TESTIMONY OF
NEW YORK STATE INSURANCE DEPARTMENT

BEFORE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

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I. INTRODUCTION

Good afternoon. I'd like to thank you, Madam Chair, and all other Members of the Subcommittee for the opportunity to speak at this hearing.

In a matter of a few short, heartrending hours on September 11th, our nation's psyche and landscape were transformed by acts heretofore unimaginable. While more than five months have elapsed since that fateful day, we are still experiencing the effects of those vicious attacks. Our journey back from that dark morning has been filled with a sense of patriotism and a steadfast commitment to rebuilding what was destroyed, although nothing we can say or do will bring back the over 3,000 innocent lives lost that day. Much of this rebuilding will take place with resources provided by the insurance community.

However, rebuilding efforts will be compounded by the enormous complexities of a post-September 11th world. For us in New York, it is a recovery effort that continues amidst dialogues as how best to restore New York to its former glory. It is a dialogue on implementing initiatives that will promote with renewed vigor, the retention of financial services operations and jobs in the financial capital of the world, with a focus on rejuvenating lower Manhattan as both a premier business center and desirable residential community. It is also a dialogue, a very real dialogue, tinged with frustration and concern, on the continued availability of, and the sources for, commercial property insurance.

II. THE EFFECTS OF SEPTEMBER 11TH ON THE INSURANCE MARKETPLACE

The events of September 11th have had major repercussions in the insurance marketplace. Significant issues have been raised for both the industry and its regulators, none more important than that of addressing the issue of coverage for terrorist acts. This issue has manifested itself in myriad ways. Coverage for acts of terrorism is no longer available for the largest commercial risks and its availability in the small and medium-sized markets is spotty and, where available, is offset by dramatic increases in rates. Large buyers of insurance are no longer reaping the benefits of scale because the very characteristics - large number of employees, vehicle fleets, valuable real estate - that made them attractive to “cash-flow” underwriters prior to September 11th, are now making them undesirable to “risk-oriented” underwriters concerned especially with single-location concentrations of risk. In light of the events of September 11th and the subsequent threats of additional attacks on American targets on domestic and foreign soil, particularly by air, underwriters are reevaluating their risk management philosophies and underwriting practices to reflect their anxieties over the real and perceived threats of terrorism.

The most immediate and dramatic effects can be seen in coverage for large commercial structures. Stadiums, office towers, government facilities, landmark buildings, and other “trophy” properties, are generally written through less regulated markets such as the surplus (non-admitted) market or in special sections of the admitted market, such as New York’s “Free Trade Zone”, which allows freedom from rate and form regulation for high-value, sophisticated risks. In these markets, or in larger manuscript policies, rates and terms of coverage are largely matters for negotiation between the insurer and the insured. This coverage, where available, is now endorsed by terrorism exclusions and, even with the coverage narrowed by these exclusions, premiums have dramatically increased. Significantly, we have seen a substantial increase in surplus lines placements over the last five months for these types of properties as availability in the traditional admitted market has declined.

Corporate entities and real estate companies are not the only enterprises facing difficult insurance markets. Governments, too, are finding it either problematic to secure coverages or afford the premiums that are being charged. As with certain landmark properties and other sensitive venues, certain government facilities have been particularly hard hit by the recent trends in the insurance market. Some cities and towns are experiencing difficulties in obtaining coverage for their public buildings. In most small towns and cities across the nation, many high profile buildings, such as the town hall, public library and other buildings that house municipal facilities or are used as places of public assembly, are located within a short distance of each other. Despite efforts – and sizeable commitments of tax resources - to enhance security at such locations, insurers are now balking at covering these properties because they present an attractive target for terrorists and the geographical concentration of these buildings exposes insurers to large losses in the event of a single terrorist attack.

Some real life stories from the private and public sectors bring the issue into sharp relief.

A multinational telecommunications company has publicly declared that insurers do not want to write global polices for their high-value buildings. The company also has 80,000 vehicles which insurers are now wary of insuring as one fleet.

A $6 billion real estate trust has raised concerns about covenants contained in various indentures requiring adequate insurance coverage. If developers are unable to secure insurance that covers acts of terrorism, existing real estate lending arrangements will most likely be disrupted, new construction of major developments may stall and banking activity that funds these developments may suffer a setback.

