have adopted these coverage requirements to help mitigate risk that banks are uncomfortable assessing and ultimately holding. If the terrorism insurance market constricts and reduces policyholders' ability to access terrorism risk coverage, both existing and future commercial loans would be severely affected.

Existing commercial loans that require terrorism risk insurance do not condition a borrower's performance of this requirement on the existence of TRIA or excuse performance if the insurance is unavailable or prohibitively expensive. As many commercial loans span multiple years, even decades, borrowers are required to purchase and renew terrorism coverage for the duration of their loans regardless of whether TRIA is reauthorized or functioning marketplace for terrorism risk insurance exists. If these borrowers and policyholders do not repurchase coverage, they would be in violation of the loan covenant; depending on the contractual language, the lender would be able to call the loan. Borrowers would be forced to purchase coverage no matter how difficult or costly to access, or face consequences for violating the loan covenant. Lenders would be forced to examine each loan and assess whether to call the loan or adjust the terms in some way to mitigate this now unprotected risk. This would result in substantial economic disruption and potential added risk for all participants in the transaction.

For future loans, lenders would assess each loan that triggers its terrorism risk insurance requirement on a case-by-case basis. This would lead to greater uncertainty in the marketplace and put lenders in the business of trying to model terrorism risk – a risk that insurers themselves cannot model at the present time.

CONCLUSION

The Financial Services Roundtable appreciates the Committee holding this hearing. We thank you for the opportunity to submit comments for the record and we look forward to our continued work with the Committee on this important issue.

The Jewish Federations OF NORTH AMERICA

In Support of Renewing the Terrorism Risk Insurance Act
November 12, 2013

The Jewish Federations of North America strongly support extending the Terrorism Risk Insurance Act (TRIA), which will expire in December 2014.

JFNA is the umbrella organization of 153 local federations and 300 independent communities which serve, support, and lead one of the Nation's largest and longest serving charitable networks that provide health, human services, and other critical humanitarian assistance at the community level. We are headquartered in New York City (with office in Washington, DC and Los Angeles) and our system's hospitals, nursing homes, social services agencies, and community centers are located in practically every major urban area in the United States.

Given the well documented threats from extremists at home and abroad to Jewish communal security, we believe that our institutions across the country represent a segment of the nonprofit sector that is particularly at risk of and vulnerable to terrorist attacks. During a recent threat briefing we received from House Homeland Security Chairman Mike McCaul and other experts informed us that Jewish institutions remain high on the list of terrorist targets and that the narrative that is evolving is getting worse, and not better, for our community. This is the backstop through which we view TRIA.

In surveying our institutions, we have found that TRIA has successfully ensured that the insurance market continues to make widely available to them adequate and affordable terrorism coverage since 9/11. Our system's catastrophic exposure has remained significantly reduced as a consequence of TRIA.

We are not a small enterprise. Our network serves tens of thousands of individuals and families in need, weekly. In times of disaster – whether in the recovery from Super Storm Sandy, Hurricane Katrina, or the attacks on September 11th, among them – our agencies help to rebuild communities through the provision of health care, counseling, shelter, resettlement, job training, food, family support services, and emergency cash assistance. We are often home-base to emergency responders for staging and coordination. TRIA has proven essential to our ability to carry out these vital services, both in the regular course of our work and in times of extenuating circumstances.

For these reasons, we urge Congress to support renewal of the Terrorism Risk Insurance Act.

Point of Contact: Robert B. Goldberg, Senior Director, Legislative Affairs, at: 202-736-5881 or rob.goldberg@jewishfederations.org.

Liberty Mutual.
INSURANCE

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November 12, 2013

The Honorable Randy Neugebauer
Chairman, Housing & Insurance Subcommittee
The Committee on Financial Services
United States Congress

The Honorable Michael Capuano
Ranking Member, Housing & Insurance Subcommittee
The Committee on Financial Services
United States Congress

Dear Chairman Neugebauer and Ranking Member Capuano:

Liberty Mutual appreciates the opportunity to weigh in with the House Financial Services Committee and express our continued, strong support for the Terrorism Risk Insurance Program. TRIA facilitates a private market for terrorism risk insurance for America's businesses by providing a high-level financial backstop in the event of catastrophic terrorist attacks on our country. Constructed as a simple program, it has worked well, as intended. Terrorism insurance is readily available to businesses and employers of all kinds and sizes, enabling billions of dollars of business transactions to go forward.

