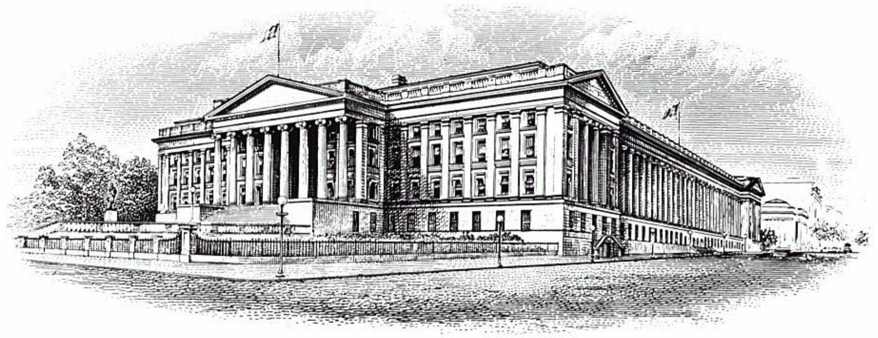

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
April 27, 2004

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Testimony of
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Before the
Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
and the
Subcommittee on Oversight and Investigations
Committee on Financial Services
United States House of Representatives

Thank you, Chairman Baker and Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez, and members of the Capital Markets and Oversight subcommittees for this opportunity to testify today on the implementation of the Terrorism Risk Insurance Act (TRIA) of 2002.

The market for property and casualty terrorism risk insurance was significantly affected by the terrorist attacks of September 11, 2001. In the aftermath of September 11, reinsurers by and large refrained from offering cover for property and casualty terrorism risk or offered reinsurance coverage at costs that were generally considered prohibitive. This then caused property and casualty insurers in general to respond by excluding terrorism coverage from commercial property and casualty insurance policies, leaving many American businesses exposed and uninsured. Perhaps the most notably negative impact of this development was the drag it created on businesses' ability to finance new job-creating economic activity in the midst of our economic downturn caused in part by the events of September 11.

To address this condition, Congress enacted TRIA in the fall of 2002. TRIA establishes a temporary Federal program of shared public and private compensation for insured commercial property and casualty losses resulting from acts of terrorism covered by the Act. TRIA in effect places the Federal government in the property and casualty terrorism risk reinsurance business through December 31, 2005.

By most indications TRIA has been successful in achieving the fundamental goal of enhancing the availability and affordability of property and casualty terrorism risk insurance, particularly for economic development purposes. No longer are heard the same level of concerns from real estate developers, for example, that new projects are on hold because financing has been frozen by a lack of terrorism risk insurance. In terms of affordability, while the information is still somewhat preliminary, accounts that we have seen indicate that premiums for terrorism risk insurance have decreased significantly throughout the early stages of TRIA and continue to do so.

There have been widespread reports that the "take up" rates for TRIA coverage have been low, or in other words, the demand for this coverage has been low. That is despite the fact that the "make available" provisions of the Act require property and casualty insurers to offer terrorism risk coverage to all of their customers, meaning that coverage is available and business and property owners that desire coverage for terrorism risk have been able to obtain such coverage. Whether this reflects a lack of interest in terrorism risk coverage at current prices even with the Federal backstop (prior to September 11, terrorism risk coverage was often provided at little or no additional cost to policyholders, while today in many cases it is being priced at a higher cost), a lack of awareness of the availability of coverage, an assessment by businesses of low terrorism loss risk, or some combination of the above will require careful study and analysis.

