STATEMENT OF WARREN HECK
CHAIRMAN AND CEO

GREATER NEW YORK MUTUAL INSURANCE COMPANY,
INSURANCE COMPANY OF GREATER NEW YORK
AND STRATHMORE INSURANCE COMPANY

ON BEHALF OF
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

AT THE HEARING ON

"PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK "

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES

AND

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

HOUSE FINANCIAL SERVICES COMMITTEE

SEPTEMBER 27, 2006

Chairman Baker, Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez and Members of the Subcommittees, my name is Warren Heck. I am Chairman and Chief Executive Officer of the Greater New York Mutual Insurance Company (GNY) and its wholly owned stock subsidiaries, Insurance Company of Greater New York and Strathmore Insurance Company.

Thanks to the dogged bipartisan efforts of the members of this Committee, as well as many members of the Senate Banking Committee, last December Congress extended the original Terrorism Risk Insurance Act (TRIA) by passing the Terrorism Risk Insurance Extension Act (TRIEA). I am convinced that TRIA played a major role in preventing an economic catastrophe and helping get the country back on its feet economically after 9/11, and that TRIEA has prevented a significant tightening of the terrorism risk insurance market.

However, as you know, TRIEA expires on December 31, 2007, and I am deeply concerned that if Congress does not adopt a long-term private/public terrorism risk insurance program, many of our citizens who need terrorism coverage to operate their businesses all across the nation will be either unable to get insurance or unable to afford the coverage that is available.

**Greater New York Mutual Insurance Company's history and post 9/11 experience**

Let me describe my experience as a medium-sized insurer of commercial properties in New York and my reasons for supporting a long-term terrorism insurance program that would maximize the development of the private market and provide a viable long-term system to protect the economic strength of the country against terrorist attacks.

While I am here today to testify on behalf of my own company, my perspective has also been shaped by my experience serving as the Chairman of the National Association of Mutual Insurance Companies (NAMIC) TRIA Task Force since 2004.

First, let me tell you a little bit about our companies and our experience with the terrorism risk, because we have been on the frontlines of this problem ever since 9/11. As with many mutual insurance companies, whether they are rural, farm, or specific to a particular industry, GNY began in the early 1900s at a time when there was a huge flood of immigration into the United States from Europe. Many of these immigrants settled in the lower East Side of New York City and earned their living as plumbers, electricians, steel workers, carpenters and in other trades. Many of them scrimped and saved and put all they had in the purchase of a tenement apartment house; however, they found it difficult to obtain liability insurance for their properties because the tenement apartment houses were extremely crowded and because of burgeoning litigation at that time. These tenement apartment house owners formed a trade association to protect their interests and to which they gave the name, Greater New York Taxpayers Association. This lack of insurance availability motivated the association to form an insurance company that became the Greater New York Mutual Insurance Company, as it is known today. Our legacy is that of early immigrants who came from humble beginnings as trades people with little formal education who started the insurance operation applying solid business principles and practices to their work.

Today, the company is a multi-line regional commercial lines company operating in New York, New Jersey, Connecticut, Massachusetts, Pennsylvania, Maryland, New Hampshire, Delaware, Virginia and Washington, D.C. The majority of our business is in New York, New Jersey and Connecticut, where we have done business for many years; we began developing business in the other listed states in recent years. Our companies have had an A+ rating from A.M. Best for many years, and an A rating from S & P.

In New York State in 2005, our companies wrote direct written premium of $188,002,484 of which $163,039,513 was Commercial Multi Peril, making us the fourth largest writer of Commercial Multi Peril business in New York State. In New Jersey in 2005, we wrote direct written premium of $71,378,689 of which $55,078,687 was Commercial Multi Peril, making us the fifth largest writer of that business in the State of New Jersey. For many years, we have been the largest writer of co-op apartment houses in the boroughs of New York, particularly Manhattan, and the leading writer of apartment buildings in the state.

Although I have served as President and Chief Operating Officer of the company for 18 years and Chairman and CEO for the past five years, I have also continued to serve as Chief Underwriting Officer, in which role I manage the underwriting activities of our companies. This has enabled me to have first-hand knowledge and understanding of the needs of our policyholders and agents, particularly with respect to the terrorism exposure.