Perhaps a commentary on our times, the United States remains under the constant and very real threat of future attacks. We experienced it in our own great city of Boston earlier this year. Make no mistake; terrorists attack the United States, not an individual city or business. As a result, it is wholly appropriate that the federal government continue to play a role in the terrorism risk insurance mechanism that works as a safety net for the entire U.S. economy. Such a mechanism secures the ability of our nation to take care of injured workers and their families, rebuild buildings, and reinvest in our economy following the financial devastation caused by future attacks.

Liberty Mutual supports the goal of a robust private insurance market whenever that market is possible. Insurers already put significant capital on the line to offer terrorism coverage to our policyholders. Industry capital in TRIA-covered lines is roughly $250b, while models estimate multiple terrorist events of more than $750b. Despite the existence of some additional capacity in the private market for selected lines in selected locations - not including nuclear, biological, chemical, and radiological risks – there still remains a deficiency in the market to cover the types of losses that only a government could withstand. Workers compensation presents an especially unique challenge because the market is not free and the coverage is prescribed by state law. Workers must be protected.

The stated goal of this hearing is to explore ways to foster private market innovation to limit taxpayer exposure. Liberty Mutual wholeheartedly supports that goal. As you explore options to increase private market participation, we hope that we can be constructive in those discussions, while preserving the mechanism already in place that has worked so well.

Sincerely,

S. Colin Dowling
Vice President &
Chief Federal Affairs Officer
Liberty Mutual Insurance

NAMIC®

NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Subcommittee on Housing and Insurance

Hearing on

The Future of Terrorism Insurance: Fostering Private Market Innovation

to

Limit Taxpayer Exposure

November 13, 2013

Introduction

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide testimony on the Terrorism Risk Insurance Act (TRIA) and the private market for terrorism insurance.

NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,400 regional and local mutual insurance member companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. Member companies serve more than 135 million auto, home and business policyholders, writing in excess of $196 billion in annual premiums that account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. More than 200,000 people are employed by NAMIC member companies.

It is our firm belief that in the absence of a terrorism loss management plan such as TRIA, no self-sustaining private market for terrorism risk coverage is likely to develop. However, the existence of TRIA allows a viable private market to function for a difficult peril which involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and purposefully unpredictable.

The hearing today seeks to discover ways of fostering private sector innovation for covering terrorism risks. We would suggest that we must start from the understanding that the TRIA program was an highly innovative and well-designed mechanism to encourage the private sector to put its capital at risk for losses that result from what amount to acts of war – which have always been considered uninsurable events with either an implicit or explicit expectation that financial responsibility resided with the governments involved. Having learned the lessons of 9/11, most insurers are not likely to offer terrorism coverage in a fully private market.

In fact, it is the unique structure of the program's recoupment mechanism that takes losses that could render a single company insolvent and spreads them throughout the private sector and over time. This mechanism allows for a large and temporal transfer of risk that would not occur in a fully private market, but in the end does utilize private capital.

In considering changes to the present system, we would caution against adopting solutions in search of problems. In fact, alterations that increase the exposure to individual companies could have the unintended consequence of reducing overall capital in this market. Through TRIA, the private sector already has a tremendous amount of capital involved in the terrorism risk insurance market and under current law every penny the federal government pays out can be recovered.

TRIA Structure Designed for Individual Company Participation

Many discussions surrounding the private terrorism risk insurance market focus on aggregate numbers i.e. how much market capacity exists, industry exposures, etc. However, the design of the TRIA program focuses on something entirely different and, in our view, more appropriate: the individual company. The program is structured this way to take into account the unique risk posed by terrorism and the fact that losses are not likely to be spread evenly among a large number of insurers even in a catastrophic event.