Treasury's Implementation of TRIA

Treasury has the chief responsibility for implementing the Federal reinsurance backstop that was established under TRIA. In broad terms, as Treasury has undertaken the overall implementation of TRIA, we have focused on five main administrative goals:

- First, to ensure that the program was operable and ready for use from the moment that it was signed into law by President Bush;
- Second, to implement TRIA in a transparent and effective manner that is fair and easily understood by all parties;
- Third, to rely as much as possible on the State insurance laws and regulatory structure by closely coordinating with the National Association of Insurance Commissioners (NAIC) in implementing the program;
- Fourth, to allow insurers to participate in the program in a manner consistent with their normal course of business by implementing TRIA's mandated requirements in the most efficient way and as most like standard reinsurance arrangements—consistent with the particular mandates of the law and its nature as a Federal government program that must be answerable to taxpayers; and

- Fifth, to ensure that in the event of insured losses, insurance benefits can be provided in the most expedited manner so as to relieve suffering and deny terrorists the achievement of their goals of economic disruption.

Perhaps the most daunting, immediate administrative task was to prioritize and undertake the actions needed to make the program operational right away. One of the key factors in this regard was that TRIA became effective immediately on November 26, 2002, when the President signed the Act into law. The immediate effective date of TRIA meant that terrorism exclusions on existing insurance policies were removed and all policyholders had the ability to secure coverage for terrorism risk. As I have often reflected, implementing TRIA has been like building a house by starting with the roof—the coverage came first.

In addition to the immediate effective date, Treasury also had to address the wide range of businesses, insurance companies, and types of policies that are affected by TRIA. The types of policyholders that fall under TRIA range from small businesses in rural America to large businesses that operate internationally. Likewise, the range of insurance companies that serve these policyholders is just as diverse, and many have unique characteristics that do not fit neatly under TRIA.

To address the immediate effective date of TRIA and provide the necessary guidance to the insurance industry to make the program operational, Treasury's first action was to issue promptly a series of three interim guidance notices. The first interim guidance notices were issued on December 3, 2002, about one week after TRIA was signed into law. Other interim guidance notices were issued on December 18, 2002, and January 22, 2003. Treasury relied on the process of issuing interim guidance notices because it provided us with the ability to respond quickly to implementation issues, and to prevent confusion prior to the issuance of formal regulations. These interim guidance notices, which were publicly released on Treasury's TRIA program website as well as published in the *Federal Register*, addressed the following implementation matters:

<u>First Interim Guidance Notice - December 3, 2002:</u> How insurers could comply with the required disclosures to policyholders, how the "make available" requirement could be met, and which lines of insurance are covered.
<u>Second Interim Guidance Notice - December 18, 2002:</u> Which entities must participate in the program and what the applicable requirements are, how affiliates would be treated, the scope of geographic coverage, how participating insurers could estimate their deductible, and additional guidance on complying with disclosure requirements.
<u>Third Interim Guidance Notice - January 22, 2003:</u> The timing and method of satisfying the required disclosures, further clarification on disclosure requirements, and questions concerning non-U.S. insurer participation.

This interim guidance provided the basis for insurance companies to proceed with offering coverage, the most immediate economic need. While there were many who participated in developing this guidance in such an expedited and effective way, particular mention should be made of Mario Ugoletti and Roy Woodall of the Treasury staff, who provided singularly dedicated and professional service in this effort.

Even while the interim guidance process went forward we began the next step in the implementation process, namely to move forward with formal rulemakings that would incorporate and supercede our interim guidance. The first rules were issued as interim final rules, as authorized in the statute, because of the immediate operational needs. The first interim final rule was issued on February 28, 2003. That rule took many of the issues that were addressed in interim guidance notices and transformed them into formal implementing regulations. Thus far, Treasury has published two interim final rules, and two proposed rules, and three of these rulemakings have been finalized. These can be summarized as follows:

<u>First Interim Final Rule - February 28, 2003:</u> This rule was effective immediately and set forth the purpose and scope of the program, key definitions, and certain other general provisions. We received over 40 comments on this rule from insurers, industry trade associations, the NAIC, and others. After review and careful consideration of the comments, Treasury revised the interim final rule and published it as a final regulation on July 11, 2003. A technical revision dealing with the definition of direct earned premium was subsequently published on August 13, 2003.