As a result of the terrorist attack on 9/11, and prior to the passage of TRIA in late 2002, most primary insurance carriers operating in New York City began to non-renew their commercial property and workers' compensation business, or reduce limits of coverage to levels below what was needed by the business community. Most primary companies refused to insure property on buildings with values in excess of $20 million, and would not insure any risk that had more than a limited number of employees in a single building. The extreme hard market for property and workers' compensation coverage in New York State, particularly in New York City, was worse than other places because New York State prohibited carriers from excluding coverage for terrorism, and reinsurance companies universally excluded terrorist acts in property and casualty treaties. The only alternative was to offer less coverage or not write the business at all.

The few companies willing to provide coverage increased their prices because of the significant terrorism exposure. However, many of those companies began to cut back when concentrations of values and employees became too large. The lack of insurance capacity had a negative impact on the New York economy resulting in the postponement of many construction projects, lack of or inadequate property coverage for many commercial office buildings, and significant increases in pricing of commercial multi-peril business.

With the passage of TRIA, the fear that a worst case terrorist event could render our company insolvent was somewhat reduced, making it possible for our company to continue to do business in New York City and other urban areas. TRIA placed a ceiling on individual company terrorism losses, which permitted our company to quantify its terrorism exposure and find a way to address the situation.

We devised a new underwriting strategy and guidelines that permitted underwriters to insure skyscraper office buildings up to $50 million or more depending upon risk accumulations in a given area of the city and proximity to so-called target buildings. We also do not insure commercial tenants in a property where the company insures the building. With respect to workers' compensation coverage, as long as employee counts were not too concentrated, our company considered offering coverage. We also implemented a computer system to geo track risk accumulations to the street level as well as the number of employees in a given building, and risk concentrations by zip code. Since the passage of TRIA, we have purchased very expensive stand-alone terrorism reinsurance to cover as much of our TRIA deductible and co-insurance as we could reasonably afford. Without the passage of TRIA and TRIEA our company could not have kept its market open in the same way in New York City, and retained the insurance capacity needed to write new business and grow its direct written premium.

**The need for a long-term private/public terrorism risk insurance partnership**

Five years out from 9/11, with no other terrorist attacks on U.S. soil, terrorism reinsurance availability remains limited, and without TRIA and TRIEA the primary insurance market would have dried up in large urban centers. In those states that mandate that insurers offer terrorism risk coverage, insurers would have had to make the difficult decision to either offer terrorism coverage or leave those markets. These problems flow from the simple, inescapable fact that terrorism insurance is a classic uninsurable risk.

In order for the private market to function efficiently, it needs to be able to make actuarial judgments based upon an historical record of frequency and severity of an event. Years of data make it relatively easy to estimate auto insurance costs. Homeowners' insurance costs are somewhat less predictable because of the uncertainty and timing of calamities such as windstorms, earthquakes, and wildfires, but we can model natural catastrophic events because we have long historical records and sophisticated geological studies and hurricane forecasting methods to help us predict the future. We can also differentiate among risks based on such factors as location and the mitigation efforts of homeowners.

When it comes to terrorism risk insurance, we have no basis for estimating frequency. President Bush and other leaders of our government tell us that there *will* be – not *may* be – another terrorist attack on our soil. They cannot tell us when or where it might occur or its likely nature. Harder still from an insurance perspective, we cannot predict its severity. Will it look like 9/11 or the recent foiled attempt to blow up multiple airplanes over the ocean? What we do know is that our enemies want to inflict massive casualties and that terrorists have the expertise to invent a wide range of attacks, including those involving the use of chemical, biological, radiological and even nuclear weapons. While exploding a small nuclear weapon in a major city could do incalculable harm to hundreds of thousands of people, as well as to businesses and the economy, exploding multiple bombs in one or more places with no NBCR components could also wreak massive damage. The damages could reach into the hundreds of billions, levels that only the federal government can afford to pay.

Since 9/11 we have been working on improvements to our modeling technology in an attempt to quantify our terrorism exposures and reduce our concentrations in New York City. As

previously mentioned, we have also geographically diversified our writings by expanding into suburban regions in other states. However, there is no guarantee that, for example, limiting one's exposure in New York City by underwriting risks in the U.S. heartland will succeed, as low-tech attacks such as those in Madrid and London could cause enormous economic harm if replicated in shopping malls in the South and Midwest. Even greater harm could be caused in these areas if terrorists attacked chemical plants or the food supply.

Smaller insurers, which comprise a large portion of NAMIC member companies, face additional problems because they operate in only a few counties in a state or in only a few states. They simply lack the financial resources to withstand a terrorist attack in their home areas. In addition, many of them today are in financial jeopardy because, when they write commercial insurance with the federal obligation to include terrorism coverage, they cannot get reinsurance to cover the higher deductibles in TRIEA.

