

Testimony of
Edwin L. Harper

SVP, Assurant Inc.
Chairman, Group Life Coalition

Before the
Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises

Committee on Financial Services
United States House of Representatives

July 27, 2005

Good morning Chairman Baker, Ranking Member Kanjorski and members of the subcommittee. I am Ed Harper, Senior Vice President of The Assurant Group, a leading health and employee benefits company. I am here in my capacity as Chairman of the Group Life Coalition. The Coalition is composed of insurance companies which provide the protection of group life insurance, both as a stand-alone product and as part of an employee benefits package.

In the public sector, I have served on the White House staffs of two presidents and was an original member of the White House Domestic Council. I have also served in the Office of Management and Budget under Democrat and Republican Administrations. I also serve as the Chairman of the American Council of Life Insurers' (ACLI) Committee on group life insurance. ACLI shares the views that I will express here today. In addition, the inclusion of group life in any mechanism going forward is commensurate with the views of the Financial Services Roundtable, which adopted a policy in 2001 supporting the inclusion of group life as a covered line under TRIA.

I want to thank you for having this hearing on the successor to the Terrorism Risk Insurance Act (TRIA) and I commend you, Chairman Oxley, Ranking Members Frank and Kanjorski for the previous bipartisan effort in 2002 that resulted in the federal TRIA program. This committee and the Administration acted to protect the economy from destabilizing terrorist attacks and we look forward to working with you to continue the federal government's role in this area.

Group life insurance represents approximately 42 percent of the U.S. life insurance market and is the proud provider of financial security to 160 million Americans. In many cases, it is the only life insurance most policyholders have to provide protection to their families. As such, the fate of group life insurance and TRIA is no trivial concern.

We strongly urge Congress to expressly include group life in any market-based successor to the TRIA program. Quite simply, Congress needs to insure the people inside the buildings too.

The Coalition joins with other insurance and financial services groups, building industries and labor unions, insurance policyholders and all state insurance commissioners in strongly urging the creation of a market-based successor to the TRIA program. The TRIA legislation produced a public-private partnership that has created stability in certain high-risk insurance markets that could not otherwise cover properties for catastrophic terrorist events.

As the current law is set to expire on December 31, 2005, we want to work with the Financial Services Committee to craft a viable solution to the terrorism insurance problem. Few people in government or private industry disagree that a successor to TRIA is necessary; the question is what the program should look like moving forward. In our view, that solution should reflect that appropriate balance of government and private industry involvement that will help to ensure economic stability in the event of another large scale terrorist attack.

Congress should include group life insurance in any market-based successor to the TRIA program going forward for many reasons. Chief of among these reasons is to protect a critical employee benefit that provides financial security for millions of Americans in the event of a devastating terrorist attack. Group life insurance is similar to workers compensation insurance, a line that is currently covered under TRIA. Like workers compensation insurance, group life is a basic benefit to workers and it is coverage for which there are no exclusions allowed under state insurance law. The high level of risk concentration at the workplace coupled with low premiums means that group life is particularly susceptible to large scale losses from catastrophic events such as terrorist attacks.

Furthermore, the means by which group life insurers had protected themselves in the past - the group life catastrophe reinsurance market - has reduced dramatically since 9/11 and has not returned in a meaningful way. In the event of another massive terrorist attack with a multitude of casualties, group life insurers could face significant losses, solvency crises and claims payment problems. The potential for these types of effects on the group life market is an acute concern particularly for high-risk jobs, such as first responders and health care workers. This is a concern not only to state insurance commissioners, but should also be of note to U.S. public health officials.

As such, the Group Life Coalition firmly supports a continuing federal role in helping to mitigate the economic effects of a catastrophic terrorist attack. Specifically, we urge members of the House Financial Services Committee to create a new successor to TRIA that includes group life insurance as a covered line in the program.

It is our belief that by including group life insurance in a successor program to TRIA, the market for group life catastrophe reinsurance will actually return as reinsurers can feel confident that they will not face immediate insolvency risks from massive terrorist attacks that cause thousands of casualties and billions of dollars worth of property damage. We are supported in this viewpoint by the Treasury Department's recent Report to Congress on the TRIA program: the review concluded that TRIA had served its purpose and the terrorism insurance market for property and casualty insurers was benefiting from the unique private-public partnership created by TRIA.

WHAT IS GROUP LIFE INSURANCE?

