Independent Insurance Agents
& Brokers of America, Inc.

STATEMENT OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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Good morning, Subcommittee Chairmen Baker and Kelly, and Ranking Members Kanjorski and Gutierrez. My name is Sharon Emek, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA) to present our association's perspective on terrorism insurance. I am a managing director and partner at the CBS Coverage Group, a regional full service insurance agency with locations in New York City, Plainview, Saratoga and West Hampton Beach, NY. I also serve as Chair of the Board for the Independent Insurance Agents & Brokers of New York.

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

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

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

Background

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

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

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

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

TRIEA, which provided a two-year extension of the federal backstop under TRIA with some modifications to encourage the private sector to take on additional risk.

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

Unfortunately, the program is scheduled to expire at the end of 2007, and there is no reason to believe that the threat of terrorism is on the decline, or that the private insurance markets alone can adequately meet our nation's need for coverage. As such, IIABA encourages Congress to develop a long-term solution to this problem, and we applaud the Committee for holding this hearing to explore these important issues.

Post-TRIA Availability of Terrorism Risk Insurance

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

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

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

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

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

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

Policyholder concerns are fueled not only by memories of the exclusions that they faced immediately after September 11th and in the months before TRIA's original expiration, but also by their current experiences in the post-2005 hurricane market. Substantial insured losses during the recent hurricane season have diminished the insurance industry's capacity for catastrophic losses in general. Under pressure from rating agencies to limit exposure, insurers are reevaluating their exposure to catastrophic losses in general and terrorism losses in particular. As underwriters continue to focus on the aggregation of losses, our members and the policyholders they serve remain concerned about how many insurance companies, particularly small and monoline insurers, will continue to write terrorism risk insurance after the expiration of the federal backstop.

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

Long-term Availability and Affordability of Terrorism Risk Insurance Coverage

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

While modeling has shown us that the size and severity of a terrorist attack could easily threaten the capacity of the insurance market, the risk cannot be assessed in traditional ways. Insurers lack confidence in modeling terrorism risk due to the lack of past statistical records for such risk.[4]

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

Unlike other types of catastrophic risks, insurers and actuaries know very little about where or when terrorism might occur; how it might occur; how often it might occur; or the nature, effects, and costs of such an attack. Much of the information that does exist is available only to governmental agencies that fiercely guard it for security and law enforcement reasons. As a result, underwriters shied away from terrorism risk before the creation of the TRIA backstop. Indeed, since the enactment of TRIA, insurers have proven unable to introduce wide-ranging, new products for insuring terrorism risk. There is currently no indication that the ability to accurately predict and underwrite terrorism risk will improve significantly in the future and certainly not before the Act's expiration at the end of 2007.

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

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

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

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

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

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

depend on the introduction of private capital from non-insurance sources and the continuation of a public-private partnership.

Specifically, IIABA believes that a private-public partnership – in some form – remains essential to the challenge of making terrorism risk insurance available after the expiration of the Act at the end of 2007. Although some potential solutions might allow for the reduction or even elimination of federal involvement in the years to come, it may be difficult to eliminate such a role in the immediate future without disrupting the market. Indeed, it will take decades for the industry to close the gap between the estimated $6 to 8 billion in current reinsurance capacity and potentially hundreds of billions of dollars in losses from a terrorist attack. [6] As such, public participation is necessary to encourage private markets to get in and stay in the business of insuring terrorism risk. [7] At a minimum, federal legislation is necessary to facilitate private sector solutions, such as risk-sharing mechanisms and capital reserve accounts. We remain optimistic that the industry and policymakers can develop solutions that will reduce the role of the federal government (and taxpayers) over time and enable the private market to build up greater capacity and ultimately shoulder more of the burden.

Tax-incentives could also prove instrumental in encouraging new sources of capital. IIABA supports efforts to allow insurers to proactively build tax-free reserves for terrorist events on a pre-event basis, and we believe that this concept is worth further consideration in the context of a broader long-term solution. This option would help insurers build capacity over time, and, given the national nature of terrorism risk, it is entirely appropriate that federal tax policy be adjusted to encourage the private sector to do so.

