NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

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INSURANCE COMPANY OF GREATER NEW YORK
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ON BEHALF OF
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

HEARING ON "THE FUTURE OF TERRORISM INSURANCE"

BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES

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Chairman Baker, Chairman Oxley, Ranking Minority Member Kanjorski, Ranking Minority Member Frank and Members of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, 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 vigorous efforts of Chairmen Oxley and Baker and of this Committee, as well as the rest of the Congress and the Administration, TRIA was adopted. NAMIC and I are convinced that it played a major role in preventing an economic catastrophe and helping get the country back on its feet economically after 9/11. We thank you for your efforts then and we thank you for your efforts today to reform TRIA and renew the federal reinsurance backstop for terrorism before it expires at the end of this year. We appreciate your comments about moving a terrorism insurance bill to the House floor in the fall as we agree with Federal Reserve Board Chairman Alan Greenspan's observation last week before this Committee that there is "no way" that the private insurance market can handle terrorism-related risk by itself because of the "very substantial" potential scope of damage and we support his endorsement of government-backed reinsurance for terrorism.

NAMIC strongly supports extension of the federal terrorism reinsurance backstop in TRIA

I am here today to testify on behalf of the National Association of Mutual Insurance Companies (NAMIC). Founded in 1895, NAMIC is the largest property/casualty insurance trade association in the country, consisting of more than 1,400 member companies that underwrite 43 percent ($196 billion) of the property/casualty insurance premium in the United States.

NAMIC strongly endorses an extension of the federal terrorism reinsurance backstop in the Terrorism Risk Insurance Act (TRIA), with modifications designed to maximize the development of a private market and to provide a viable long-term system to protect the economic strength of the country against terrorist attacks.

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

Let me tell you a little about our companies and our experience with terrorism risk because we have been on the frontlines of this problem. As with many mutual insurance companies, whether they be rural, farm, or specific to a particular industry GNY began in the early 1900s at a time when there was a flood of immigration into the United States. Many of these immigrants settled in the lower East Side of New York City and they earned their living as plumbers, electricians, steel workers, carpenters and laborers in other trades. Many of them saved and purchased tenement apartment houses, however, they found it difficult to obtain liability insurance for their properties because the tenement houses were extremely crowded and because of burgeoning litigation at that time. These tenement house owners formed a trade association to protect their interests and to which they gave the name of 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 and 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 and Virginia. 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. We have also been selected as one of Ward's 50 Benchmark property/casualty companies for the last five consecutive years for outstanding achievement in the areas of safety, consistency and performance.

In New York State in 2004, our companies wrote direct written premium of $189,371,747, of which $158,405,329 was Commercial Multi Peril, making us the fourth largest writer of Commercial Multi Peril business in New York State. In New Jersey in 2004, we wrote direct written premium of $73,068,997 of which $56,246,531 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 four years, I have continued to also serve as Chief Underwriting Officer and 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 large 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 pricing 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 deal with it.

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 real-time computer system to track risk accumulations and the number of employees in a given building and 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 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 Treasury Department's recommendations are a reasonable starting point for short-term reform of TRIA

We think the Treasury Department recommendations for changes in TRIA are a reasonable starting point for short-term reforms. We agree with Treasury's assessment that "the immediate effect of the removal of the TRIA subsidy is likely to be less terrorism insurance written by insurers, higher prices and lower policyholder take-up." Given the Madrid bombings of last year and the recent bombing events in London, including one devastatingly successful one, we think the failure of the Congress to extend a terrorism reinsurance backstop could have a very harmful impact on the U.S. economy if terrorists such as al Qaeda and its Hydra-headed offspring succeed in attacking the United States again. If Treasury is correct in its assessment of the short-term effect of ending the program, then the economic cost to our country of another terrorist attack would undoubtedly be far greater if the program is ended instead of extended. The cost of government reinsurance provided under TRIA would pale in comparison to the billions in aid that the government would inevitably disburse in the form of terrorism disaster relief. That would be a cost borne by not just by the people where the attack occurred but by taxpayers from Hawaii to New York, as well as from Alaska to Maine and all the states in between.

"The Economic Effects of Federal Participation in Terrorism Risk," an excellent report written by the former Chairman of the Council of Economic Advisers, Glenn Hubbard, and Bruce Deal of the Analysis Group, estimated the economic impact of not extending TRIA:

- Absent another major terrorist attack, GDP may be $53 billion (0.4 percent) lower, household net worth may be $512 billion (0.9 percent) lower, and roughly 326,000 (0.2 percent) fewer jobs may be created.
- Were another attack to occur of the size of 9/11, tens of thousands more jobs could be lost due to the lack of insurance coverage and thousands of additional bankruptcies could occur compared to the 9/11 event, which was covered by the insurance industry.

These potential results are not acceptable risks in a world where the Secretary of the Department of Homeland Security warns us that another terrorist attack on our homeland will – not could – occur.

As I mentioned previously, I think Treasury outlined several key areas of reform, particularly higher deductibles and a higher event trigger. The private sector has shown that it can operate with a 15 percent deductible. Raising the deductible would provide a further test of private sector capacity. Similarly, an increase in the event trigger is within the realm of reality. However, raising the event trigger much higher would be problematic, particularly for medium and small companies. In establishing new deductible levels and a higher event trigger, one must recognize that, if they are set too high, the program will unfairly discriminate against the medium to small companies in favor of large companies that can afford a much larger hit.

