A REVIEW OF TRIA AND ITS EFFECT ON THE ECONOMY: HELPING AMERICA MOVE FORWARD

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTEREPRISES

AND THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

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A REVIEW OF TRIA AND ITS EFFECT ON THE ECONOMY: HELPING AMERICA MOVE FORWARD

Wednesday, April 28, 2004

U.S. House of Representatives,
Subcommittees on Capital Markets, Insurance, and
Government, Sponsored Enterprises and
Subcommittee on Oversight and Investigations
Committee on Financial Services,
Washington, D.C.

The subcommittees met, pursuant to call, at 10:02 a.m., in Room 2128, Rayburn House Office Building, Hon. Richard Baker and Hon. Sue Kelly [chairmen of the subcommittees] presiding.

Present: Representatives Baker, Kelly, Royce, Gillmor, Ose, Shays, Hensarling, Garrett, Brown-Waite, Barrett, Kanjorski, Maloney, Gutierrez, Velazquez, Sherman, Moore, Capuano, Lucas, Crowley, Clay, Israel, Matheson, Miller, Emanuel, Scott and Bell.

Chairman Baker. [Presiding.] I would like to call our subcommittees's meeting to order this morning. This morning, we have a joint meeting of the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee, together with the Oversight and Investigations Subcommittee chaired by Ms. Kelly, for the purpose of receiving comment on the advisability of an extension of and the effectiveness of the current Terrorism Risk Insurance Act adopted by the Congress in 2002.

As all of us are painfully aware, the events of September 11 brought about the necessity for change in many aspects of American life. One area not given a great deal of attention, but extremely important for the functioning of our commercial enterprises is that of our insurance network necessary to enable the production, distribution and sale of almost every commodity and many activities in daily life.

Because of the enormous exposures created by the concentration of loss in this terrible event, it was necessary for the Congress to act to provide a backstop to the private marketplace to enable appropriate adjustments to be made in the free market system to prepare for what we hope will never happen again. As we approach the expiration mandated by the legislation of this network, it is now appropriate and advisable for the committee to hear comment as to whether the market is sufficiently prepared for a transition to a free market remedy, or whether it is appropriate for some extension of the current guarantees to be considered by the Congress in light of the difficulty of assessing the current risks.

It is also appropriate to note that the legislation did require the Treasury Department to prepare an analytical study and assessment of the adequacy of the system and to make such report to the Congress by June 30 of the following year. It has been my observation that perhaps it would be advisable in light of that professional analysis to wait on the conclusion of that report and study before the Congress makes final determinations. The report requirements go to the very issues of whether extensions are warranted or not, and I believe would be greatly influential in the Congress's final determinations as to whether the market structures are adequate to face the long-term needs of insurance coverage.

I am pleased this morning to have the witnesses before us who can give us informed insight on these matters and I look forward to their testimony.

Mr. Kanjorski?

Mr. KANJORSKI. Mr. Chairman, we meet today for the first time in the 108th Congress to examine the effectiveness of the Terrorism Risk Insurance Act. As you know, I worked closely with you during the 107th Congress to enact this important economic stabilization law.

Prior to the terrorist attacks on the World Trade Center and the Pentagon, most Americans took their security for granted. These attacks, however, altered how we each assess risk. This adjustment was especially apparent in the insurance industry.

Prior to 2001, many insurers could not price for terrorism risk and offered it for free. Ultimately, the industry sustained approximately $40 billion in losses on September 11 as a result of its poor economic judgment. Subsequently, it turned to the Congress to seek assistance in protecting the American public against future terrorism attacks, particularly in the short term.

Terrorism insurance is critical to protecting jobs and promoting America's economic security. Unfortunately, reinsurers curtailed the supply of terrorism reinsurance and insurers began to exclude terrorism coverage from customers's policies in the wake of the 2001 terrorist attacks. Eventually, we belatedly approved the Terrorism Risk Insurance Act to address these pressing problems.

Seventeen months have now passed since the Terrorism Risk Insurance Act became law. It is therefore an appropriate time for us to begin to examine the effectiveness of this statute. Because we crafted the law to last just 37 months, it is also an appropriate time for us to begin deliberations over the program's future.

Today, Mr. Chairman, we will hear from several insurance experts on these important matters. I am especially pleased that our witnesses will report that the Terrorism Risk Insurance Act has worked to increase the availability of Terrorism Risk Insurance. As I understand, it has also lowered the cost of such insurance, contributed significantly to stabilizing the overall insurance marketplace, and advanced delayed economic development projects.