Sports teams are also having trouble securing terrorism insurance. Across the country, insurers are offering significantly less coverage at substantially higher rates to professional sports teams in all venues. Insurers are concerned that the inherent characteristics of sporting events (i.e., high profile and the large number of people amassed at a single location) make them a prime target for a terrorist strike. As a case in point, it was reported that the New Jersey Sports and Exposition Authority, which manages Giants Stadium, saw its insurance costs more than triple to $2.4 million. As summer approaches, there are many other national and local events with a similar profile that could easily become a casualty of lack of terrorism insurance, namely state, country and trade fairs, as well as large conventions and expositions.

Hospitals were the first New York business sector to experience significant difficulties in obtaining adequate and affordable property coverage for their facilities post-September 11th. A major New York philanthropic organization, which operates a number of hospitals throughout the New York metropolitan area, provides a pointed example. The institution renewed its property insurance coverage on November 1, 2001 but was able to obtain only 20% of the expiring policy's coverage limits. Even this drastically reduced level of coverage was subject to broad terrorism exclusions and a tighter "occurrence" definition. The premium was three times higher and a total of 23 insurers, including 3 unlicensed insurers, had to be enlisted to secure one-fifth of the coverage supplied by a single insurer last year.

In the absence of an appropriate federal response to the issue of terrorism, consumers or their primary insurers will be ultimately left to assume and address the terrorism exposure. Carriers, already reeling from the record-setting losses attributable to the World Trade Center attack, will see a further deterioration of the industry's capital base in the event of a disaster – be it manmade or natural disaster – that results in even a fraction of the expected total loss from September 11th. Businesses and individuals will be forced to make economic choices when faced with suddenly higher premiums for less coverages or faced more dramatically with the notion of going without insurance for terrorist risk, i.e., covering the risk with their own resources. Many may well have to reconsider expansion plans in the works just months ago, consider reducing employee benefits, such as health insurance, consider the likelihood of securing lending without the availability of all-risk coverages, or consider amending the amount of insurance they carry in order to be able to afford the premium increases. A more drastic measure could be a decision to "go bare" and operate without insurance coverage, something many commercial entities have already decided as their only course of action. Some may even decide to adopt the risk management technique of "avoidance" by disengaging themselves from otherwise economically sound activities that may be subject to the peril of terrorism. In fact, we know of individuals and businesses vacating the upper floors of high rise buildings not only because they are unable to obtain appropriate insurance coverage but out of the additional concern for personal security and safety. None of these responses are desirable and their ramifications will certainly reverberate throughout our nation's economy.

The federal government must act quickly to address this situation with a goal of ensuring that our insurance marketplace remains sound in order to foster a full recovery from the September 11th events and to sustain the overall growth of the national economy. Federal action must not only take the form of a response to the insurance issues raised by the terrorism threat but should also include further actions to address ongoing concerns for personal safety, especially as it relates to the security of the skies. The New York State Insurance Department (Insurance Department) has been told that the insurance marketplace will be difficult to stabilize so long as there are continued real or perceived concerns about the security of the civil aviation system. In the insurance world, the perceptions of a threat could be just as important as a real threat. Stability in the insurance marketplace will be difficult to achieve if underwriters are not convinced that all necessary measures are being taken to secure the safety of our air transport system. Congress recently enacted legislation to address airport security and the impact of this piece of legislation will only be realized over time in terms of public confidence. So too will be its impact upon the confidence of insurers and their underwriters to return to the market.

III. CURRENT STATE OF AFFAIRS AND OUR RESPONSE

The Insurance Department estimate of losses arising from the September 11th events now stands at approximately $30 billion and $50 billion net and gross of reinsurance, respectively. Industry loss estimates may vary but by any measure this was a staggering event that will undoubtedly be recorded as the largest single insurance loss in the history of the insurance industry. The approximately $18 billion in losses resulting from Hurricane Andrew pale in comparison to the losses faced by the industry as a result of the events of September 11th. In fact, gross loss estimates for the September 11th events exceed combined losses from Hurricane Andrew ($18 billion) and the Northridge earthquake ($15 billion).

The insurance industry responded to the needs of its policyholders professionally and compassionately by providing critical funds sorely needed in the immediate aftermath of the disaster to rebuild devastated lives, businesses and properties. In general, contractual obligations were honored and insurance proceeds were paid to victims and their families promptly. Indeed, to date insurers have recorded better than \$15 billion in claims reported or paid on better than 27,000 claims filed. To their credit, the industry did not resort to “act of war” or other exclusions to avoid paying claims. Despite certain misleading press reports, the sense of the Insurance Department is that the industry continues to approach its claims obligations responsibly. Any difficulties arising in the claims process, we have found, is usually from limitations on coverages, the collecting and evaluating of certain business records necessary to the claims process, or to the need to keep claim files open until all losses are determined.