One hundred-and-sixty million working Americans hold group life insurance policies. For many, this employer-sponsored benefit represents their only source of life insurance coverage because it is provided at little or no cost to them and is available without underwriting limitations. Everyone from survivors of cancer to the healthiest employees qualify for some coverage because the underwriting for such coverage is based on mortality tables provided by state insurance departments and the theory of large numbers used in insurance underwriting. The typical group life policy provides coverage in the amount of one and up to two times a worker's annual salary and most employees have come to expect as a part of their total compensation packages. At the end of 2003, the average face amount of a group life policy was \$44,500 per certificate. In this way, group life insurance functions as a privately funded Social Security death benefit for middle-income Americans.

The pricing of group life insurance is not regulated as the market is so competitive that it is not uncommon for carriers to lose policies to other competitors on pennies on the dollar.

The terms of the coverage are also not particularly regulated with one key exception: An insurer operating in the United States must pay out the coverage for ANY cause of death. There is no reason an insurer can not pay a legitimate claim upon proof of death. There are no “time of war” exclusions or exclusions for deaths caused by nuclear, chemical, biological or radiological incidents. If there is a death of a covered individual, group life insurers pay the claim. In fact, even in instances where there isn’t a confirmable death – a sad facet of the 9/11 attacks – insurers created new ways to meet their obligations in a timely and sensitive manner.

REINSURANCE IS WHAT MAKES GROUP LIFE INSURANCE WORK

From the insurers’ perspective, reinsurance is what allows carriers to provide coverage to employees at a relatively low cost to the employer. Carriers assume that in any given year, insurers will pay claims on a small number of employees for whatever reason (generally 3 out of 1,000 employees). In most instances where more than a small number of employees die in a particular year, general reinsurance that is capped and limited as well as insurer reserves allow group life insurers to meet their obligations.

In a catastrophic event, such as a terrorist attack or an industrial accident where there may be wide-scale death and destruction, group life insurers - before 9/11- purchased catastrophe reinsurance as a way to further hedge the concentration risks associated with many covered employees generally working in the same location. Since 9/11, numerous studies and the Treasury Department have confirmed that the once-viable group life catastrophe reinsurance marketplace barely exists in any meaningful way that would cover insurers in a massive terrorist attack with many deaths.

STUDIES CONFIRM NO VIABLE GROUP LIFE CATASTROPHE REINSURANCE MARKET

Milliman Inc., a leading actuarial consulting firm with extensive experience in helping insurers and reinsurers address all types of risk, has conducted three separate studies on the state of the group life catastrophe reinsurance market. The first study was conducted one year after the September 11 attacks and a less formal one was performed mid-year 2004. The results of both of those studies indicated a significant decline after September 11, 2001 in the number of group life insurers that have catastrophe reinsurance, along with a dramatic increase in deductibles and cost.

A June, 2005 survey also conducted by Milliman, Inc. (“*Recent Trends In Catastrophe Reinsurance For Group Life Insurance*”) was the most comprehensive portrait of the group life catastrophe reinsurance market in that it solicited information from insurers regarding how their catastrophe reinsurance coverage had evolved from a pre-9/11 marketplace to the current situation with extremely limited catastrophe reinsurance. Information obtained included specific dollar amounts in terms of differing coverage amounts over three different time periods (one of them being pre-9/11) and any new

information on what companies had been doing to protect themselves from catastrophe risk in an age of terrorism. Additional data on underwriting, pricing, or benefits changes among the group life insurers was also surveyed.

The key findings from the survey of twenty-five companies who offer group life insurance and which represent over 70% of the group life insurance market were:

- Fewer than half of those surveyed currently had catastrophe reinsurance.
- From 9/11/2001 to 12/31/2002, the average amount of catastrophe reinsurance decreased 50-60% while deductibles increased 10-15 times and prices increased 500 -700%.
- From 12/31/2002 to 6/1/2005, despite modest increases in coverage amounts and decreases in costs, coverage was still only 37% of prior levels and cost was over six times higher.
- The use of exclusions for terrorism due to nuclear, biological, and chemical events has increased significantly since 9/11/2001. Prior to that date, only one company of those surveyed had an agreement with such exclusion. Today, nearly half of all catastrophe reinsurance agreements have some such exclusions.
- In the absence of meaningful catastrophe reinsurance, companies have taken a variety of other actions, including examining new pooling arrangements, making changes to traditional reinsurance programs, increasing premium rates, and restricting availability to certain industries and locations.

In addition to privately-funded studies, the Treasury Department's July 2005 Report to Congress on the TRIA program notes "...there was a general lack of catastrophic reinsurance for insurance companies that offer group life coverage..."