We wisely designed the Terrorism Risk Insurance Act as a temporary backstop to get our nation through a period of economic uncertainty until the private sector could develop the models to price for terrorism reinsurance. I agreed with this decision. The reinsurance industry is dynamic and we should not disrupt the development of new products.

Nevertheless, I now believe that we might have decided to sunset this program too soon. In designing the law, we sought to give insurers a transitional period. The General Accounting Office, however, has recently determined that the industry has made little progress to date in providing terrorism insurance without government involvement. This finding causes me significant concern.

Although the law will expire at the end of 2005, many industry participants have also already called upon the Congress to act expeditiously in 2004 to extend the life of the Terrorism Risk Insurance Program in order to prevent short-term market disruptions. I agree.

As I have previously noted, terrorism insurance plays an important role in the efficient functioning of our economy. We should therefore pursue appropriate action before the end of the 108th Congress to provide greater stability to our capital markets in the short term, while they work to develop private sector solutions to these problems for the long term. It is also my expectation that the Treasury Department will decide as soon as possible to extend the "make available" provisions of the law that require companies to offer terrorism insurance on the same terms and conditions as other property-and-casualty products.

In debating any plan to extend the Terrorism Risk Insurance Act, we additionally ought to work to incorporate group life insurance into the federal backstop program. Group life products have characteristics similar to commercial property-and-casualty insurance in that there is often an excessive concentration of risk within a small geographic area. Despite a lack of terrorism reinsurance, group life insurers have remained in the marketplace, fully exposed to future terrorism events. This reality has created significant anxiety in the life insurance industry and uncertainty for individuals who obtain life insurance through their employers.

In closing, Mr. Chairman, time is of the essence. I stand ready to work with you and all other interested parties on these matters in the upcoming months. I am also looking forward to hearing from each of our witnesses to learn of their insights on these matters.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Paul E. Kanjorski can be found on page 46 in the appendix.]

Chairman BAKER. I thank the gentleman.

The Chair of the Subcommittee on Oversight, Ms. Kelly?

Chairwoman KELLY. Thank you. I want to thank you, my colleague, Mr. Baker, for being willing to hold this hearing. This is a very important issue for the people of America. I thank Mr. Kanjorski and Mr. Gutierrez for also their cooperation in holding this hearing.

In the last 2 1/2 years, our country has been engaged in a war against terror that has permeated virtually every aspect of American life. Congress and the Administration have responded to our new realities with comprehensive reforms that seek to eradicate the threat posed by fanatical terror networks to our citizens, our economy and our way of life.

Today's hearing highlights a law that has made a significant contribution to this effort. The Terrorism Risk Insurance Act ensures the availability of terrorism insurance that is crucial to our economic security. After 9-11, the marketplace for terrorism insurance vanished. With losses from the terrorist attacks exceeding $40 billion and uncertainty in the marketplace, insurers and reinsurers began to exclude terrorism coverage from commercial policies. Hospitals, office buildings, malls, stadiums, museums, and even small businesses located near these large facilities had difficulty finding terrorism insurance coverage. Without this insurance, commercial development stalled and workers missed out on jobs.

As the availability of coverage continued to disappear and threaten our economic security, it was clear that the market for terrorism insurance would not return on its own. Something needed to be done to provide stability and avoid market disruptions. Congress, with strong support from the Administration, passed legislation to address the uncertainty in the market, protect American jobs, and strengthen the resiliency of our economy.

TRIA established a 3-year program to pay the federal share of compensation for insured losses resulting from foreign acts of terrorism. In TRIA, our goals were clear: make terrorism insurance affordable and available to policyholders in the short term, while also giving the market time to develop resources and mechanisms to ensure viability beyond the expiration of the Act.

Today, the committee will examine the effectiveness of TRIA and its impact on the economy. Thus far, the results of TRIA have been very positive. Terrorism insurance is widely available and a growing number of businesses are accessing this coverage. By enabling commercial policyholders to obtain terrorism insurance, TRIA has provided a boost to construction and job creation, strengthened economic growth and security, and reduced the impact of any future terrorist attack. Overall, TRIA has been an important stabilizing factor in the market, as we will hear from the General Accounting Office today.

