



**U.S. House of Representatives Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and Government Sponsored
Enterprises and Subcommittee on Oversight and Investigations
Hearing on "A Review of TRIA and its Effect on the Economy: Helping America
Move Forward "
April 28, 2004**

**Statement submitted on behalf of:
American Insurance Association (AIA)
Council of Insurance Agents & Brokers (CIAB)
Independent Insurance Agents & Brokers of America (IIABA)
National Association of Professional Insurance Agents (PIA)
Property Casualty Insurers Association of America (PCI)
Reinsurance Association of America (RAA)
Surety Association of America (SAA)
UWC – Strategic Services on Unemployment & Workers Compensation (UWC)**

The national trade associations above represent the majority of the property and casualty insurance industry writing all lines of business in every jurisdiction in the United States. Our member companies provide various types of insurance that include terrorism risk pursuant to the Terrorism Risk Insurance Act of 2002 (TRIA). TRIA has helped stabilize the private market for terrorism risk insurance. As we approach December 31, 2005 (the date TRIA expires), reinsurers are not able to provide the market with sufficient reinsurance capacity for this catastrophic risk. As a result, we urge Congress to extend the federal terrorism insurance program because the nature and insurability of terrorism risks in the United States – and the capacity of the industry to manage this risk – remain in question.

The tragic attack of September 11, 2001, forced all Americans to directly confront the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil aimed primarily at civilians. The devastating economic consequences of the attack also forced insurers and other businesses to re-examine the nature of terrorism-related risks, as well as how such risks (which now more closely resemble war than any other peril) were being spread and managed. Insurers responded to September 11 claims in an unwavering manner, and without the benefit of a single dollar of federal assistance.

However, the September 11 attack dramatically altered the future landscape of terrorism risk capacity and insurability, leaving no ready mechanisms to stabilize the market. Congress provided definitional parameters of the terrorism risk and tools for insurers to manage this risk by enacting TRIA in November 2002. TRIA creates a public/private “shared loss” program that provides a federal backstop to the private commercial property-casualty insurance system in the event of further catastrophic attacks by foreign terrorists against U.S. targets. In effect, TRIA provides stability because it has created statutory caps for insured losses that apply to both the insurance industry and the federal government.

Since TRIA’s enactment, affordable terrorism risk insurance has been more readily available to commercial policyholders, as insurers have passed on the benefit of the backstop to consumers. This market-stabilizing effect has enabled billions of dollars of business transactions previously stalled to go forward without threatening the solvency of the commercial enterprises involved or their insurers. A recent Mortgage Bankers Association (MBA) survey of its 40 largest commercial/multi-family mortgage banking firms revealed that TRIA has made terrorism insurance both more available and less expensive. The MBA survey also found that failure to extend TRIA would have an adverse impact on the commercial real estate market by re-creating the pre-TRIA environment that had led to rating agency downgrades of commercial mortgage-backed securities due to lack of adequate terrorism insurance.

TRIA also has helped insurers manage exposure to terrorism risk, and write or renew high-risk policyholders that might have been uninsurable (or only insurable on unfavorable terms) without TRIA. This is because TRIA provides individual insurance companies with some certainty as to the dollar amount of risk that they retain. Moreover, TRIA’s thoughtful use of the insurance industry’s infrastructure to deliver the federal share of compensation to impacted businesses has allowed Treasury to establish and administer the program with minimal investment and minimal ongoing expense. There is no doubt that the stability TRIA provides to policyholders and insurers alike has calmed a market struggling to come to terms with the uncertainties of 21st Century terrorism that continues to challenge our homeland security apparatus.

While TRIA was designed to be a three-year bridge to development of what was envisioned as a functional, wholly private sector terrorism insurance market, TRIA has not – and indeed cannot – change the underlying characteristics of terrorism risk in the United States. These characteristics weigh heavily in favor of a continued federal terrorism insurance backstop.

- **The commercial property-casualty insurance sector continues to lack the necessary capacity to handle catastrophic terrorism losses on its own.**

Under certain plausible event scenarios, estimated insured losses from another catastrophic terrorist attack on U.S. soil could exceed \$250 billion, which far exceeds the entire commercial property-casualty industry’s estimated capacity. Obviously, the risk of

financial ruin for the industry – and the concomitant impact on policyholders – is simply too great, absent continuation of a federal backstop.