NO CATASTROPHE REINSURANCE LEAVES INSURERS WITH FEW OPTIONS

Faced with the reality of extremely limited or no catastrophe reinsurance protections, group life insurers are faced with few options to address concentration risks in an age of terrorist attacks. The limited menu of immediate options to address concentration risks include:

1. **Drastically raise prices of group life insurance.** An insurer could decide to raise their prices for group life insurance to boost both immediate profits and reserves in an effort to meet future unanticipated and incalculable risks associated with terrorist attacks.

Why this is not a viable option: Raising the prices of the premiums of group life insurance would not have the immediate intended effect of raising profits or reserves to meet future costs because that insurer would no longer be in business. Again, the group life insurance market is one where policies are bought from the lowest bidder, usually as part of an employee benefits package: raising premiums to cover numerous potential claims due to a massive terrorist attack will price an insurer out of the group life market or the employee benefits market.

If smaller insurers raise their prices, only the very largest insurers could remain in business because they are large enough or diversified enough to “self re-insure.” As competition decreases due to the exiting of smaller insurers, market dynamics dictate that the availability of group life insurance will become limited or restricted to select employees and prices will increase. Coincidentally, the Treasury Department’s Report to Congress confirms this reality when it stated that “the immediate effect of the removal of TRIA ...is likely to be less terrorism insurance written by insurers, higher prices and lower policy holder take-up.”

Moreover, there is no accurate or agreed-upon way for an insurer or a group of insurers to raise prices or instill a “terrorism risk” cost into pricing group life policies. As terrorism on U.S. soil is a recent phenomenon, it is virtually impossible to quantify its risk. Studies indicate that terrorism is both multifaceted and dependent upon factors that are beyond our experience. Not only insurers, but the U.S. government is grappling with the absence of data and how to handle this new risk.

Additionally, the profit margins in selling group life insurance are too low to allow shareholders to ever recover from a significant catastrophic loss. Prior to 9/11 catastrophic reinsurance was the mechanism that allowed companies to mitigate this risk and this reinsurance is currently either not available or is very limited, very costly and excludes acts of terrorism in most cases.

2. **Exit the group life insurance marketplace.** An insurer could decide that providing group life insurance as part of the employee benefits packages entails too great a solvency risk and thus no longer sell group life insurance. In effect, this insurer may exit the group life market but not the employee benefits marketplace all together.

Why this is not a viable option: For an insurer, giving up a specific market can be difficult and final—posing significant regulatory, financial, and public relations issues. In some cases, companies have sold products that cannot be cancelled (unless premiums are not paid or the group’s participation falls below an acceptable level). Also, group life insurance coverage constitutes a portion of a typical employee benefit package—which normally includes group medical, group disability, and pension benefits. If a group life writer were to stop offering life insurance coverage, that carrier would be at a competitive disadvantage for other products in the package. Such barriers to exiting the market may be why companies are still offering group life insurance.

3. **Purchase remaining available catastrophe reinsurance coverage.** An insurer could decide to buy currently available catastrophe reinsurance - despite significant increases in cost for limited and capped catastrophe reinsurance and loaded with multiple exclusions.

Why this is not a viable option: Purchasing currently available catastrophe reinsurance as detailed in the June 2005 Milliman Inc. survey shows that prices cost over six times their 9/11 levels while only offering 37% of the pre-9/11 coverage. Moreover, many more reinsurers are writing exclusions in their agreements with insurers for terrorism and nuclear, biological and chemical events. In essence, the available coverage does not begin to address the potential risk.

4. **“Fly naked” and proceed as if a catastrophic terrorist attack will never occur.** An insurer could continue to provide group life insurance in an age of terrorist attacks with no or highly defined and limited catastrophe reinsurance.

Why this is not a viable option: As the Treasury Department Report to Congress has noted “Group life insurance companies have stayed with their customers and continued to make group life insurance available on much the same terms as before September 11th.” Most fortunately, the United States has not experienced a terrorist attack on scale or larger than the 9/11 attacks. Yet, as recent world events attest to, the problem of calculated terrorist attacks intending to inflict mass casualties remains a persistent threat in today’s world.

Ultimately, an insurer needs to consider all risks, even the unthinkable catastrophic event, and weigh such potentialities against its current business model. However, the limited capacity and reserves of the group life industry as well as the absence of a viable catastrophe reinsurance market, coupled with the inherent responsibility of the federal government to prevent terrorism through federal policy, naturally and appropriately calls for a federal public-private TRIA-like solution for group life insurance. Without reinsurance, the companies remaining in these tenuous markets run the risk of being worthless shells of companies that cannot keep their promises to their policyholders.