But as the program moves closer to expiration in 2005, we must examine the future of terrorism insurance and whether the private market will be able to make coverage available without a federal backstop. While there is no doubt that our country is better prepared today than it was prior to 9-11, we remain on heightened alert and still face the threat of terrorist activity. This uncertainty makes it difficult to determine methods to price coverage and to ensure a viable marketplace without a federal backstop. As a result, it remains unclear whether there will be a sustainable marketplace after TRIA expires.

Given the state of the insurance marketplace and the continued war against terror, there is compelling reason to continue the federal backstop for terrorism insurance until we can ensure a viable marketplace that enables businesses to receive coverage. To begin with, it is crucial that the Treasury Department extend the requirement that private insurers continue to "make available" terrorism reinsurance.

This provision, which sunsets at the end of 2004, guarantees that commercial policyholders have access to terrorism coverage. A wide range of businesses and organizations, from the transportation, energy and real estate industries to manufacturing, construction, entertainment and retail sectors, are rightfully concerned that the failure to extend the "make available" provision will ultimately impact their operations, business development and ability to create jobs. This clearly threatens both our economic growth and our security.

When it comes to the security of our country and our economy, we must take every necessary precaution to defend the American people. The Administration is doing everything possible to strengthen our security, from efforts to secure our nation's borders, ports and major transportation systems to additional resources to dry up terrorist financing.

The TRIA program is essential to the economic security of the American people. I want to thank Chairman Oxley and Subcommittee Chairman Baker for their cooperation in holding this important and timely hearing on terrorism insurance. Their leadership and perseverance, along with that of the President, is the reason that Congress was initially able to pass this monumental legislation, despite significant obstacles.

I also want to commend the Treasury Department and the National Association of Insurance Commissioners for their collaborative work on these important issues under extraordinary circumstances. The Treasury Department and state insurance commissioners have been faced with an extremely difficult task of developing a reinsurance market through an unprecedented program. As we speak, businesses and insurers are beginning to make decisions that impact operations beyond the potential sunset of the "make available" language. As a result of these operational realities, I urge the Treasury Department to provide Congress with information on the future of TRIA in a timely manner in order to help the businesses make informed decisions about the future.

We need to make informed decisions about the future of this program. I look forward to continuing to work with the public and private sectors to protect and preserve the economic security of the American people.

Thank you for letting me speak.

Chairman BAKER. Thank you for your statement, Ms. Kelly, and your interest in this subject.

[The prepared statement of Hon. Sue W. Kelly can be found on page 40 in the appendix.]

Mr. Gutierrez?

Mr. GUTIERREZ. After listening carefully to the preceding opening statements, I find that my opening statement should be submitted for the record in its entirety, if it is okay with everybody on the committee.

Chairman BAKER. I do not think anybody is going to object.

Mr. GUTIERREZ. Thank you, Mr. Chairman.

Chairman BAKER. Reluctantly so made part of the official record.

Are there members with further statements? Mr. Israel? And then I will come to you, Mr. Scott.

Mr. Israel?

Mr. ISRAEL. Thank you, Mr. Chairman. Let me thank you and Chairman Kelly and Ranking Members Kanjorski and Gutierrez for this hearing.

I also want to take this opportunity to welcome Mr. Serio, the Superintendent of the New York State Insurance Department. Mr. Serio knows that my congressional district is less than 50 miles from ground zero. In the aftermath of 9-11, one of the leading concerns for businesses in New York City and near New York City was the need to get back up on our feet and rebuild as quickly as possible. One of the major obstacles to doing that was in fact the apparent inability of the insurance industry to assess and absorb the risk of another large-scale terrorist threat.

I was very proud to be a part of this committee when we acted quickly to create a federal government backstop for terrorism insurance in the event of another catastrophic occurrence. It is a profound example of what this committee can do when members from both sides of the aisle work together with each other and with industry to a common goal and a common sense goal.

Mr. Chairman, I believe that TRIA has worked fairly well. It has in fact allowed businesses in my district and businesses in New York City, where many of my constituents work, to continue uninterrupted. However, as we have heard, we are now faced with the possibility of a sunset and we cannot allow this to happen. I was very proud to sign a letter written by Ranking Member Frank encouraging the Secretary of the Treasury to exercise his ability to extend the "make available" provisions of TRIA and I think that this is an important and necessary first step.

But I do not believe it goes far enough. TRIA needs to be reauthorized. During the original consideration of this legislation, there was a great deal of debate regarding how long the authorization should last. The final product settled on three years, with the Department of the Treasury being required to issue a report in 6 months before the program expires, detailing any problems with the program.