Workers' compensation presents particular concentration risks. For workers' compensation, a private mutual insurance company or a state fund handles the bulk of insurance coverage for businesses in 27 states. Many of these companies, often characterized as guaranteed markets, must accept all applicants. While most large multi-line commercial insurers may limit the scope or aggregation of risks that they are willing to cover in a specific area, many private mutuals or state funds find themselves with tremendous risk concentration. The California State Fund best exemplifies this concentration of risk, which is the single largest writer of workers' compensation business in the United States despite the fact that it only operates in its own state.

Also relevant to this discussion is the fact that insurers do not operate in a free market in many states. State laws prohibit workers' compensation policies from excluding terrorism related losses, thus leaving many regional workers' compensation specialists in an extremely vulnerable position. Many of them have a high concentration of risk, a mandate to take all customers and an inability to exclude terror-related events that could potentially inflict catastrophic levels of human and economic devastation in particular areas or regions. Thanks to rate regulation in many states, insurers also are not free to charge what they believe is an actuarially sound price for the risk involved.

Even if an insurer were able to diversify its risk exposure through modeling and get sufficient private reinsurance to cover the TRIEA deductibles, the notion that the private market can protect itself through good modeling is flawed. Absent a terrorism insurance program, a $778 billion terrorist event—the high estimate for a single terrorist event by the American Academy of Actuaries in New York City—would wipe out more than the total property/casualty insurance industry surplus for all lines, estimated at $414 billion as of September 30, 2005 by the Insurance Information Institute. This would mean that the industry would be unable to meet its obligations to its other insureds for the many different coverages beyond terrorism insurance protected by that surplus.

While the private market cannot cover events of such magnitude without either bankrupting insurers and reinsurers or wiping out so much insurer surplus that they could not meet their obligations on other lines of insurers, the private market does have the ability to cover lesser, clearly defined losses. TRIA and TRIEA were both reasonable attempts to limit the maximum

exposure of insurers so that the private market can play a role in terrorism risk insurance. These statutes made a private/public bargain: Insurers would offer terrorism coverage in return for a guarantee from the federal government that it would pick up losses beyond the insurers' capacity. The purpose is to make sure that the economy can recover in as orderly a fashion as possible from the next terrorist event.

What would have happened to the property and casualty insurance market had there been no federal program to insure terrorism? My experience tells me that it would have been similar to what happened after 9/11. Insurers would have excluded terrorism risk unless required by states to offer it or withdrawn entirely from perceived terrorism exposed areas. In urban centers like New York City, there would likely have been high demand and a low supply of terrorism insurance, forcing prices to increase (if permitted by state law) for the limited amount of terrorism insurance that would have been available thereby inhibiting development and economic growth.

The caveats in the above paragraph with respect to mandatory coverage and rate regulation make the point that not having TRIA in the first place, or letting TRIEA expire, would not permit a free market test for terrorism insurance because terrorism insurance does not operate in a free market in the United States. For example, the state regulators in New York—the state many view as the most likely to be a terror target—have prohibited companies from excluding coverage for terrorism. There is no similar regulation requiring the reinsurance market to provide protection to the direct market, leaving insurers in a Catch 22 should TRIEA expire. Medium and small companies would face a difficult choice: leave the marketplace for terror target-area risks or face the prospect of a financial disaster that could result if they write coverage. To the extent that companies choose to leave the market, competition would be significantly reduced.

What about the capital markets? Would they have picked up the slack? There simply is no reason to believe the capital markets would have replaced the missing insurance capacity and there is no evidence that TRIEA has crowded out private market capacity. Terrorism risk has presented a real opportunity for reinsurers and they have not chosen to take on very much of this risk. The Reinsurance Association of America has indicated that worldwide capacity for terrorism risk in the United States is approximately $6 to $8 billion without NBCR, far below the amount needed. The capital markets have taken their cue from the reinsurance market. There have been very few terrorism catastrophe bonds issued and Wall Street has no apparent intention to move into this market in any significant way. Moreover, there is no capital market appetite whatsoever for bonds for nuclear, biological, chemical, and radiological (NBCR) events.

How would another terrorist attack have affected the resources of the federal government if there had been no TRIA program? Given the very limited amount of terrorism insurance that would have been available in the absence of TRIA, I think Hurricanes Katrina and Rita provide a glimpse into that world. The federal commitment to cover the portion of the 2005 hurricane losses that exceeded private market coverage is closing in on $100 billion. Moreover, a significant portion of that money has been siphoned off by fraud because the government is not skilled at settling claims and doesn't have the manpower to handle a major catastrophic event as evidenced by its experience with Hurricane Katrina.