In reforming TRIA, it is important to recognize that terrorism insurance does not operate in a free market in the United States. The state regulators in New York, the state 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: Medium and small companies will face a difficult choice, leave the market place for terror target-area risks or face the prospect of a financial disaster that could result if they write coverage. Should companies choose to leave the market, then it would eliminate competition in the market place.

Such government intervention by some state regulators to prevent terrorism coverage exclusions or by all states that require the inclusion of terrorism risk in workers' compensation insurance, is the very problem preventing the development of a terror cover market. Forcing companies to write this coverage prevents the free market forces from developing a private market that can be priced and reinsured accordingly. Thus, unless the terrorism insurance bill includes the ability to exclude coverage in all states in the same manner as TRIA, Congress must provide a meaningful backstop that does not discriminate among insurers. Otherwise, a market will never be created that is priced according to the true nature of the risk.

NAMIC supports a public/private partnership as the key element of a long-term solution

A long-term solution is likely to involve a public/private partnership as well. Here the Treasury report is less instructive than elsewhere as it says only that, "Over time, we expect that the private market will develop additional terrorism insurance." I'm afraid that such a conclusion is based more on perhaps excessive faith in the private enterprise system than a more pragmatic understanding of the distinction between the insurability of large natural disasters and unpredictable catastrophic acts of terrorism by barbaric people whose goal is to cause the maximum number of casualties and to bring the U.S. and other western economies to their knees. Unfortunately, all it requires to make weapons of mass destruction in 2005 is a computer, Internet access and a college-level education. The effects can be devastating, as reflected in the recent report by the Organization for Economic Co-operation and Development (OECD), which estimated that the maximum losses that could result from a single terrorist attack range from $50 billion to $250 billion. That is from *one* terrorist attack, not multiple attacks as historically favored by al Qaeda.

While the Treasury Department is correct that the U.S. insurance industry has improved its modeling of terrorist attacks, such modeling is not analogous to modeling hurricanes and other natural disasters which have long historical records and whose future predictability is buttressed by sophisticated geological studies. Terrorism modeling can help individual insurers reduce their exposure by diversifying their risk geographically and otherwise. 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, as are many 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 deductibles set by TRIA today, nevertheless the higher deductibles in a modified TRIA extension could very well work for companies other than those very small companies.

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. This concentration of risk is best exemplified by the California State Fund 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.

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 high a concentration of risk, a mandate to take all customers and an inability to exclude terror related occurrences which have the ability to render catastrophic levels of human and economic devastation in particular areas or regions.

Even if an insurer were able to diversify its risk exposure through modeling and get sufficient private reinsurance to cover the TRIA deductibles, the notion that the private market can protect itself through good modeling is flawed. Absent a terrorism insurance program, a $250 billion terrorist event, the high estimate by the OECD, would wipe out so much of the property/casualty insurance industry surplus for all lines, estimated at $350 billion in 2003, that it would be unable to meet its obligations to its other insureds for the many different coverages beyond terrorism insurance protected by that surplus.

So what would a long term terrorism insurance solution look like? Raising the deductibles and the event trigger along the lines I discussed earlier would provide a further test of private market capacity. The failure of sophisticated investors to actively seek out profit opportunities since 9/11 indicates that they understand that predicting terrorism risk is itself a highly risky investment. Nonetheless, I believe higher deductibles and event triggers will provide a further real world test of the private sector's willingness to make terrorism insurance available at an affordable price.

I think it is more likely that the creation of a private/public partnership, as exists in Great Britain with the Pool Reinsurance Company Limited, commonly known as Pool Re, can be a substantial part of the solution. Pool Re is a mutual insurance company that is authorized only to write reinsurance relating to terrorism risk on commercial property insurance. It differs from normal insurers and reinsurers in that it reinsures its liabilities with the British government, to which it pays a reinsurance premium and from which it will recover any claims that exceed its resources. I think such a balanced private/public partnership might be a key element to protecting the U.S. economy from the *sui generis* risk presented by a catastrophic terrorist attack.

What other components might the Congress consider? A new RAND Center for Terrorist Risk Management Policy study recommended two possibilities: (1) requiring that terrorism insurance cover acts by domestic groups as well as foreign terrorists, a wise admonition in light of the London attacks, and (2) requiring that insurance cover attacks involving chemical, biological, radiological or nuclear (CBRN) weapons, perhaps through a direct government insurance program. Most private insurance policies now exclude such coverage and yet our government has warned us time and again that terrorists are trying to obtain such weapons to use against us and other opponents of terror.

Now would also be a good time for the federal government to examine tax and accounting policies that NAMIC believes are major impediments to increasing the capacity of insurers and reinsurers to provide terrorism coverage. For example, insurers are not permitted to deduct reserves set up for just these types of situations. That policy creates a huge disincentive for insurers to do just what they should do to maximize protection against terrorism risk. It also creates a disincentive for the private sector to invest in the insurance industry.

The flow of private sector capital to this industry is also inhibited by outdated state regulatory policies that often require regulatory approval of the prices insurers charge. Such controls have been lifted from almost every other area of the economy and should be lifted from the insurance industry as well.

Finally, Mr. Chairman and Members of the Subcommittee, thank you once again for the opportunity to testify on this issue of vital importance to NAMIC member companies and the U.S. economy. Your continuing leadership on this issue represents the best in public policymaking and NAMIC stands ready to assist you in any way in developing the best possible terrorism insurance legislation.