I fear that we may have painted ourselves into a bind with this language and on this timetable. By the time the report is submitted to Congress, I believe it is going to be too late for Congress to fully get and act upon the concerns that that report may raise. Indeed, I strongly believe that TRIA must be reauthorized before June of next year to allow industry adequate time to ensure the continuation of current policies.

So in order to give us adequate time to consider this and any other concerns that may come to light in the Treasury report without disrupting the market, I am very proud to be working with Mr. Capuano on crafting a clean, quick, short-term extension of TRIA until December of 2006. I believe that by acting on such a measure, we will fulfill our responsibility to ensure the orderly continuation of the insurance market in high-risk areas, and at the same time allow ourselves sufficient time to conduct a full and necessary review of this new and important program.

I look forward to working with Mr. Capuano and all members of this committee to ensure the continuity of our markets and the continuity of capital.

I thank the Chairman and yield back the balance of my time.

Chairman BAKER. I thank the gentleman.

Mr. Scott?

Mr. SCOTT. Thank you very much, Mr. Chairman. I certainly look forward to the testimony of this very distinguished panel.

I want to thank the Chairman and Ranking Member of both the Capital Markets and Oversight Subcommittees, Mr. Kanjorski, Mr.

Gutierrez, as well, for holding this hearing today on the Terrorism Risk Insurance Act. I also look forward to some very good information to be exchanged and questions asked in today's testimony.

Access to terrorism insurance is very essential to business confidence and continued economic growth. From the written testimony, I understand that TRIA has been successful in providing an insurance backstop for consumers, thus enabling millions of dollars in business transactions to proceed. However, this law is only a temporary backstop for property and casualty insurance risk. According to the Bush Administration, the United States remains at a high state of alert and could be the target of terrorist actions this year, and especially because this being a very critical important election year.

In my area of metropolitan Atlanta, we have the world's busiest airport located in my district. In addition to that, we have Fort McPherson that handles ForceCom, controls all the logistics and command for the forces in Iraq and in Afghanistan; also Fort Gillem, which handles all of the call-up and processing for our Reservists and National Guard in the eastern half of the United States east of the Mississippi, which is approximately 65 percent of those call-ups, all processed in my district.

We also have the Centers for Disease Control located in my district. The World Congress Center, trade and convention facilities, and two of the highest recognized brand names in the world in Coca-Cola and CNN. And very, very important and critical financial service institutions and sensitive sites that are at risk, making Atlanta potentially high target and as a matter of fact has been on several lists of terrorist targets for terrorist attacks.

So quite naturally, I am very concerned that businesses and my constituents in my district will come to expect a permanent terrorism insurance backstop, regardless if they use it now to make sure future business decisions. As we move forward in today's hearings, we should ask that if the law expires, how that will affect private markets.

Thank you again, Mr. Chairman, and I await the statements from our panel.

Chairman BAKER. I thank the gentleman.

Are there any other members? The gentleman is recognized.

Mr. GARRETT. I thank the chairman for holding this hearing today. As was previously indicated, obviously the visual effects of 9-11 are burned in our minds. The economic effects and the dollar and cents ones are sometimes a little bit harder for us to comprehend.

Overall, though, of course all the numbers in the last few weeks and months are showing that the economy is turning around and things are picking up and we are on to a robust economic recovery. But the net effect of 9-11 was over $50 billion has been paid out in insurance claims due to that attack, the largest manmade insurance disaster in history. The effect of that was that many reinsurers were simply unable to price for future such risk due to the unique nature of those attacks. When an insurer is unable to price for a risk, well then they simply stop offering the insurance coverage. That was the impact of that attack.

Now, when we recognize these possible negative impacts on the insurance market and therefore the economy, I have to commend the members of this committee here before me who acted quickly and responsibly to come up with a solution to it. This measure was necessary to simply stabilize the terrorism market in the United States.

I join my colleagues on the other side of the aisle who have already pointed out that TRIA has been successful in accomplishing the goals that were laid out by Congress. It has provided a program that shares the commercial property and casualty losses between the federal government and the private insurance market in a way that obviously has worked and benefited this economy. For that reason, I share their concerns also and share their feelings that we should make available provisions and TRIA should be extended prior to the September 1 deadline.