<u>Second Interim Final Rule - April 18, 2003:</u> This rule was effective immediately and addressed the requirements governing disclosures insurers must make to policyholders and the "make available" requirements. Treasury received 12 comments on this interim final rule and, after making appropriate revisions, published it as a final regulation on October 17, 2003.

<u>First Proposed Rule - April 18, 2003:</u> This proposed rule addressed issues involving State residual market insurance entities and State workers compensation funds. Treasury received 4 comments on this proposed rule and, after reviewing the comments submitted, revised the proposed rule and published it as a final rule on October 17, 2003.

<u>Second Proposed Rule - December 1, 2003:</u> This proposed rule set forth procedures for filing claims for payment of the Federal share of compensation for insured losses under the program. We have been reviewing comments submitted on the proposal, and we anticipate issuing the final rule in the very near future.

I believe that it is important to stress that while we have been moving progressively through the rule making process, the program from the beginning has been and continues to be fully operational. These rules have been put forward as refinements to and improvements on practices and operations, but from the earliest days of the program, we have had procedures and resources at the ready to respond to any covered insurable event that might arise.

In addition to the regulatory actions outlined above, Treasury has also created and staffed a Terrorism Risk Insurance Program (TRIP) office to administer the Act. We were very fortunate to bring on board as Director of the TRIP office, Jeffrey Bragg, who brings deep experience from the property and casualty insurance markets as well as experience as a former administrator of the Federal flood insurance, riot insurance, and crime insurance programs. Director Bragg in almost no time has assembled an outstanding team of insurance professionals, several of whom have been willing at some sacrifice to interrupt successful private careers to help administer this important program.

Among their accomplishments, the TRIP office has developed systems to handle claims processing, payment, and auditing of claims should a covered event occur. In addition to the December 1, 2003, proposed rule on the claims process, the TRIP office has also been hard at work providing detailed operating procedures for claims filing, processing and payment that are separate from the regulation.

For example, these operating procedures include developing actual claims forms, providing specific contacts for submitting forms and obtaining assistance, and providing information on the required account information for the payments to the insurers. In addition, the TRIP office has been consistently responding to requests for interpretation of the Act and its regulations from insurers; many of those interpretations have been made available to the general public on the TRIP website (www.treas.gov/trip).

TRIA is an interesting hybrid program jurisdictionally; it provides a Federal reinsurance backstop to insurance programs that are regulated almost exclusively at the State level. This type of program would likely be unmanageable without the cooperation of the State insurance regulators, both among themselves and with the Federal government. Throughout the implementation process, Treasury consulted and worked closely with the NAIC, and the NAIC's assistance has been invaluable in implementing TRIA. The NAIC's input was especially important in assisting Treasury with the interim guidance notices that we issued soon after TRIA was signed into law. We look forward to continuing to work closely with the NAIC regarding Treasury's remaining responsibilities under TRIA.

Comprehensive Market Information and Analysis Requirement

An important requirement of TRIA is to implement the Act with a careful eye on market conditions and developments, and report to Congress. In particular, Treasury is required to report to Congress by June 30, 2005, on specific issues associated with the Act and its purposes. Specifically, Treasury is required to assess—

- The "effectiveness of the Program;"
- The "likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program;" and
- The "availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit."

Together with this analysis, Treasury is also required under TRIA to compile information on premium rates for property and casualty terrorism risk insurance.

To assist in the evaluation of the Act's effectiveness and to meet TRIA's premium information collection requirement—and to ensure that we do so with as comprehensive a view of the markets as possible—Treasury has contracted with an outside survey research firm to conduct a comprehensive survey with a nationally representative sample of policyholders and insurers. In the process of developing the survey instruments, Treasury's Office of Economic Policy has worked closely with policyholder and insurer representatives. The Office of Economic Policy is also in the process of developing a separate survey instrument for reinsurers.

Some of the information being collected through the surveys includes the cost of terrorism risk insurance as compared to total insurance within eligible lines, basic financial data, insurance deductibles and limits for terrorism as compared to non-terrorism insurance, use of reinsurance and self insurance, and the types of risk management programs.