The current program requires all insurers selling covered lines to offer terrorism coverage, compelling many insurers that had previously exited that market to return and dramatically reducing the amount of potentially uninsured losses in the event of an attack. In return, the federal mechanism for risk-sharing provides more definitive loss parameters for each company; specifically, the individual company retention (20% of the prior year's direct earned premium for covered commercial lines) and the co-pay (15% of all losses above the individual company retention). By placing a ceiling on individual company terrorism exposure, insurers have the benefit of knowing their total possible losses, allowing them to make coverage available and price accordingly.

It is important to note that simply because an individual company's losses are capped, this does not mean that the private sector participation ends there and the federal taxpayer pays for the rest. Rather, TRIA works through its recoupment mechanism to take those losses and spread them back throughout the private sector and over time. In this way, TRIA acts as a shock-absorber for the U.S. economy to reduce the financial impact of a jarring terrorism event.

By law the federal government *must* recoup the difference between insurers' total costs and the industry aggregate retention of $27.5 billion (assuming the total cost of the event with government payments is $27.5 billion or higher) over time through surcharges on every policy covered by TRIA. Since 2007, the government must actually recoup 133 percent of this mandatory recoupment. In the event the insurers' total costs exceed $27.5 billion then the government can still recoup whatever money it pays out, but this is at the discretion of the Treasury Secretary. The recoupment is done through an assessment on every TRIA-covered, commercial line sold in the U.S. over time. The initial outlays of the federal government that are so important to maintaining an individual company's solvency are in fact borne by the private sector (and paid back with interest for the mandatory recoupments). ***Taxpayers are completely protected under TRIA.***

The structure of the program is important – it is why questions of overall industry capacity can distract from the serious concerns about terrorism risk that remain for individual insurance companies. Even in a catastrophic event, the losses are not likely to be spread evenly among a large number of insurers. This is especially so in the case terrorism because perpetrators have the ability to precisely target particular properties or assets. Hence, insurance companies may either suffer no losses or else they could suffer losses sufficient to threaten their very existence. The TRIA program – through the mechanism of initial federal outlays recovered through recoupment – allows this "bet the company" risk to be spread throughout the private sector and over time in a manner that cannot be duplicated by the private sector.

Altering the Program

Most insurers would likely not offer terrorism coverage in the absence of a federal risk-sharing mechanism like TRIA.[1] It was only with a program in place that put some structure around an ill-defined catastrophic risk that the private sector was able and willing to participate at current levels. We cannot hastily conclude that because the private sector can handle a portion of the risk, it could figure out a way to handle all of it. Similarly, assuming that substantively altering the federal government's role will simply result in private market innovation that has heretofore failed to materialize is unwise. Although individual market players may indicate willingness to take on greater exposure in the abstract, there has been an unwillingness to accept a significantly larger portion of this potentially devastating risk, in particular when it comes to offering affordable limits to protect the solvency of the workers' compensation insurers.

That said, even if there were a guarantee that reinsurers would provide coverage where and when the markets needed it, relying too heavily on them is problematic. Not least of these problems concerns the question of what happens following another large catastrophic event and the limited capacity that has developed is depleted? The U.S. commercial insurance market would be right back to where it was following 9/11 with constrained markets and limited availability with no guarantee (particularly if the event in question is of an unforeseen nature) that the capacity and willingness to take on terrorism exposure would return.

Additionally, in seeking to accomplish the goal of increasing private sector participation in the terrorism insurance market, it is important to recognize the presence of other risks that need to be insured in our dynamic economy. That capacity cannot be exposed beyond a reasonable level without failing in its primary purpose - supporting the economy by protecting against non-terrorism related losses and events. In the event of a major attack, substantially depleted reserves and surpluses, and insolvencies could mean that policyholders of non-covered lines could go unprotected. A company that engages in business that endangers the ability to pay on existing or future policies is violating its duties to existing policyholders.