The NAIC is appropriately considering the role that pooling and syndication might play in expanding capacity, and we encourage continued exploration in this area. As a key stakeholder in the process, IIABA believes that variations on such mechanisms – whether voluntary or not and whether single or multiple in form – should remain under consideration in the debate as a potentially important, if not exclusive, means of building capacity to insure terrorism risk.

Finally, FAIR Plans and other residual market mechanisms, with appropriate modifications, could potentially play a limited role in the long-term solution to terrorism insurance availability, but this option alone cannot substitute for the participation of the federal government. In addition, terrorism and the risks posed by such attacks are inextricably linked to federal and foreign policy, and this peril cannot be solely addressed at the state level without federal government assistance.

Now is the time to analyze these potential solutions. The creation of an effective and long-term mechanism is essential for managing the risk posed by terrorist events. Without some form of meaningful solution, terrorism coverage will be extremely difficult – if not impossible – for most to obtain after December 31, 2007, and, as noted above, the impact will likely be felt before then. Such an outcome would be especially troubling for small and medium-sized businesses, which are already challenged by the current environment and are not in a position to self-insure. The vast majority of businesses in this country are of this size, and the nonexistence of some form of a terrorism insurance

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

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

program could have devastating effects on the national economy. For these reasons, IIABA urges Congress to continue analyzing long-term strategies, including the solutions mentioned above, before the expiration of the federal backstop next year.

In order to facilitate a long-term solution for terrorism insurance, the Big "I" also supports H.R. 4619, the Commission on Terrorism Risk Insurance Act of 2005, introduced by Reps. Vito Fossella (R-N.Y.) and Carolyn Maloney (D-N.Y.). This legislation would create a national commission on terrorism insurance comprised of 11 stakeholders, including an independent insurance agent and a broker, to review the current program and make recommendations to assist the market after the Act's expiration.

Insurance Coverage for NBCR Events

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

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

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

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

During our participation in the development and extension of TRIA, IIABA supported mandatory availability of insurance coverage for NBCR losses. Based on our experience in the market,

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

[9] *Id.*

we know that policyholders desire a long-term solution to the availability of terrorism risk insurance, including coverage for NBCR events. Policyholders want certainty for their business planning and operations, and they clearly do not want to be subject to on-again, off-again terrorism insurance mechanisms, and exclusions for NBCR losses. Terrorism is perhaps the greatest threat to our nation's economic future, and we believe that the reality of potentially large losses from NBCR events must be addressed to protect our economy, as well as policyholders and taxpayers.

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

We urge policymakers to develop a system of public-private compensation for NBCR losses that offers taxpayer payback protections similar to those currently available with respect to TRIA-covered lines.[10] Otherwise, taxpayers face a much larger, unexpected payout in the wake of a substantial NBCR event.

Nationwide Need for Terrorism Risk Insurance

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

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[10] As discussed below, we believe that it is important that such a system avoid distinguishing domestic terrorism from foreign terrorism.

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

[12] *Id.*

Domestic v. International Terrorism

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

Conclusion

IIABA applauds Congress for not ending TRIA abruptly last year and for having the foresight to try to "phase-out" the program only as markets are able to develop. This type of thoughtful approach, which recognizes market capabilities and restraints, will be essential to ensuring long-term affordability and availability of terrorism insurance as well as capacity in both the short-term and long-term.

Although the terrorism insurance program was only recently extended less than a year ago, it is time to start looking ahead, and we thank the Committee for beginning this process today. The need for action is actually more urgent than many might realize, and it will not be long until policyholders are renewing policies with contract terms that extend beyond December 31, 2007. If a solution is not in place well in advance of the end of next year, insurance markets may once again face significant disruption and uncertainty, and we anticipate that insurers would exclude terrorism risks from policies where authorized.

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

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