Moving forward from the industry’s response to the claims arising from September 11th has proven to be more problematic than the challenges of addressing the losses already incurred. For several months after the disaster, virtually all reinsurers, which are not subject to regulation by the individual states, excluded coverage for losses caused by acts of terrorism from contracts. While some flexibility was found in the renewals effective January 1, 2002, there was still widespread displacement in the market, particularly for large commercial risks. Along with this elimination of coverage for terrorist acts, there are dramatic increases in reinsurance premiums, and an overall reduction in the amount of coverage that the reinsurers would be willing to underwrite. While this development is expected in a hard insurance market, and while some may even attribute this to a certain amount of opportunism being exercised in the industry, by and large the impetus for this market dynamic appears to be the concern for providing coverage in the event of another terrorist attack or other large insurance event.

The lack of reinsurance capacity and the exclusions for terrorist acts has caused primary insurers to search for new avenues of capacity and to file their own terrorism exclusions for approval by the states. Consequently, within a month of the tragedy, primary insurers began filing proposed policy form amendments that would exclude coverage for any losses arising from the commission of a terrorist act on a virtually absolute basis. The Insurance Department has received 98 such filings to date. In addition to independent filings on behalf of 256 insurance companies, filings were received from the Insurance Services Office, Inc. (ISO), which generally serves as the property and casualty industry standard for policy terminology and practices.

Initial proposals of exclusionary language for acts of terrorism varied among the individual insurers that made the filings. Though they differed somewhat in the actual verbiage, the filings generally defined “terrorist acts” and the exclusionary “triggers” quite broadly. ISO’s initial proposal was similarly broad in scope and approach. Following discussions with a special committee formed by the NAIC, ISO amended its proposal to define more narrowly the scope of the exclusion, most significantly by inserting a provision of $25 million in aggregate losses arising from a single act as the threshold for invoking the exclusion.

After careful review of the proposal, the Insurance Department, on January 24, 2002, disapproved ISO’s filing pursuant to the controlling statute as being misleading and violative of the public policy of New York state, as is the standard of review under section 2307(b) of the New York Insurance Law. Among the reasons cited for the finding were:

- the unrealistically low aggregate loss threshold relative to property values in New York that would be likely to be affected by the exclusion;
- the inability of property owners to readily determine whether the exclusion actually applied to their insurance coverage, given the imprecise nature of loss estimation;
- the form's overly broad description of terrorist acts, which would likely exclude losses that, in the public's perception as well as in an insurer's original policy intent, would otherwise be expected to be covered; and
- the potential adverse effect that the exclusion would have on economic recovery in New York City and on general economic development throughout the state.

With the disapproval of ISO's form, we proceeded to disapprove all of the other pending filings.

While overly broad terrorism exclusions are not the appropriate solution, the Insurance Department recognizes that terrorist acts represent a catastrophic exposure that can not be retained by primary insurers without appropriate reinsurance. Requiring insurers to retain this exposure without the benefit of reinsurance or other mechanisms for laying off such risks raises serious solvency concerns, assures wider dysfunction of the property/casualty market, and may also result in possible violations of statutory "per risk" limitations. This concern is balanced against the equally compelling public policy priority of protecting businesses and consumers from being the last stop on the "pass the exposure express" Insurance regulators in a market as diverse and complex as that in New York must be the line of defense between insurers and those who would ultimately bear the risk. In the absence of a federal backstop for terrorism losses, which the Insurance Department believes is the single best mechanism to balance these competing issues, the Insurance Department will be compelled to consider exclusions, though we will continue to insist upon specific, targeted and well-defined terrorism exclusions that enable consumers and insurers to clearly understand the application of the exclusion and the substance of what is being omitted from coverage.