CONGRESS HAS ALREADY APPROVED GROUP LIFE INCLUSION

Congress approved the inclusion of group life into the original TRIA program that was created in 2002. As drafted, TRIA provided the Treasury Department with broad authority to study and decide on “an expedited basis” whether “adequate and affordable” catastrophe reinsurance was available to group life insurers and to what extent the threat of terrorism was reducing the availability of group life coverage of consumers in the United States. The Treasury Department found that even though group life catastrophe reinsurance coverage had receded, primary group life insurance still existed. Due to this finding, the Treasury Department excluded group life insurance from TRIA.

Since that time, lawmakers in both the House and Senate have introduced legislation that would extend the TRIA program as well as include group life insurance as a covered line. In the 108th Congress, the House approved legislation sponsored by Chairman Baker and Representatives Eric Cantor (R-VA), Sue Kelly (R-NY) and Pete Sessions (R-TX), that included group life insurance as part of the federal TRIA program.

Notably, the state insurance commissioners - who have a dual responsibility to protect consumers by making sure companies make good on their claims as well as ensuring the solvency of such companies - have repeatedly urged Congress to extend TRIA and include group life. Most recently, the National Association of Insurance Commissioners (NAIC) unanimously approved a resolution during the 2005 NAIC summer meeting urging Congress to renew the TRIA program with group life insurance.

WHY CONGRESS SHOULD INCLUDE GROUP LIFE

As Congress moves to address and improve upon the federal TRIA program with a market-based successor, the Coalition believes that group life insurance should be included for the following reasons:

1. **Group life inclusion addresses a potential solvency crisis in the group life insurance market and provides the private market with a role in helping people recover financially from a massive terrorist attack.** Notwithstanding the recession of the catastrophe reinsurance market, the apparent stability of the primary group life insurance market is an illusion in at-risk sectors. If group life insurance was excluded from a successor to the TRIA program going forward, many group life insurance companies would exit these at-risk markets and make a business decision not to insure at-risk workers.

Worse, some insurers may choose to stay in these markets without catastrophic reinsurance to cover their exposure and create a ticking time-bomb solvency concern. A collection of group life insurers providing a meaningless veneer of "protection" will be of little comfort to victims seeking death benefits from insolvent companies. One only needs to remember the disaster of the Victims Compensation Fund from the 9/11 attacks to see a need to create an orderly way to manage financial loss for victims of terrorist attacks.

2. **The Federal government naturally has a role in addressing terrorism risk through its policy and actions.** Federal lawmakers have a responsibility to proactively take steps to insure the financial security of the people inside the buildings prior to a catastrophic terrorist attack as well as ensure that insurance companies are solvent; that the insurance market remains competitive; and that insurers meet their obligations in the times when such protection is most needed.

3. **Group life insurance has a similar risk concentration profile to worker's compensation insurance which is currently included in the TRIA program.** Worker compensation was included in the original TRIA program due to its concentration of risk and no meaningful reinsurance coverage. Similarly, group life insurance is also offered at the workplace, has no exclusions for acts of war or nuclear, chemical, biological or radiological attacks. Moreover, death benefits on group life policies are to be paid in total immediately and at significantly higher amounts of payouts than typical workers compensation payments. According to the Treasury report, the inclusion of workers compensation in TRIA has improved the private reinsurance market. Conversely, without TRIA's protection, the private group life insurance reinsurance market has not reappeared because the exposure and risk that reinsurers face is unknown.

4. **The 9/11 attacks showed how vital catastrophe reinsurance is to the group life market.** On 9/11/2001, CNA Financial had a 3% national share of the group life insurance market, but had a 35% share of the market for companies in the World Trade Center. As the group life insurer for the brokerage firm Cantor Fitzgerald, which lost 658 employees in the attack, as well as other large tenants, CNA had an exposure of \$175 million. All but about \$15 million of the claims were covered by reinsurance. Post 9/11, the market for such reinsurance has been reduced dramatically and the method to mitigate the risk from this type of attack has vanished. CNA Financial was able to meet its obligations after the 9/11 attacks because of reinsurance that is now no longer widely available or affordable.

BOTTOM LINE

Including group life in a market-based successor to TRIA will preserve a fiercely competitive market for consumers; provide a critical death benefit to middle class workers in high-risk professions and/or areas; and establish a high end level of federal liquidity that will not be accessed by a group life insurance company except in the case of ten of thousands of lost lives. Lastly, group life's inclusion will create an orderly mechanism to quickly provide a death benefit to victims and the Treasury will ultimately recoup money for these payments.