Moreover, private market mechanisms are insufficient to spread the risk of catastrophic terrorism in a meaningful way. In its recently released Workers' Compensation Terrorism Reinsurance Pool Feasibility Study, Tillinghast Towers Perrin cited "lack of capacity" as the primary reason why a voluntary workers' compensation terrorism reinsurance pool would not be a viable mechanism to handle mega-terrorism risk. This conclusion is not unique to workers' compensation insurance, but would apply to the ability of a pool to address catastrophic terrorism in other lines as well.

- **Because the United States remains under the constant and very real threat of further attacks, catastrophic terrorism remains an uninsurable risk in the traditional insurance marketplace.**

Both National Security Advisor Condoleezza Rice and Department of Homeland Security Secretary Tom Ridge have alerted Americans to the possibility of terrorist attacks during this election campaign season, and the United States remains on a high state of alert for terrorist activity. Unfortunately, as President Bush has reminded us, we are engaged in a long-term war on terrorism and the situation is not expected to improve before TRIA's currently scheduled expiration date. The relative infancy of terrorism modeling provides additional evidence for this conclusion. While modeling firms have worked diligently to produce terrorism risk models that accurately predict terrorism events in the United States, they have **not** been able to model accurately for frequency of terrorist attacks, because terrorists control that variable. Even if the modeling were able to reasonably account for frequency as well as severity, in contrast to natural disasters such as hurricanes, past terrorism event experience is **not** predictive of future acts. From a severity standpoint, the total loss from a terrorist event, as mentioned earlier, could well exceed the capacity available in the insurance industry. Consequently, catastrophic terrorism is uninsurable. It cannot be underwritten and an appropriate premium charge cannot be determined.

As briefly noted above, natural catastrophe modeling does not aid the terrorism modeling process. Not only is modeling for natural catastrophes far more mature than terrorism modeling, but past natural catastrophes are predictive of the nature, frequency and severity of future natural catastrophes. This is why insurers are better able to underwrite and rate for natural catastrophes. The same cannot be said for terrorism risk.

The possibility of nuclear, biological, chemical, or radiological attacks (NBCR) reinforces the conclusion that catastrophic terrorism risks are uninsurable. Potential terrorism scenarios now routinely include discussion of NBCR events. The anthrax attacks perpetrated through the U.S. postal system, even though limited in scope and severity, demonstrated potential consequences associated with such events. The possibility of NBCR events makes the severity component of the terrorism models even more difficult to grasp. As a result, insurers remain reluctant to provide NBCR coverage for terrorism risks in their policies beyond that already "made available" for other types of insured loss.

- **Unlike other risks of loss, terrorism is an interdependent risk.**

Loss control or mitigation techniques employed by one commercial business may not protect that business from catastrophic loss. The World Trade Center is the most compelling – but not the only – example of the interdependent nature of terrorism risk. The World Trade Center was a model of security and disaster planning, yet nothing done at the World Trade Center could have prevented planes leaving airports with hijackers aboard, and nothing done at the World Trade Center could have prevented planes being used as weapons from flying into the towers. The interdependent nature of terrorism risk, with vulnerability measured by the weakest link in the chain, minimizes the effectiveness of business-by-business loss control.

Because of these characteristics, terrorism risk defies normal underwriting and rating principles, effectively limiting the ability of property-casualty insurers to advance a private mechanism for that risk. The combination of these intrinsic characteristics of terrorism risk argues in favor of a federal backstop that will provide both certainty and stability to the marketplace. A federal backstop will also help mitigate the continuing absence of a viable reinsurance market. During the policy renewal period following September 11, 2001, reinsurers largely declined to provide capacity against the risk of foreign terrorism in the United States. Reinsurers continue to consider terrorism risk uninsurable in the traditional sense, and are not expected to provide the market with sufficient capacity when TRIA expires. Thus, the federal government must continue the role it has filled under TRIA: supplying capacity that is unavailable in the private reinsurance market in order to provide the reinsurance protection that is critical as long as even a possibility for catastrophic loss exists.