To be sure, the insurance marketplace was changing prior to the attacks on the United States last fall. The events of September 11th accelerated a previously developing hard market. The property/casualty insurance market has been largely unprofitable from an underwriting perspective for the last 4 or 5 years. The realization of adverse loss development has resulted in additional underwriting losses. These deteriorating underwriting results converged with declining investment returns, low interest rates and, of course, the occurrence of the first catastrophic event to implicate virtually all lines of insurance coverage, to create an unprecedented market challenge. Thus, it was only a matter of time before the industry's willingness to absorb these losses reached its saturation point, turning, and then propelling, the insurance cycle. As occurs in most hard market situations, insurers can be expected to do a complete reassessment of their business plans and underwriting standards. Lines of business and individual accounts that have experienced losses or have been otherwise unprofitable are now the subject of very close scrutiny and intense re-evaluation, even if such losses had nothing to do with events that occurred on that day in September.

As noted, the September 11th attacks and lack of reinsurance coverage for terrorism losses have primarily affected the property and casualty marketplace. However, the life and health insurance markets have not been immune to the fallout from September 11th. In recent discussions with several life insurers, we have been advised that catastrophic stop loss reinsurance coverage has become significantly more expensive while, at the same time, excluding acts of terrorism including nuclear, biological, and chemical incidents or attacks. The impact on the direct market (i.e., the cost and availability of life insurance coverage) is difficult to ascertain at this time. Several life insurers are considering whether this higher cost and more restrictive coverage is an effective and efficient way to manage their risks. In light of this development, life insurers are reassessing their geographic concentration of risks and exploring other alternatives in managing these risks. For example, some life insurers are considering altering their sales and marketing plans as a means of managing their risk concentration concerns.

Concern has been expressed regarding those who may have lost employer–sponsored health insurance coverage as a result of the September 11th tragedy. Loss of such coverage may be attributable to the termination of the employer's health plan, termination of employment, or for surviving spouses and dependents, the death of the employee.

Federal and state continuation laws (COBRA) permit former employees and surviving spouses and dependents to continue group coverage at their own expense when the employer group plan remains intact. They are also entitled under state conversion requirements to purchase the standardized HMO and point-of-service (POS) products available in the direct payment market. The HMO and POS contracts are also available when COBRA is not an option due to termination of the group plan. However, these options may be prohibitively expensive for many individuals. COBRA eligible individuals must pay the full group premium rate at their own expense, and the direct payment contracts in most cases are significantly more expensive than COBRA rates.

For those who have lost their employer sponsored health insurance, Healthy NY may be an attractive alternative to COBRA and conversion coverage. Available January 1st, 2001 as a part of HCRA 2000, Healthy NY offers eligible individuals a comprehensive health plan at premium rates made more affordable through a stop-loss funding mechanism established under HCRA 2000. Healthy NY may be particularly attractive to those whose only alternative is the direct payment conversion contracts.

Surviving dependents of a WTC victim would meet the eligibility criteria under a variety of scenarios. For example, Healthy NY is available if the surviving spouse is employed or becomes employed by an employer that does not offer group coverage, and the household income of the family is less than 250% of the federal poverty level at the time of application. Though survivors of WTC victims may believe that they are not eligible for Healthy NY because they were insured prior September 11th and/or because their household income was above 250% of the federal poverty level prior to September 11th, HCRA 2000 provides for exceptions to the general requirement that applicants be uninsured prior to the date of application. Loss of prior coverage due to death of a spouse and termination of prior group coverage are two such exceptions. In addition, Healthy NY considers current income. The situation of the survivors at the time of application is what is important. Healthy NY is designed to be helpful to those whose lives have been suddenly altered. I encourage employees and families affected by the disaster to visit www.healthyny.com or to call the Insurance Department for more information on Healthy NY.

Three insurers have also received Insurance Department approval to provide discretionary group status to the employees and survivors of victims that can not access COBRA benefits because the group contractholders (i.e., the employers) have ceased to exist as a result of the September 11th events. The three programs are summarized below:

- Oxford's Lower Manhattan Discretionary Group: Deadline for enrollment was either December 31, 2001, or January 31, 2002, depending on when group coverage was terminated. However, the Insurance Department, through discussions with the insurer, was successful in getting the enrollment deadline extended to April 1, 2002. To be eligible for coverage, a person must:

- have been an Oxford member on September 11, 2001; and
- work or have worked for a group located in lower Manhattan on or south of Canal Street (or is a covered spouse or dependent of such person); and
- have lost group coverage due to the group going out of business or because the group became unable to pay the insurance premiums as a result of the WTC tragedy.