One member has indicated already the issue of timing. My experience, having been in the industry, is that timing is a significant aspect for carriers because it is not an industry that can simply snap into a response on the spur of the moment; that notices will be going out not literally as we speak, but shortly as we speak, because of the nature of the business and the nature of renewals. So that is something that we all have to be mindful of, of how the industry actually respond to and how their paperwork actually flows with regard to any insurance product and market.

Finally, I would just say this. Where I come from, I am from the State of New Jersey. I live in the metropolitan area. As I say, we still have the visual impact of 9-11 there, but also from an economic point of view many businesses are still recovering from that attack to this day. The importance therefore, of the reinstitution of TRIA is even more heavily important for my district as well.

I thank you again, Mr. Chairman, for holding these hearings today.

Chairman BAKER. I thank the gentleman for his statement.

Does any other member desire to make an opening statement? If not, this is a joint hearing with Ms. Kelly's subcommittee and Ms. Kelly is going to take the chair for our panel of witnesses.

Chairwoman KELLY. [Presiding.] I am going to take the chair from here.

Before we move to our panel, I would like to enter into the record several documents that include a letter that 18 Republicans sent to Secretary Snow in support of extending the "make available" provision; another letter on "make available" from the Real Estate Roundtable; a support letter requesting the extension of TRIA from the American Insurance Association, the Council of Insurance Agents and Brokers, the Independent Insurance Agents and Brokers, the Property-Casualty Insurers Association of America, the Reinsurance Association of America, and the UWC, Strategic Services on Unemployment and Workers Compensation.

Another TRIA support letter from Group Life Coalition, the ACLI, and the Financial Services Roundtable; and a support letter from the Coalition to Insure Against Terrorism, which is a broad coalition of businesses and organizations from the transportation, energy and real estate industries, to manufacturing, construction, entertainment and retail sectors.

With unanimous consent, I am entering these into the record. So moved.

[The following information can be found on pages 139, 107, 136 and 115 in the appendix.]

We now turn to our panel. Our first witnesses representing the Department of Treasury, is Mr. Wayne Abernathy. Mr. Abernathy is the Assistant Secretary of Treasury for Financial Institutions, where he oversees Treasury's Terrorism Risk Insurance Program. I commend you, sir, for your work on such a difficult task and I look forward to your testimony.

It is also a great pleasure to have the opportunity to welcome back to the committee again Mr. Greg Serio, Superintendent of Insurance back from the great State of New York. New York knows first-hand the threat and devastation of terrorism. In the aftermath of 9-11, many individuals responded in a way that represents the best of America's spirit. I believe that Superintendent Serio is one of those individuals. In addition to his work on terrorism insurance issues, Mr. Serio serves in the leadership of NAIC, and has been an active participant in the insurance roadmap the committee is exploring. We thank you very much for your valuable service and your testimony here today. It is a pleasure to see you.

Our third witness is Richard J. Hillman, Director of Financial Markets and Community Investment at the General Accounting Office. I thank you, Mr. Hillman, for being here, and the GAO for their comprehensive report on the state of terrorism insurance.

Without objection, your written statements will be made a part of the record. You will all be recognized for a 5-minute summary of your testimony. I just want to remind you that the lights in the boxes at the end of the table, the green light indicates that you have 5 minutes for your testimony; the yellow light means you have 1 minute remaining; and of course the red light means stop.

With that, we will proceed with you, Mr. Abernathy, and thank you for being here.

STATEMENT OF HON. WAYNE A. ABERNATHY, ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS, UNITED STATES DEPARTMENT OF THE TREASURY

Mr. ABERNATHY. Thank you, Chairwoman Kelly, Chairman Baker, Ranking Member Kanjorski, Ranking Member Gutierrez, members of the two subcommittees. It is a pleasure to be here today to report on the Terrorism Risk Insurance Program as we approach the mid-stream of that program as established by Congress.

TRIA establishes a temporary federal program of insured commercial property and casualty terrorism losses. TRIA, in effect, places the federal government in the reinsurance business through December 31, 2005. TRIA has been successful in achieving the fundamental goals of enhancing the availability and affordability of commercial property and casualty Terrorism Risk Insurance. No longer are heard the concerns from real estate developers that new project financing has been frozen.

Preliminary accounts indicate that premiums have decreased significantly throughout the early stages of TRIA and continue to do so. Reports are that the demand for this coverage is low, but coverage is available and those that desire coverage have been able to obtain it. Whether the low take-up rate reflects a lack of interest in terrorism coverage even with the federal backstop; a lack of awareness of the availability of coverage; an assessment by business of low terrorism loss risk, or some combination, will require careful study and analysis.