Finally, NAMIC would caution policymakers not to assume that they can guarantee increased private sector participation through statutory changes. Increasing the nominal amount of private sector involvement in the current TRIA structure does not

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[1] Recent research by Aon shows that more than 85 percent of insurers will no longer insure terror risk if the federal program went away. http://www.carriermanagement.com/news/2013/09/17/113143.htm. Additionally, State insurance regulators indicate that they have not seen evidence suggesting that the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing coverage for acts of terrorism in the absence of the program.

immediately translate into an increase in private sector capital in the marketplace. In fact, altering trigger levels or individual company retentions may cause market participants – particularly small and medium-sized companies – to exit, thereby reducing total private capital. An effective terrorism loss management plan depends on participation by insurers of all sizes and structures.

Conclusion

Private insurance companies, including mutual companies, are return-seeking operations. Therefore, if they believe there is an opportunity to earn an economic return and it is possible to do so in accordance with an overall successful business model, then they will. In other words, if there was money to be made in insuring against terrorism risk, coverage would be offered without government intervention. To that point, the companies would be arguing for less—not more—government intervention to increase that earning potential. The fact that they are uniformly not doing so and in fact suggesting that without the TRIA program private coverage would not expand and instead retract, is telling.

Under the current TRIA program the private sector is heavily involved in absorbing the losses from a terrorist attack against the U.S. Ultimately, it is involved in covering *all* the losses at the discretion of the Treasury Secretary. This private sector involvement reduces the unaddressed needs of victims which in turn reduces the need for government intervention – thus taxpayer exposure – post attack. In contemplating altering the current mechanism, it is important to identify the specific problems that need to be addressed.

In the end, the purpose of the program is not to protect insurers, but to make sure that the economy can recover in as orderly a fashion as possible from a terrorist event. In order to encourage private sector involvement in the terrorism insurance marketplace – and thereby protect and promote our nation's finances, security, and economic strength – we should maintain long-term a terrorism loss management plan on the model of TRIA that is functioning well.

NAPSLO

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Testimony of
the National Association of Professional Surplus Lines Offices

Before the
House Financial Services Committee,
Subcommittee on Housing and Insurance

NAPSLO is the national trade association representing the surplus lines industry and the wholesale insurance distribution system. Since its formation in 1975, NAPSLO has become the authoritative voice of the surplus lines industry, advocating for the industry's vital role as a "safety valve" for hard-to-place and specialty insurance risks and for the industry's importance in the insurance marketplace and global economy. NAPSLO members also play an important role in creating new insurance products in response to the needs of an ever-changing social, business and insurance environment.

NAPSLO's membership consists of approximately 400 brokerage member firms, 100 company member firms and 200 associate member firms, all of whom operate over 1,500 offices representing approximately 15,000 to 20,000 individual brokers, insurance company professionals, underwriters and other insurance professionals in the 50 states and the District of Columbia. NAPSLO is unique in that both surplus lines brokers and surplus lines companies are full members of the association; thus NAPSLO represents and speaks for the surplus lines wholesale marketplace. We appreciate the opportunity to submit testimony to today's hearing.

NAPSLO commends the Committee for its continued focus on the Terrorism Risk Insurance Act (TRIA), particularly in light of its pending expiration at the end of 2014. In considering an extension of any program it is important to evaluate how the program has functioned and what aspects, specifically, are key to its success. NAPSLO believes TRIA has been successful primarily because it serves as a tool for insurers to better manage the risk of terrorism events and provides certainty to the industry in offering private capital and solutions to policyholders. Surplus lines insurers currently provide certain terrorism coverage pursuant to the mandatory provisions and subject to the deductibles and triggers of the existing federal program.

In general, we believe private market solutions should be exhausted before government-sponsored programs or residual markets are considered, and governments should not provide coverage options the private or open market is able to address. However, NAPSLO believes a role exists for the federal government in the management of terrorism risk, especially with respect to the areas of workers' compensation and nuclear, biological, chemical or radiological exposures (NBCR). While insurers can model the severity of a hypothetical terrorist attack, it is impossible to model the likelihood or frequency of such attacks. As a result, we support a thoughtful and thorough review of TRIA with a goal of maintaining or increasing opportunities for capacity and solutions in the private market.