If the federal government assumes such a huge responsibility for these natural catastrophes, as it has done in the past for other such extreme events, regardless of the party in power, then it seems a fair conclusion that the government would step in and actively help people harmed by a terrorist event. For people who believe that a terrorist attack in a part of the country where they do not live would not affect them, it is important to note two things. One, a large attack would hurt them directly by weakening the economy. It would also hurt them, perhaps somewhat less directly, by forcing the Congress to either cut programs or raise taxes to keep the deficit under control. In short, the cost of the losses would be borne by not just by the people where the attack occurred but also by taxpayers from Hawaii to New York, as well as from Alaska to Maine and all the states in between.

A long-term private/public terrorism insurance plan would reduce the federal government's exposure and provide for an orderly processing of claims. The result would be a speedier economic recovery for both the area that was attacked and for the economy as a whole. Moreover, in order to keep the federal budget deficit from reaching disastrous proportions, the Congress would have to either reduce funding for other programs or raise taxes, or both.

**The shape of a long-term private/public terrorism risk insurance program**

The insurance industry has been working to devise a long-term program for congressional consideration that would maximize private sector participation without threatening the economic viability of the industry.

While the interests of companies vary depending on such factors as size of surplus and geographic distribution of writings, there is broad agreement on the need to maximize private sector participation and to have the federal government provide a backstop if insured losses would be too great. That is the basis for the structure the Congress created in TRIA and TRIEA, with event triggers, insurer co-payments and industry deductibles as the means for maximizing private sector participation. This structure makes sense for "conventional" terrorist events that do not involve the use of NBCR elements. However, it is worth exploring ways to encourage more private sector participation. One way might be to create a federally chartered entity to facilitate reinsurance capacity below the deductibles. With voluntary insurer participation, this "middle layer" of potential risk-bearing capacity would provide the kind of private market test that some in the Congress believe is needed. If the effort is successful, then the federal government's responsibility could recede. If not, then we would know that we have maximized private market capacity.

The NAMIC TRIA Task Force to which I referred earlier made an important observation concerning the effect of the current TRIEA program's escalating event trigger level on the ability of small and medium-sized insurers to participate in providing terrorism risk insurance. The Task Force concluded that for such companies, the event trigger is the key to their ability to continue to provide coverage. Too high a trigger would drive them from the market because reinsurance costs would be too high, making primary coverage unaffordable. As a medium-sized insurer in New York that covers some very large buildings, I can tell you that a trigger in excess of $50 million would severely limit GNY's ability to offer as much coverage as it now offers. I

simply could not justify to policyholders or state regulators my company's decision to take such a large risk relative to the size of the company's surplus. Furthermore, my company would risk a downgrade in our financial strength rating by rating agencies under new requirements that insurers provide information about their exposure to terrorism risk including estimated potential insured losses resulting from simulated terrorism events.

Why should Congress care? I think the answer is simple. Small and medium-sized insurance carriers form the backbone of the industry and support niches of terrorism coverage that many larger carriers have avoided since 9/11. Those small and medium-sized companies will be forced to exit the market, which will erode capital rather than build it. For example, in 2004, of the 2,100 property and casualty insurance companies operating in the United States, only 40 companies had writings in excess of $1 billion and only 58 had policyholder surplus in excess of $1 billion. A smaller private insurance market will further expose the federal government to greater costs should another terrorist attack occur.

In order to assure their continued involvement in the sale of terrorism risk insurance, I believe that the trigger in any long-term program should be set at a level that will continue to encourage their participation. If the event trigger is too high and we are forced to withdraw, there will be many markets where the large insurers will not take up the slack, resulting in serious harm to policyholder companies in those markets. While the cost to the federal government of a long-term trigger of $50 million would be negligible, the cost to these companies of a higher trigger would be too much for them to assume and the cost to the economy could be overwhelming.

I'd like to make one more comment on a long-term program. While the capital markets have limited appetite for terrorism risk, they have almost no appetite for NBCR coverage. In order to make limited coverage available, and bearing in mind the inevitable involvement of the federal government should such an event take place, I would recommend the federal assumption of NBCR risk on a reinsurance basis for certain losses, with perhaps the first $10 billion of loss to the federal plan reimbursed by a post-loss assessment as a percentage of industry premium in covered lines.