Treasury has five main administrative goals: first, to ensure that the program was ready for use from the day it was signed into law; second, to implement TRIA in a transparent manner that is fair and easily understood; third, to rely as much as possible on the state insurance regulatory structure; fourth, to allow participation in a manner consistent with the normal course of business; and fifth, to ensure that benefits can be provided in the most expedited manner.

As I have often reflected, implementing TRIA has been like building a house by starting with the roof. The coverage came first. TRIA's first action was to issue a series of interim guidance notices beginning on December 3, 2002, about 1 week after TRIA was signed into law. This allowed us to respond quickly to implementation issues and to prevent confusion prior to the issuance of formal regulations. Even while the interim guidance process went forward, we began formal rulemakings.

It is important to stress that while we have been moving progressively through the rulemaking process, the program from the beginning has been and continues to be fully operational. These rules have been refinements and improvements on practices and operations, but from the earliest days we have had procedures and resources "at the ready" to respond to any covered insurable event that might arise.

Treasury also created and staffed a Terrorism Risk Insurance Program office to administer the Act. TRIP office director Jeffrey Bragg brings deep experience from the property and casualty insurance market, as well as experience as a former administrator of the federal flood, riot and crime insurance programs. In almost no time, he has assembled an outstanding team of insurance professionals who have been willing at some sacrifice to interrupt successful private careers to help administer this important program.

TRIA is an interesting hybrid. It provides a federal reinsurance backstop to insurance programs that are regulated almost exclusively at the state level. This would be unmanageable without the cooperation of the state insurance regulators. Throughout the implementation process, Treasury has consulted and worked closely with the NAIC and the NAIC's assistance has been invaluable.

An important requirement of TRIA is to keep a careful eye on market conditions and report to Congress by June 30, 2005. Specifically, Treasury is required by the statute to assess the effectiveness of the program, the likely capacity of the industry after termination of the program, and the availability and affordability of such insurance for various policyholders.

Together with this analysis, Treasury is also required to compile information on premium rates. To ensure that we do this with a comprehensive view, Treasury has contracted with an outside research firm to conduct a nationally representative survey. Companies chosen for the survey will be contacted several times to capture effects of changes in TRIA's insurer deductibles in successive program years. The first survey wave was mailed to over 30,000 policyholders and almost 500 insurers. A second wave to collect 2004 data is planned for early this fall. The last survey wave is planned for January and February of 2005.

This phased structure will allow us to move beyond snapshots and anecdotal evidence to a broader and more dynamic view of the conditions in the marketplace. Anything less would not provide the full and reliable information, the kind of basis that is needed to make a careful, trustworthy and responsible evaluation that is called for by Congress in the statute.

The Secretary of the Treasury is required to determine by September 1, 2004 whether to extend TRIA's "make available" provisions into the third year of the program, that is, through December 31, 2005. Treasury is now developing a base of information from which to make this determination. We encourage any who have views on this question to share those views with Treasury with as much detail as they can provide.

We must all remember that the basic goal of TRIA as called for by President Bush was to develop a temporary backstop for property and casualty commercial insurance against terrorism risk so that private markets would have a chance to adjust. We would encourage interested parties to think creatively and to consider methods to allow for broader private sector involvement in the market for managing property and casualty terrorism risk.

Treasury looks forward to completing our review and considering the many complicated issues presented to us in a thorough manner, with the best information that can be obtained. Our obligations to the taxpayers and the need for the long-term health and vitality of our financial services markets require nothing less.

While we hope that we will never be called upon to trigger the coverage under TRIA, the program stands ready today as it has from its earliest days to meet its responsibilities.

Thank you.

[The prepared statement of Hon. Wayne A. Abernathy can be found on page 49 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Abernathy.

Mr. Serio?

STATEMENT OF HON. GREGORY V. SERIO, SUPERINTENDENT, NEW YORK STATE INSURANCE DEPARTMENT

Mr. SERIO. Good morning, Madam Chair, Mr. Chairman, and members of the subcommittee. Thank you for the opportunity to come before you today to relate New York's experiences with the Terrorism Risk Insurance Risk. It is greatly appreciated.

Let me get right to the point. TRIA is a success by any measure and has been very effective in stabilizing a tumultuous insurance marketplace in the aftermath of September 11 and it has been a key factor in stabilizing and reenergizing New York's economy. As we have opined several times over the past 2 years, sometimes before these subcommittees, TRIA was and is an insurance buyers law, allowing the continuation of critical insurance coverages for those who needed to or wanted to maintain the level of coverage routinely available prior to September 11.