Many argue the deductibles and limits of the existing program and the lack of any triggering events has effectively already shifted terrorism risk to the private market. Under existing TRIA triggers and insurer liability caps, a significant terrorism event will have a material impact on the industry, and could cause financial impairment for certain smaller insurers. TRIA's caps on insurer liability provide some level of certainty and help insurers better manage the risk; increasing these caps would reduce the level of certainty in terrorism risk management, will place smaller insurers at greater risk, and may further limit the availability of private capital solutions for terrorism risks.

Another key consideration for the Committee is the timing on an extension to the program. While the program does not expire until the end of next year, it is important that Congress act quickly as insurers issue policies with coverage periods beyond 2014 and it is vital to have certainty with respect to the provisions of TRIA beyond its expiration date. Therefore, we thank the Committee and its leadership for its timely review of this program and would encourage its continued focus until an extension has been enacted.

Thank you again for the opportunity to comment on this important issue.

Testimony of the
Property Casualty Insurers Association of America (PCI)

Subcommittee on Housing and Insurance
Committee on Financial Services
United States House of Representatives
November 13, 2013

The Property and Casualty Insurers Association of America (PCI) commends Chairman Neugebauer and the Subcommittee on Housing and Insurance for holding this hearing on "The Future of Terrorism Insurance: Fostering Privet Market Innovation to Limit Taxpayer Exposure." PCI is composed of more than 1,000 member business, home and auto insurance companies, representing the broadest cross-section of any national insurance trade association. PCI members write more than $195 billion in direct premium, which is 39 percent of the nation's property-casualty insurance.

As we indicated in our September testimony to the full Committee, PCI believes it is appropriate for members to inquire whether there are any changes that could be made to attract even greater private capital to support terrorism risks. We agree that the program should continue to seek to maximize commercial participation. Indeed, that goal is harmonious with PCI's mission to promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers. However, PCI also hopes that Members of the Subcommittee will recognize the enormous success of the Terrorism Risk Insurance program in providing widely available private sector terrorism risk coverage to consumers in a fiscally responsible manner that reduces the need for government catastrophe assistance after a catastrophic terrorism event. Having a terrorism risk insurance plan in place that protects economic resiliency and national security is essential to our country's future growth.

TRIA Program Maximizes Private Sector Participation. The current TRIA program does an excellent job of keeping commercial insurers participating in the terrorism insurance market, thus protecting taxpayers from most terrorism losses. Commercial insurers pay losses through their annual TRIA deductibles and then additional co-pays even if federal payments are made. This keeps commercial insurers on the hook for all but the most catastrophic terrorism losses. Indeed, over the past twelve years, the commercial insurance industry's participation in writing terrorism risks has gradually increased as insurer deductibles and co-pays have increased. The Congress wisely designed the program to keep the maximum amount of private capital at work in the market, reserving a government role only for catastrophic events that commercial insurers simply cannot handle alone. In addition, when federal payments are made, taxpayers are protected by a mechanism that allows federal payments to be recouped from the insurance marketplace. And this recoupment is mandatory for all but the largest of losses. Taken together, these features make TRIA an extraordinarily fiscally responsible program.

PCI is very concerned about the unintended consequences of proposals to increase the thresholds for the insurer deductible, co-pay or the program trigger. The current TRIA deductible is already high at 20 percent of the prior year's direct earned premium. For large insurers, the deductible is so high that many already are unlikely ever to access the backstop, even though the backstop was meant to be a quid pro quo for accepting the "make available" requirement to which they are still subject.

