Statement of

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on behalf of the

American Council of Life Insurers

on

Protecting Americans From
Catastrophic Terrorism Risk

before the

Subcommittee on Capital Markets, Insurance and Government
Sponsored Enterprises
and
Subcommittee on Oversight and Investigations

of the

House Financial Services Committee

of the

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Introduction

Chairman Baker, Chairwoman Kelly and members of the Subcommittees, my name is Ed Harper and I am Senior Vice President at Assurant - a premier provider of specialized insurance products (including group life insurance) and related services in North America and other selected markets.

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

I am here today on behalf of the American Council of Life Insurers (ACLI). The ACLI is the primary trade association of the life insurance industry, representing 377 member companies that account for 91-percent of the industry's total assets in the United States. ACLI members offer life insurance, annuities, pensions (including 401(k) plans), long-term care insurance, disability income insurance, reinsurance and other retirement and financial protection products.

I am also chair of the Group Life Coalition (an organization of some of the industry's top group life carriers) and the ACLI's Federal Legislative Strategy Group for Group Life.

Overview

I would like to thank the Subcommittees for holding this hearing on protecting Americans from catastrophic terrorism risk. Having just passed the fifth anniversary of the September 11, 2001 attacks, we are all, unfortunately, very well aware of the risks that our country continues to face from various domestic and international extremist and terrorist groups. I will never forget that fateful September morning, walking through the smell of quenched fire and looking down from my office window onto the gigantic hole in the ground which was the site of the World Trade Center – "Ground Zero."

In addition to implementing effective homeland security measures that will help prevent large-scale terrorist attacks, we must also sufficiently insure our nation's most vulnerable assets (including its critical infrastructure) and its citizens in case such attacks do take place. Terrorism insurance is a vital component of maintaining our robust economy and providing a safety net to those who financially depend on the victims of such attacks.

While much of today's discussion has focused on the need for adequate terrorism insurance within the property and casualty (P&C) insurance industry, it is also important to discuss how this issue affects the life insurance industry and its policyholders, particularly with regard to group life insurance. We respect the need for adequate insurance for buildings, but does it make sense to insure buildings and not the people whose lives might be lost if those buildings go down as a result of a terrorist attack?

I am here today to urge the Subcommittees to include group life insurance in any workable long-term, public/private solution that would help make terrorism insurance (and reinsurance) more available and affordable throughout this country.

In addition, to the extent that Congress extends the Terrorism Risk Insurance Act (TRIA) beyond 2007, I urge you to add group life insurance as a covered line (as it was in the House version of the extension bill). The ACLI also believes that any TRIA extension should include group life, and the National Association of Insurance Commissioners (NAIC) has adopted a resolution in support of group life's inclusion as well. Howard Mills, New York's Superintendent of Insurance, recently restated his support for group life inclusion during a meeting at the NAIC's Fall National Meeting in St. Louis.

The Importance of Group Life Insurance

Group life insurance is a critical employee benefit. For millions of Americans, especially lower-income workers, it is the only life insurance that their families have and can rely on if they were to unexpectedly die. Group life is usually part of an employee's benefit package that contains medical, disability and other coverages, and remains available and affordable (as it did before 9/11).

At the end of 2004, there were about 165 million certificate holders of group policies, with an average coverage amount of $46,250. Almost $19 billion was paid to group life beneficiaries in 2004. Group life insurance represents about 44% of all life insurance in force - $7.63 trillion out of a total $17.5 trillion at the end of 2004.

In addition, 60% of ACLI member companies sell group life insurance. For some of these insurers, it makes up all or most of their business. Group life insurers received about $27.7 billion in net group life insurance premiums (which is almost 20% of the $139.7 billion of total net life insurance premiums).

Potential Exposure to Group Life Death Claims

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

For example, if a terrorist attack were to kill 20,000 individuals insured under one or more group plans, based on an average coverage amount of $46,250, group life insurers could collectively be liable for almost $925 million in death claims. If 100,000, 500,000, or one million people were to perish, potential claims would increase to $4.6 billion, $23.1 billion and $46.2 billion, respectively.