The success of this initiative cannot and should not be measured simply by the number of businesses who have availed themselves of terrorism risk protections through TRIA. Some businesses chose to go without coverage for terrorism risk. That is their decision. Others chose to rely upon the already meaningful protections offered by the standard fire insurance policy widely available in the United States prior to September 11, 2001, and still in place in New York and other states to this day.

For those businesses that wanted or needed terrorism insurance protection, though, TRIA became their safety net. Coverages were required to be made available at the same limits and terms as the other property-casualty coverages, thus assuring all risk protection for those who needed it for lending agreements, contractual obligations, or frankly their own peace of mind.

The businesses of New York who availed themselves of the opportunity to establish captive insurance companies, to better manage and frankly afford the terrorism risk coverage through the benefits of TRIA should also be counted among those who consider TRIA a success. Yet those who did the responsible thing by establishing self-insurance mechanisms to manage terrorism risk do not get included among those who opted to take up TRIA-provided terrorism coverage, even though the covering of risk placed through captives is one of the strongest provisions of the TRIA law and of the decisions made by the Treasury Department.

President Bush, the Congress, especially the leadership shown by the House Financial Services Committee and these subcommittees before whom we appear today, together with the Treasury Department and the manner with which they have managed the TRIA program, are all owed a debt of gratitude in moving with singularity of purpose to help protect New York's businesses and those of the country.

As the National Association of Insurance Commissioners indicated in a letter to Secretary Snow, and I believe you have a copy of it and I would appreciate it if that would be made a part of the record as well, we think the continuation of the "make available" provision of TRIA beyond September 1 is crucial. Maintaining a steady flow of insurance to the business community will keep business and the economy moving without fear of or actual disruption caused by the lack of availability of all-risk insurance coverage.

TRIA has been one of the main ingredients in the recovery and renewal of lower Manhattan and the New York economy and it should continue to provide that positive stabilizing element as we continue to strengthen. The restoration of the national economy and the economies of all major cities that depend upon insurance as a key component are also benefit from a decision to maintain the "make available" provision in TRIA.

There is already much discussion taking place on the larger issue of the continuation of TRIA. As with the "make available" issue, early consideration and deliberation on the reauthorization of TRIA is also in everyone's collective best interest. Even as Treasury performs its due diligence on the law's effectiveness, there can and should be discussions on steps to be taken to ensure the continuity of coverage that is TRIA's hallmark along with the business cycle of insurance. Again, the mere potential for disruption should be avoided.

Already there is a school of thought and a growing body of evidence that TRIA should be continued and improved. Straight reauthorization of the Act without deliberation on improving private participation in terrorism risk coverage, the availability of state-based options, better managing the still-unaddressed concentration of risk issue, and other considerations would not be advisable.

Rather, reconsideration of the group life insurance participation in TRIA, an issue on which we respectfully disagree with Treasury's final determination to leave group life out of the TRIA program, maintaining and expanding TRIA's protections for captive and other self-insurance mechanisms, and addressing straight-on the complexities of workers compensation issues in the terrorism risk context, that being heavy concentration risk with long-term liabilities making it particularly challenging, could all improve the TRIA Act.

Knowing of and appreciating the federal government's concern over permanentizing TRIA, something we do not advocate at this point, is important to this discussion, but a public-private partnership with meaningful federal government participation is critical to the continued stabilization of the commercial insurance marketplace, at least in the near term. That participation in fact should well be calibrated to the viability of long-term solutions to the terrorism and catastrophe risk and insurance challenges before us now.

Short-term continuity of coverage through TRIA, together with productive discussions on long-term remedies, I believe is in everyone's best interest. To that end, New York, taken with the commissioners of the District of Columbia and the other states most affected by terrorism risk, have been meeting with congressional and Treasury staff, insurance brokers, carriers, and most importantly our respective business communities, to spearhead the discussion on appropriate changes and improvements at TRIA, greater private sector participation in the Terrorism Risk Insurance market and state options for improving these markets.

Governor Pataki from New York, in a workers compensation reform bill that he submitted to the legislature just 2 weeks ago, provides one such option by calling for a change in the way workers compensation insurance is written in New York. By diffusing the concentration of risk, by allowing multiple insurers on a single workers compensation risk. Changing the statutory requirement on the risk coverage to allow a syndication of workers compensation risk may just be one way for us to effectively manage this issue, and one way that can serve as a catalyst for additional discussions along these lines.