For a more detailed description of NAMIC's views regarding a long-term proposal, I am attaching NAMIC's Statement of Principles on Terrorism Risk Insurance.

Finally, Mr. Chairman, Ms. Chairwoman, and Members of the Subcommittees, thank you once again for the opportunity to testify on this issue of vital importance to myself and NAMIC member companies and the U.S. economy. Your continuing leadership on this issue represents the best in public policymaking and we stand ready to assist you in any way in developing an effective long-term terrorism insurance plan.

## ATTACHMENT

# NAMIC STATEMENT OF PRINICPLES
# ON TERRORISM RISK INSURANCE

1. Terrorism is an ongoing threat to the people and government of the United States. Therefore, a long term insurance industry program coupled with a government backstop at an appropriate level of loss is essential to assuring an orderly economic recovery and reconstruction effort after any significant terrorist attack.
2. The Terrorism Risk Insurance Extension Act of 2005 (TRIEA) is a temporary measure. The nation's economic security requires a long-term private/public sector program.
3. The government backstop was established under the Terrorism Risk Insurance Act of 2002 (TRIA) and extended under TRIEA because there was, and still is, insufficient private sector terrorism insurance and reinsurance coverage to provide adequate coverage in the event of another large-scale terrorist attack.
4. A long-term private/public terrorism insurance program is necessary because terrorism is fundamentally an uninsurable risk, due to the inability of insurers to predict when events will occur and because of the potentially catastrophic costs of an attack.
5. To be effective, a permanent terrorism program must allocate the costs of terrorism events between the private and public sector in a way that maximizes private sector involvement while assuring that private insurers can continue to meet their obligations across all economic sectors and insurance product lines after a terrorism event.
6. The goal of public policymakers should be to allow the private sector to take on more of the risk over time by enacting a long-term terrorism insurance plan that will enable insurers and reinsurers to gradually develop additional capacity in order to provide coverage to businesses and property owners that need it.
7. We recommend adoption of a three-tier solution.
    1. The first layer would consist of private primary insurance and reinsurance, as exists under TRIEA, and would include the following elements:
        - Small and medium-sized insurance carriers form the backbone of the industry and support niches of terrorism coverage larger carriers have historically avoided.
        - A permanent event trigger should be set at a level that will continue to encourage participation by small and medium-sized insurers. Too high a trigger would drive them from the market because reinsurance costs would be too high, making primary coverage unaffordable.
        - Individual company deductibles and the industry retention level should be tied to premium income, but set at levels that would enable the industry to continue to meet its other claims obligations and perform its economic role after paying off its share of the losses from a terrorist attack.
        - State laws that (a) prohibit insurers from excluding terrorism and (b) prevent the free market from setting adequate rates for terrorism insurance should be preempted.
    2. The second layer would be an industry-sponsored reinsurance facility to encourage the development of new private sector capital for terrorism. It would act as a bridge between the purely private sector layer and the private/public sector liquidity backstop in the third layer.

    - Initially it might cover losses of about $10 billion to determine how much private sector capacity can be developed from the capital markets.
    - U.S. companies eligible to access recoveries from this facility would fund the initial and ongoing capitalization through a policyholder surcharge.
    - The facility should be authorized to purchase reinsurance protection.
    - The facility would collect premiums and provide Industry Loss Warranty (ILW) reinsurance to insurers and reinsurers.
  3. The third layer would be a private/public partnership that would provide a liquidity backstop in the wake of catastrophic terrorist events.
    - Outlays would be recovered, in part, by a fixed annual policyholder surcharge.
    - Aggregate annual financial protection would be provided for 90 percent of all eligible losses, losses beyond those covered by the first two tiers, up to $100 billion.

8. In addition, we recommend a separate federal reinsurance program for losses arising from NBCR attacks.
    - For losses covered by private reinsurance (e.g., worker's compensation, fire following), the program would provide first-dollar reinsurance.
    - For losses not covered, but that would be covered in the absence of an NBCR exclusion, a direct federal NBCR insurance rider should be created, to be administered by the insurer on a follow-form basis.
    - The first $10 billion of insured losses paid for by the federal plan should be reimbursed by a post-loss assessment as a percentage of industry premiums in covered lines.
    - The NBCR program should apply to the commercial lines covered under TRIEA.
9. By encouraging the maximum private sector protection while recognizing the need for federal participation, a successful terrorism risk insurance program will reduce government exposure, increase the take-up rate for terrorism coverage among businesses and commercial property-owners, and thus reduce the costs the federal government would otherwise bear in the event of a catastrophic terrorist attack.