- HIP's World Trade Center Continuation Rider: The original deadline for enrollment was January 31, 2002. Again, the Insurance Department, through discussions with the insurer, was successful was in getting this date extended to May 31, 2002. To be eligible for coverage, a person must:
    - have been a HIP group member at the time of the WTC tragedy; and
    - have lost health care coverage because his or her employer terminated a HIP small group policy as a result of the WTC tragedy; and
    - have been working for an employer located below Canal Street in Manhattan.
- Fidelis Hope Program: Deadline for enrollment is September 11, 2002. To be eligible for coverage, a person must:
    - have experienced unemployment, underemployment and/or the loss of health insurance coverage as a result of the WTC disaster; and
    - not be eligible for Medicaid or any government funded health insurance program; and

- be a New York State resident who works or resides in the “covered service area” (boroughs of Queens, Bronx, Brooklyn, Manhattan and Staten Island or Nassau, Suffolk, Westchester, Rockland, and Orange counties).

Gathering information on the impact of September 11th on consumers and the insurance industry was, and continues to be, a priority for the Insurance Department. To this end, and since the hours after the events on that day, the Insurance Department has pursued a course of action to monitor and respond to the rapidly changing market conditions. From eliciting signals of future market dynamics through the loss development arising out of the World Trade Center disaster and the claims practices of insurers in responding to it, to conducting statewide insurance marketplace forums concerning the availability and adequacy of coverage to homeowners, small businesses and large commercial risks throughout New York, to responding in timely fashion to the concerns of virtually every business group relating to adequacy of coverages, the Insurance Department has made an unprecedented commitment of resources to ascertaining the most current market conditions.

In the forums held on Long Island and Manhattan, consumers expressed concerns regarding the operation of property damage and business interruption coverage and the availability and affordability of renewal coverage. At the Albany forum held just this week, the Department heard from a steel merchant and fabricator in the Capital district; his story is representative of the concerns faced by businesses throughout the state. The company’s general liability premiums skyrocketed from

$8,000 last year to $75,000 upon renewal this year; the premiums for their automobile coverage jumped from $31,000 to $56,000; and the umbrella policy premiums increased from $6,000 to $34,000. In all, this company's insurance bill for these coverages increased from $45,000 in 2001 to $165,000 in 2002, a 267% increase! To add insult to injury, the president of the company complained that while they began shopping around for these coverages months before they were due to expire, they were able to obtain only two quotations from the market just 4 days before the expiration date of their current policies. In 2001, they had the luxury to choose insurers and coverages from over a dozen quotations. In order to stay in business and fund this exorbitant increase in premiums, this company is contemplating raising costs to its fabrication customers by 10%. The company also considered lowering their insurance bill by getting out of the fabrication business entirely and focusing only on selling steel.

A representative from a nonprofit entity employing 25 people in the Wall Street area complained that premium costs for both primary and excess business liability coverage nearly doubled upon renewal. Although no claims were submitted as a result of the September 11th disaster or any other incident, the premium for the nonprofit's primary liability insurance policy rose from $32,000 to $60,000 for $1 million in coverage. The premium for the excess liability policy rose from $13,000 to $26,000 for the next $1 million in coverage. The representative testified that the broker was unable to secure better rates for this coverage in the market.

A representative of a large retailer of electronic equipment and computers employing 600 people in lower Manhattan stated that insurance premiums for all coverages pertaining to the business have, in total, increased over $1 million. The representative indicated that this increase in insurance premiums could jeopardize jobs and the future of the business in general.

This represents a small sampling of the numerous stories on how the disruptions in the insurance marketplace in the wake of September 11th are affecting the lives of real people. I believe these stories provide a poignant response to the question raised by the title of this hearing “How much are Americans at risk until Congress Passes Terrorism Insurance Protection?” Additional examples of the impact of the current crisis can be found in the transcript of the testimony presented at the forum held in Manhattan on February 21, 2002.

Our outreach to businesses was supplemented last week by the distribution of a survey of insurance issues related to the WTC disaster. The survey was hand-delivered by Insurance Department staff to all street-level businesses in the area south of Chambers Street and west of Broadway in lower Manhattan. Eighteen members of the Insurance Department, in teams of two, walked from door-to-door and handed out approximately 400 surveys with postage-paid return envelopes. Businesses were encouraged to bring any insurance-related issue or problem to the Insurance Department’s attention either by completing and mailing the survey or by personally visiting our downtown offices.