A NEXT GENERATION OF TRIA

The committee has asked for our views on the future of a successor to the TRIA program and what policy principles should guide Congress. We believe the following four key principles should be considered:

Create Long Term Solution: Congress should take this opportunity to create a long term solution to a long term threat. Historically, as has been the case in times of war and particularly WWII, the federal government has made most legislation permanent or set to expire after a war's end. Just recently, we have seen the House make the key provisions of the Patriot Act permanent in recognition of the long term danger of terrorism.

Unfortunately, the risk of terrorism and our nations struggle with the specter of terrorist attacks is not likely to end soon. As such, it is only common sense that the Congress should put a system in place to provide long term stability to the economy in the wake of a terrorist attack. All other governmental approaches to the terror threat are constructed along these lines of long term solutions to dangerous problems. Providing economic stability in the face of terrorist attacks should be no different. Terrorist attacks remain the single biggest threat to our economy. Surely this reality deserves a well thought-out, long term solution that creates that protects the economy, the individual and taxpayers as a whole.

The risk facing group life insurance from terrorist events can be viewed as three layers. The first layer is the potential losses that can be absorbed by the direct writers of the coverage. The size of an event that could be handled by this first layer is hard to quantify since it would depend heavily on the size of the company and how concentrated the losses were for any particular company.

The second layer is the losses that could be absorbed by spreading the losses as widely as possible over the entire group life industry. Prior to 9/11 the mechanism for creating this spreading of loss was reinsurance. However, since 9/11 investors have been very reluctant to put their capital at risk and as a result there is very little reinsurance available to cover terrorist related losses. The amount of losses that can be handled by this second layer has decreased dramatically since 9/11. Any governmental effort should strive to materially increase the amount of losses that can be handled within this second layer.

Broadly speaking the way to create a much larger second layer is to have a government mandated pooling of risk. The government does not bear the risk or the costs. Rather, it creates a new structure that materially increases the capacity of the industry to bear the risk. A government mandated pooling structure would greatly increase the amount of risk that could be handled in this second layer. The costs and risks associated with this mandatory pooling would be largely borne by the group life insurers. It is estimated that with the right structure a terrorist event that produced 100,000 deaths could be handled without any government funds.

Finally, the third layer would require government funds to be directly involved. As mentioned above this layer would exist only if there were an event that was so large that there would be roughly 100,000 or more deaths.

Specifically, a new federally-administered pooling fund might be created in order to make available additional risk-bearing capital via free-markets. Should an event exhaust the retention of insurers and the capacity of the capital markets, the federal government would provide the necessary liquidity to handle the event through a financing mechanism. All insurance companies would face significant trigger and retention levels prior to accessing the fund. Once an event triggered payouts from the structure, re-payment (with market-based interest) would be accomplished via assessments against insurance company premiums with the companies receiving the most benefits being assessed first. Participation would be mandatory for all companies writing applicable business.

Balance the Burden to Make Program Workable: Any long-term solution should require that the industry "pay to play" and have the appropriate level of shared burden with the federal government. However, any program must also recognize that the industry only has a limited capacity to self-protect from high end terrorist attacks and remain solvent and stable for the next attack or the next claim.

Provide for Orderly Transition: The creation of a long term solution may be achievable yet this year but the implementation will take time to get right. We support any extension of TRIA with appropriate reforms to the extent necessary as a transition to a more comprehensive approach or as an alternative to a comprehensive, long-term approach if the latter is not politically viable to enact this year. Our view would be to extend the current program for a short period of time while the Treasury enacts regulations to guide the new program. As the new program will almost surely have a higher threshold for government involvement, Congress and the short term extension should use the transition phase to orient the market towards higher trigger and retention levels while taking care to keep the program viable as a backstop.

Specifically, we would support extending TRIA with group life for 2 years with upwardly adjusted triggers, retention levels and co-shares to provide catastrophic protection for the policyholders and the economy and to protect the taxpayer. As the new program is ready to be engaged and begin functioning, the "old" TRIA model should sunset.

Protect the Financial Security of People as well as Buildings: Any program must include group life as a covered line of insurance to make sure that the financial security of the people in the buildings is covered too. Bricks and mortar are of no greater value than the financial security, the protection and the dreams of the people inside those buildings.

On behalf of the Group Life Coalition, I want to thank you and your colleagues for holding this hearing on this important subject. We look forward to working with you on a solution to continually insure America's economic security against terrorist attacks.