A deductible increase will also significantly and negatively impact smaller and medium sized insurers. Ninety-four percent of companies writing TRIA lines of insurance are small or medium-sized. These insurers write over 21 percent of the TRIA-covered lines of business in the nation, including numerous specialty lines and businesses. If TRIA is reauthorized with excessively high deductibles, then the retained risks to smaller and mid-sized insurers and some large insurers would exceed their maximum acceptable loss limits and they would be driven out of the market. Indeed, subsequent to the Committee's September hearing, the A.M. Best Company issued a briefing paper suggesting that, even at the current 20% deductible, a number of small to mid-sized insurers may be subject to ratings downgrades.

Since TRIA requires insurers to make terrorism coverage available for covered lines, the only way insurers can avoid exceeding their maximum acceptable risks is to exit some TRIA-covered lines or risks altogether, making not just terrorism coverage but also the underlying insurance for high profile risks far less available. Congress would thus create a significant moral hazard, severely constricting the number of insurers willing and able to underwrite higher profile risks, driving those insurers out of certain markets and greatly reducing the available private capital and competition for consumers.

The impact on surplus is only made worse by the insurer's TRIA retention (coinsurance share) of an additional 15 percent of losses above its deductible. While insurers have some certainty in the trigger and their individual deductible, an insurer's co-share is potentially unlimited other than the $100 billion aggregate marketplace loss cap. The uncertain and relatively unlimited co-share is particularly difficult to self-insure or reinsure since terrorism events are not independently correlated. The fundamental genius of TRIA is that it caps the liabilities for an otherwise largely unpredictable terrorism risk for the marketplace, allowing insurers to underwrite at least a large portion of the non-catastrophic exposures. However the unlimited co-shares undermine the liability caps, and could significantly undermine the private market if further increased.

The current $100 million trigger means that no insurer will be reimbursed unless the total industry TRIA losses exceed $100 million. It is important to emphasize that this does not mean that the government pays all losses above $100 million – only that the program becomes available to participate with the private sector in paying claims when aggregate annual losses reach that amount. As noted above, commercial insurers will continue to bear the risk of loss for all but the largest catastrophic attacks. And many commercial policyholders will continue to bear a sizable amount of self-insurance before reaching their insurance. But an increase in the trigger threatens to undermine smaller insurers in particular because it puts too high a fraction of a smaller company's capital at risk, particularly for multiple attacks that may be harder to reinsure. Those companies have a smaller surplus and are thus less well-equipped to handle a large hit to surplus such as might result from being forced to accept a larger level of terrorism risk. To avoid this risk, small and medium-sized companies are likely to exit certain TRIA lines or risks if the trigger is excessively increased. This, in turn, would negatively impact competition; currently only 6 percent of TRIA-lines insurers write 78 percent of the business. Insurance consumers have more choices, prices are lower, and product innovation is enhanced when the greatest possible number of strong, viable competitors serves the market.

Certification. Consumers rely on insurers to make timely payment of insured losses. Insurers in turn rely on TRIA's certification process to determine whether a terrorist attack is considered an act of terrorism and thus whether the consumer potentially insurer would be covered. The Boston attack has raised a number of issues about how well the TRIA certification process works. State laws generally require timely payment of claims. However, there is no requirement that the Treasury Secretary make a determination to certify an act of terrorism within any particular time period. In many cases consumers would not be able to know if their losses were covered until a certification decision is made (if ever), and insurers would have to make claims payment decisions based on terrorism coverage without knowing whether an event will meet the federal classification. Consumers and insurers are thus both disadvantaged by the uncertainty, increasing the likelihood of litigation and forcing insurers to either make inappropriate claims payments or potentially violating state Unfair Claims Practices laws and regulations. Particularly for large losses, it could take months for liability and business interruption losses to be finalized, and one of the three government officials required for certification could be unavailable for a time, pushing the timing of the government certification process far past the needs of consumers and insurers.

The responsibility for data collection to determine whether to certify an event as an act of terrorism under TRIA is also undefined. Treasury can impose data calls directly on insurers for the purposes of determining federal loss payments and recoupments, but the statute and regulations fail to provide guidance on data collection for purposes of an initial certification. The Committee should consider program changes that could improve the data collection requirements in ways that will provide greater certainty to the marketplace.