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

Insurers Limited Capacity to Cover Catastrophic Losses

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

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

Therefore, while the life insurance industry as a whole would be able to absorb tens of billions of dollars in death claims resulting from a catastrophic attack(s), those small to medium-sized insurers, and possibly some large-sized insurers, that receive an unexpectedly high number of claims (especially those whose main line of business is group life) would be forced into insolvency.

It is worth mentioning that some life insurers that are not domiciled in New York State have created separate subsidiaries in New York. These subsidiaries have less overall surplus funds from which they can draw upon to pay unexpected claims. This, in turn, increases the risk of insolvency for these New York companies, as well as the non-payment of claims to those beneficiaries that reside in New York.

Group Life Insurers' Vulnerability to Large-Scale Attacks

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

Unlike deaths from accidents, diseases, murders and natural disasters, which have been tabulated and analyzed over dozens of years and incorporated into mortality and morbidity tables (which helps determine pricing of policies), there is insufficient historical data in this country for deaths from terrorism that can be factored into such tables. Furthermore, terrorism is, by its nature, unpredictable, so it cannot be accurately forecasted or priced. However, group insurers are compelled to include group life policies in its benefit packages at low cost for competitive reasons. Bids on employer benefit packages can be won or lost on just a few pennies per employee covered.

Second, since 9/11, group life insurers have generally been unable to obtain catastrophic reinsurance for terrorism risks, especially for NBCR events. To the extent such reinsurance is available, it is limited in coverage and very expensive. Reinsurance is a fundamental risk spreading mechanism underpinning the insurance industry. Without adequate catastrophic reinsurance, many group life insurers risk financial ruin if a significant terrorist attack(s) were to occur in the U.S.

In addition, Assurant, as well as the ACLI, are not aware of the use of terrorism exclusions (including those for NBCR events) by life insurers in either individual or group policies. We are also unaware of any states that allow such exclusions (except for KS and NC under very limited circumstances). Furthermore, even if an insurer does business in a state(s) that allows for terrorism exclusions, it is very likely that it would not include them in its policies or deny terrorism-related claims (if such exclusions are included in its policies) for business and public policy reasons.

<u>Group Life Should be Part of a Long-Term Public/Private Solution</u>

Since group life insurance is an important benefit for many Americans, it needs to be part of a viable and financially sound long-term solution that makes terrorism insurance (including catastrophic reinsurance) available and affordable. Until then, insurers, policyholders and beneficiaries will remain vulnerable to a major terrorist attack.

Our industry is currently reviewing the terrorism reinsurance pooling mechanism (which is based on the United Kingdom's Pool Re program) that was recently developed by the Real Estate Roundtable. We are also open to other ideas or proposals that would help make terrorism insurance more readily available within the P&C and life insurance industries.

<u>Group Life Should Also Be Included in any TRIA Extension</u>

The initial TRIA bill that was signed into law in November, 2002 gave Treasury the authority to include group life in the program if catastrophic reinsurance and group life insurance "is not or will not be reasonably available to both insurers and consumers." While Treasury agreed that there was a general lack of catastrophic reinsurance, it decided not to extend group life to TRIA since it found "no appreciable reduction in the availability of group life insurance coverage for consumers." While group life has been readily available (for competitive reasons, as mentioned above), if a major terrorist attack were to occur, it is highly likely that some or many group insurers would be unable to fully pay their death claims. In addition, group life coverage would probably not be widely available after such an event since many providers would decide to exit the marketplace.

Group life insurance is also very similar to workers compensation – in that most workers across the country are covered by both. The latter was included in TRIA (and its extension) and, as a result, experienced an increase in the availability of related reinsurance. We are confident that catastrophic reinsurance would become more available and affordable for group life if it were added as a covered line in any TRIA extension. This additional reinsurance capacity would significantly reduce that risk of insolvency that many group insurers would surely face if a large-scale terrorist attack(s) were to occur.

Therefore, if TRIA is extended beyond December 31, 2007, we respectfully request that group life be included as it was in the House-passed extension bill (H.R. 4314), which included a mandatory recoupment provision.

Conclusion

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