In addition to gathering information from consumers, the Insurance Department sought information on the insurance industry's intentions regarding their pricing structure, coverage limits, exclusions, as well as their experiences in the marketplace. On December 3rd, a survey was sent to 69 insurer groups comprising some 389 companies that account for approximately 92% of commercial property insurance and 94% of personal property insurance writings in New York State. The purpose of this survey was to assist the Insurance Department in its continuing effort to closely monitor issues and developments affecting the availability of vital insurance coverages and the ability of insurers to maintain a viable presence in the marketplace. The survey required insurers to respond to several questions regarding their underwriting and rating plans, practices and intentions, and their experiences with reinsurance. Responses were received from companies that account for approximately 89% of commercial insurance and 93% of personal insurance writings in New York state. Following is an abstract of findings based on a compilation of the individual responses.

With respect to commercial property and liability insurance:

- 54% plan to reduce coverage limits on both new and renewal business;
- 12% plan to materially curtail the number of policies written in certain lines of business;
- 11% ceased writing or materially reduced the number of policies written in New York; 18% did so outside New York in 2001;
- 12% plan to cease writing or materially reduced the number of policies written in New York; 24% plan to do so outside New York in 2002;

- 81% of insurers responding that they are licensed to issue policies in the Free Trade Zone plan to exclude or limit coverage for acts of terrorism;
- 83% indicated that their reinsurers excluded or limited coverage for acts of terrorism;
- 32% indicated that their reinsurance premiums have increased by at least 10%;
- 64% indicated that their reinsurers reduced the limits they are offering;
- 27% indicated that their reinsurers increased coinsurance percentages;
- 38% indicated that their reinsurers increased required retention levels; and
- 95% indicated that they do not plan to materially reduce assumptions of reinsurance in 2002, however, the overwhelming majority indicated that they intend to exclude or otherwise limit coverage for acts of terrorism, to increase reinsurance premiums by at least 10%, and to reduce limits or increase coinsurance percentages.

With respect to personal lines (private passenger automobile and homeowners insurance):

- 20% plan to reduce coverage limits on some or all new business;
- 21% plan to reduce coverage limits on some or all renewal business;
- 5% plan to materially curtail the number of policies written in certain lines of business;
- 13% ceased writing or materially reduced the number of policies written in New York; 23% did so outside New York in 2001;

- 6% plan to cease writing or materially reduced the number of policies written in New York; 22% plan to do so outside New York in 2002;
- 14% indicated that they have or plan to seek approval to exclude or limit coverage for acts of terrorism;
- 78% indicated that they have or plan to increase premiums in New York;
- 54% indicated that their reinsurers excluded or limited coverage for acts of terrorism;
- 61% indicated that their reinsurance premiums have increased by at least 10%;
- 33% indicated that their reinsurers reduced the limits they are offering;
- 15% indicated that their reinsurers increased coinsurance percentages;
- 23% indicated that their reinsurers increased required retention levels; and
- All respondents indicated that while they do not plan to materially reduce assumptions of reinsurance in 2002; they intend to exclude or otherwise limit coverage for acts of terrorism, to increase reinsurance premiums by at least 10%, and to reduce limits or increase coinsurance percentages.

The above market survey was followed by an Insurance Department request for information on the underwriting practices employed by insurers in lower Manhattan. This request was prompted by reports that insurers may be restricting the writing of business in lower Manhattan by discouraging agents from submitting applications for new and/or renewal business. On February 15th, we requested information from 343 insurers (including 54 insurer groups) on their underwriting practices in Manhattan. The questionnaire requests information on applicable premium writings for personal and commercial automobile insurance, commercial multiple peril insurance, workers' compensation insurance, and homeowners insurance, on a monthly basis from January 2001 to the present. The reports are returnable on March 8, 2002. We are planning to follow this survey with a series of targeted market conduct investigations that will focus on insurers' cancellation, nonrenewal, underwriting and rating practices post-September 11th.

The Insurance Department is also in the process of establishing a Blue Ribbon Commission whose overall mission will be as follows:

- Analyze and compare the pre and post-September 11th conditions in the insurance marketplace throughout New York state;
- Identify the nature and extent of the insurance marketplace changes that (i) have arisen as a direct result of the September 11th disaster; (ii) were already taking place prior to September 11th and were affected by the disaster; and (iii) took place independently from the September 11th events;
- Consider availability and adequacy of coverages to homeowners, small businesses and large commercial risks in the New York market and changes arising in both availability and adequacy as a result of September 11th;
- Develop a strategy to increase the preparedness of the insurance community in handling future disasters or catastrophes; and
- Recommend appropriate legislative, regulatory and marketplace changes to address the identified issues.