Clarification of Treatment NBCR and Cyber Risks. The current understanding within the industry and at Treasury is that the TRIA program covers nuclear, chemical, biological, and radiological (NBCR) risks as well as cyber risks to the extent that insurers provide such coverage to their policyholders. The requirement that insurers make those coverages available applies only to the extent coverage for non-terrorism related NCBR and cyber risks is provided in the underlying policy. However, given the significant potential liabilities that could arise from these risks, especially NCBR, Congress should provide statutory clarity as to how these risks are covered.

The American People Support TRIA. Earlier this year, PCI conducted some polling and focus groups to learn what voters think about how their government protects them from the effects of terrorist attacks. Among the key findings were:

- A majority of voters, 72%, agree that responsibility for the costs from injuries to workers and property damages from a terrorist attack should be a combination of the federal government and private insurance companies.
- A majority of voters agree that it is important for America's economy to have a plan in place before an attack to ensure large projects can be built in a timely, cost effective manner.
- 90% of the participants agree that the federal government should be at least in part responsible for protecting against losses from terrorist attacks against the United States.
- A majority of voters, 64% agree that it is difficult for insurance companies to provide affordable terrorism insurance because of the randomness and difficulty in predicting the likelihood or magnitude of terrorist attacks.
- A rural-urban divide does not exist; 68% of voters understand the national economic implications of a terrorist attack.
- 67.6% of voters favor continuing the Terrorism Risk Insurance program.

The study showed unmistakably that Americans want their government to have a risk management program in place to protect the U.S. economy against the effects of a catastrophic terrorist attack and that both the commercial insurance industry and the government have important roles to play in such a plan.

Conclusion. It is essential for America's economy to have a terrorism insurance plan in place to ensure large projects can be built in a timely, cost effective manner after an attack occurs which would help keep the economy stable and provide jobs. Having a terrorism risk insurance plan in place helps thwart the devastating economic impacts of a terrorist attack and protects our national security. TRIA is a fiscally responsible program that has cost the taxpayers almost nothing in its 11 year existence while protecting economic resiliency and reducing the need for additional government catastrophic response programs that can be far more costly after the fact. PCI strongly supports reauthorization of the current TRIA program with thresholds that will continue to encourage the full marketplace to provide private sector capital to compete and ensure availability of coverage. PCI also supports efforts to clarify TRIA's application and coverage, particularly with respect to improving the terrorism event certification process.

OFFICE OF THE PRESIDENT

TEXAS A&M UNIVERSITY

November 13, 2013

The Honorable Jeb Hensarling
Chairman, House Committee on Financial Services
2228 Rayburn HOB
Washington, D.C. 20515

Dear Mr. Chairman:

As you continue with hearings regarding the future of the Terrorism Risk Insurance Act of 2002 (TRIA), I appreciate this opportunity to share Texas A&M's experience with this legislation.

On any given day, Texas A&M hosts a variety of public events as well as conducts sensitive and indeed, in some cases, classified research for sponsoring federal agencies. Consequently the risk profile of facilities throughout our campus is elevated to potential terrorist threats. We take steps to secure these facilities and implement risk mitigation measures to prevent or minimize the impact of threats to these facilities.

In addressing the potential financial impact of a terrorist event, the University purchases insurance coverage that is made available through the TRIA. The availability of this program has certainly decreased the state's financial exposure. Commercial coverage for terrorist activities has not developed to replace the current program made available through TRIA.

In my role as a member of the Department of Homeland Security's Academic Advisory Committee—and in my capacity as Chair of the Subcommittee on Campus Resilience—I am always available to discuss my perspective on this important issue with you or staff in more detail.

Thank you for the opportunity to share our experience with this program as you evaluate future legislative action. Please contact me or Scott Sudduth in our Washington office at 202-461-3488, ssudduth@tamus.edu, if you have further questions or if we can assist you in any way.

Sincerely,

R. Bowen Loftin
President

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