Each company that is chosen for the survey will be contacted at least twice and possibly three times (depending on their policy renewal dates) to capture effects of changes in TRIA's insurer deductibles in successive program years. The first survey wave collected data from 2002 and 2003. Surveys for the first wave were mailed out late in 2003 and early 2004 to over 30,000 policyholders and almost 500 insurers. A second survey wave to collect 2004 data is planned for early this fall, and the last survey wave is planned for January and February of 2005. This phased structure will allow us to move beyond snapshots and anecdotal evidence to obtain a broader and more dynamic view of the conditions in the market place. We believe that anything less would not provide to the Secretary the full and reliable information basis needed to make the sort of careful, trustworthy, and responsible evaluation called for by Congress in the statute.

To safeguard the confidentiality of the business information requested in these surveys, Treasury has taken great care to ensure that the data are assembled at arm's length from the government. All identifying information will be removed, transformed to ratios, or otherwise masked prior to analysis by Treasury officials. Treasury has also tried to minimize respondent burden by merging publicly-available financial data and data filed with NAIC sources.

In addition to the formal surveys that Treasury is undertaking, Treasury also continues to consult with the NAIC, and a broad range of experts representing the insurance industry, policyholders, taxpayer groups, and with Members of Congress. Indeed, Secretary Snow has been insistent that we draw upon as many sources of information and input as possible. The completed survey results, as well as these consultations, will form the basis for Treasury completing its report to Congress on the effectiveness of TRIA and the capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the program, by the June 30, 2005, deadline set by Congress in the 2002 legislation.

Determination on Extending the "Make Available" Requirement

The Secretary of the Treasury is required to determine by September 1, 2004, whether to extend TRIA's "make available" provisions into the third year of the program (i.e., through December 31, 2005). The "make available" provisions of TRIA require that, from the date of enactment (November 26, 2002) through the last day of the second year of the program (December 31, 2004), each insurer must make available, in all of its commercial property and casualty insurance policies, coverage for insured losses under the Act. In this regard, TRIA also requires that such insurance coverage must not differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism.

TRIA requires that Treasury's determination on whether to extend the "make available" requirements through the third year of the program is to be based on the same factors described above regarding Treasury's overall study of the effectiveness of TRIA.

Treasury is now developing a base of information from which the Secretary can make this required determination, consistent with the terms of the Act. Various trade groups and other interested parties have contacted Treasury regarding the "make available" decision. We encourage any who have views on this question to share those views with Treasury as soon as they can, with as much detail as they can provide.

In making this determination, however, while examining similar issues as those outlined for the larger examination due by June 2005, Treasury will be looking at those issues with the specific, narrow focus of the "make available" question, and with the use of much less information than will be available for the larger, broader study. Therefore, each examination will be conducted independently of the other.

Conclusion

We must all remember that the basic of goal of TRIA was to develop a temporary backstop for property and casualty terrorism risk insurance so that private markets would have a chance to adjust. We would encourage insurance companies, state insurance regulators, other financial services providers, and other interested parties to think creatively in this regard, and to consider what methods can be employed to allow for broader private sector involvement in the market for managing property and casualty terrorism risk. Treasury looks forward to completing our review of the effectiveness of TRIA and considering the many complicated issues presented to us in a thorough manner with the best information that can be obtained. Our obligations to the taxpayers, and the need for the long-term health and vitality of our financial markets, require nothing less.

In summary, while we hope that we will never be called upon to trigger coverage under TRIA, the program stands ready today—as it has from its earliest days—to meet its responsibilities. The extensive work done by Treasury in developing the basic framework of TRIA through interim guidance notices and regulations, the proposed claims regulations, the drafting of claims forms and review with industry organizations and the NAIC, and contingency procurement plans, all have contributed to an effective program that the Treasury will continue to refine over the life of the program. We look forward to moving forward with the implementation process and evaluating the effectiveness of the program in the weeks and months ahead.