Aside from the inherent systemic issues associated with insuring catastrophic terrorism and the insufficient capacity reinsurers are able to bring to the market, there is strong consensus among commercial policyholders, state insurance regulators, and the insurance industry that continuation of a federal backstop (either the current TRIA or a modified program) is essential. There also is strong consensus that, because of insurance and business cycles, reauthorization cannot wait. Congress must take action in 2004 in order to avoid the kind of market dislocation that was so destabilizing prior to the law's initial passage.

Immediate congressional action is necessary for several interrelated reasons:

- **TRIA's "hard" end date is inconsistent with rolling expiration dates provided by underlying insurance policies.**

TRIA has a "hard" expiration date of December 31, 2005, after which date Treasury will be unable to certify any terrorist act. By contrast, the underlying insurance policies that rely on TRIA are written every day of the year, generally for a 12-month term (although some commercial property policies covered by TRIA are multi-year). This sequential mismatch will create great confusion for policyholders and uncertainty for insurers, because policies written after January 1, 2005 (and sometimes earlier), will have a coverage term that extends beyond the backstop. As a result, insurers will have no choice

but to evaluate every policyholder considered for coverage during this period as if the backstop does not exist for part of the coverage period.

- **Treasury’s “make available” decision adds to the uncertainty.**

TRIA directs Treasury to decide by September 2004 whether to extend current “make available” provisions to the third year of the program. A number of business groups have publicly urged extension of the “make available” requirement, because the private terrorism insurance market has not yet stabilized. Insurers have expressed concern about the potential mismatch between policies sold during 2005 and the hard sunset date. Despite somewhat differing perspectives on the “make available” requirement, policyholders and insurers agree that it is critical to extend the backstop beyond December 31, 2005. Securing the extension in 2004, rather than 2005, would avoid difficult implementation of the “make available” provision during the third year of the program.

These “dates certain” in TRIA do not coincide with state regulatory requirements or implementation timelines of property-casualty insurers. Post-TRIA policy forms must be approved prior to their use in the market, and that process has already begun. New forms submitted for state regulatory review must delineate what (if any) terrorism coverage is granted, and what (if any) is excluded. Without a doubt, some of those policy forms are premised on TRIA expiration at the end of 2005.

- **Once policy forms are approved, system changes must be implemented.**

New policy forms (along with any required policyholder notices) will need to be loaded into insurance company systems, a process that may take several months, especially if states adopt inconsistent policy forms or notice requirements, which past experience suggests is a likelihood. These changes must be in place before any policies using the new forms can be underwritten consistent with state regulatory requirements.

For large commercial policyholders, the underwriting process will take several months. Many policyholders that benefit most from TRIA have relatively complex insurance arrangements that generally require two to three months of negotiation prior to being finalized. As a result, the first policies that are likely to be affected by TRIA’s “hard” sunset (i.e., those that are up for renewal starting January 1, 2005) will be negotiated in the late summer or early fall of 2004, extending the period of uncertainty that is so disruptive to insurance markets. In addition, ongoing uncertainties surrounding TRIA’s hard sunset date will more immediately and adversely impact small to mid-size commercial insurance policyholders. These businesses comprise the majority of the commercial lines marketplace. They rely on TRIA much more than their larger counterparts, because their operating margins are thinner, and they have less leverage in the marketplace.

State cancellation/non-renewal requirements add more complexity. Insurers that cancel or non-renew certain policyholders because of concern about post-TRIA exposure levels will have to comply with a myriad of state cancellation and non-renewal notification requirements, generally ranging from 30 days to 90 days. Policyholders who receive such

notices may have to engage in several different underwriting assessments by multiple insurers. We urge Congress to consider these points as it decides how to address TRIA and terrorism risk.

Conclusion

TRIA's public-private partnership is working to stabilize the commercial insurance markets that underpin our entrepreneurial, free-market economy. Terrorism remains an uninsurable risk; therefore, it is critical to extend this backstop in a manner that avoids the types of market dislocations TRIA was designed to address. Because of the regulatory and operational lags that are inherent in the insurance system, Congress must take action in 2004, even though the law itself does not expire until year-end 2005. Because insurance remains a key critical infrastructure of the United States economy and given the importance of TRIA to U.S. national and economic security, we urge prompt and positive action on TRIA reauthorization.