In addition to any issues that Commission members shall identify, the Insurance Department has prepared a list of issues to be presented to the Commission for consideration. The composition of the Commission will be announced shortly. We expect the Commission to issue its recommendations by September 2002.

There have been many calls by legislators for the production of concrete evidence that the failure to enact a federal reinsurance backstop has resulted in a market upheaval. In response, I would like to submit that we have a developing crisis on our hands. To those who were expecting a sudden and precipitous market displacement, I would like to caution that because of market dynamics, the effects of a lack of a backstop for terrorism losses may be gradual and subtle, but just as detrimental. Rather than a sudden decapitation, the market effect may be analogous to a slow death by a thousand cuts for a variety of reasons.

There may be hesitancy on the part of many businesses to publicly acknowledge that they are conducting their affairs without the benefit of appropriate insurance protection. They are concerned, and genuinely so, that public disclosure of this information may adversely affect their client/customer base and put their business at a competitive disadvantage. Also, reinsurance programs typically contain various layers of coverage, with some layers possibly expiring on different dates and issued by separate reinsurers. While many reinsurance treaties expired on January 1, 2002, many other reinsurance contracts remain in force until April 1, 2002 or July 1, 2002. Accordingly, many primary insurers continue to have some reinsurance coverage for terrorist acts which may or may not be diminished because of the varying expiration dates of reinsurance contracts in successive layers of coverage.

IV. CONCLUSION

The insurance industry and their regulators are responding to the worst disaster in our nation's history. As discussed above, the events of September 11th have raised many issues that need to be resolved; however, none is more crucial than the lack of coverage for acts of terrorism.

Prior to September 11th, estimates of maximum probable loss for acts of terrorism were limited and comparable to other insurable losses. September 11th changed those calculations dramatically. A coverage that was essentially given away before September 11th became uninsurable post-September 11th.

The insurance industry does not have the capacity to absorb repeated losses such as the one inflicted on September 11th. The catastrophic nature of, and the potential of unlimited losses stemming from, this exposure make it impossible for the industry to bear this risk. Secondly, insurance rates are predicated on reasonable assumptions of loss frequency and severity. The frequency and severity of terrorism losses are impossible to predict. Therefore, even if we were to assume for a moment that the industry had infinite resources to pay for terrorism losses, it would be nearly impossible for the industry to develop an appropriate premium for the coverage using the sparse data currently available on terrorism losses in the United States. With a backstop for terrorism losses in place, insurers and reinsurers will be able to appropriately price the risk because they will know the extent of their exposure to terrorism.

Some may consider this to be solely a private sector issue, but it is not. The private sector, by itself, does not have the capability to develop a solution to this problem. I believe that the solution lies in a public/private partnership. Government participation is necessary because the nature of the risk has the potential to disrupt our national economy and presents a significant hurdle to recovery from the current recession. In the normal course of events, commercial activity that is transacted in our economy would not occur but for the availability of insurance and the ability of businesses to transfer the financial consequences of uncontrollable events to an insurer. Continued economic activity is dependent on well-functioning insurance markets and it is incumbent upon us, at both the state and federal level, to formulate an appropriate strategy to ensure that the insurance infrastructure remains sound and that public confidence in the insurance industry's ability to honor its promises is maintained.

To be sure, the Insurance Department and other state insurance regulators have taken the necessary measures to address pre and post-September 11th marketplace issues. These efforts were well under way prior to September 11th. However, many of the issues driving the current market, such as the public uncertainty about the security measures implemented to thwart future terrorist attacks and a general sense of insecurity prevailing in the civil aviation industry since September 11th, are not within the realm of insurance regulation and can only be tackled at the national level.

I strongly urge Congress to pass legislation that will, for a period of time, appropriately limit the industry's exposure to future terrorism losses. This will allow the industry to resume allocation of their resources to traditional insurance risks, including the ability to offer and price a level of terrorism coverage adequate to meet the legitimate needs and expectations of policyholders. It will also allow for the crafting of remedies to both the short and long-term weaknesses in the insurance system.

Thank you for allowing me the opportunity to testify today. I will be happy to answer any questions you have.