Thank you for allowing me to present these views this morning. I look forward to answering your questions.

[The prepared statement of Hon. Gregory V. Serio can be found on page 80 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Serio.

Mr. Hillman?

STATEMENT OF RICHARD HILLMAN, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, UNITED STATES GENERAL ACCOUNTING OFFICE

Mr. HILLMAN. I am pleased to be here today to discuss our report on the implementation of the Terrorism Risk Insurance Act of 2002 or TRIA and the Act's impact on the insurance market. Our report being released today on the implementation of TRIA has two objectives. First, we describe the progress made by Treasury and insurance industry participants in implementing TRIA. We found that Treasury has made significant progress in implementing the provisions of TRIA, but has important work to complete in order to comply with all of its responsibilities under the Act.

Second, we discuss the changes in the market for terrorism insurance under TRIA. As requested, my testimony today focuses on the second of these two objectives, that is, how TRIA has affected the market for terrorism insurance, and more generally the economy.

Additionally, I have included appendices to this statement that provide background information on TRIA and describe completed and ongoing engagements that GAO has under way for this committee that relates to increasing the insurance industry's capacity to provide insurance for terrorism and national catastrophe risks.

In summary, it appears that Congress's first objective in creating TRIA, to ensure that business activity did not materially suffer from a lack of available terrorism insurance, largely has been achieved. Since TRIA was enacted in November 2002, terrorism insurance generally has been available to businesses. In particular, TRIA has benefited commercial policyholders in major metropolitan areas perceived to be at the greatest risk to a terrorist attack.

Prior to TRIA, we reported concerns that some development projects had already been delayed or canceled because of the unavailability of insurance and continued fears that other projects would also be adversely affected. We also conveyed widespread concern that general economic growth and development could be slowed by lack of available terrorism insurance. Since TRIA's enactment, terrorism insurance has generally been widely available even for development projects in perceived high-risk areas, largely because of the requirement in TRIA that insurers make available coverage for terrorism on terms not differing materially from other coverage.

However, despite increased availability of coverage, limited industry data suggests that only 10 to 30 percent of the commercial policyholders are purchasing terrorism insurance. According to industry experts, purchases have been higher in areas considered to be high-risk of another terrorist attack. However, many policyholders with businesses or properties not located in perceived high-risk locations are not buying coverage, perhaps because they view any price for terrorism insurance as high relative to their perceived risk exposure.

Some industry experts are concerned that those most at risk from terrorism are generally ones buying terrorism insurance. In combination with low purchase rates, should a terrorist event occur, these conditions could impede business recovery efforts for those businesses without terrorism coverage or cause financial problems for insurers.

Moreover, we found that even policyholders who have purchased terrorism insurance remain exposed to significant risks arising from certified events, including losses from nuclear, biological or chemical agents or radioactive contamination. Since September 11, 2001, the insurance industry has moved to tighten longstanding exclusions from coverage for losses from such events. As a result, these exclusions and these policyholders who choose to buy terrorism insurance may be exposed to potentially significant losses.

Nearly 1 1/2 years after TRIA's enactment, we found that there has been little progress towards Congress's second objective, to give private industry a transitional period during which it could begin pricing terrorism insurance and develop ways to cover losses after TRIA expires. Industry sources indicate that under TRIA insurance market participants have made no progress to date toward the development of reliable methods for pricing terrorism risks and little movement toward any mechanism that would enable insurers to provide terrorism insurance to businesses without government involvement.

According to industry sources, TRIA's ceiling on the potential losses has enabled reinsurers to return cautiously to the market. That is, some reinsurers are offering coverage for terrorism risks within the limits of the insurer deductibles and the 10 percent share that the insurers would pay under TRIA. However, insurance experts said that without TRIA caps on the potential losses, both insurers and reinsurers likely still would be unwilling to sell terrorism insurance coverage because they have not found a reliable way to price their exposure to terrorist losses. Without being able to set appropriate prices, such losses could lead to their insolvency.

Not only have no private sector mechanism emerged for supplying terrorism insurance after TRIA expires, but to date there also has been little discussion of possible alternatives for ensuring the availability and affordability of terrorism coverage after TRIA expires. Congress may benefit from informed assessment of possible alternatives, including both wholly private alternatives and alternatives that could involve some government participation or action. Such an assessment could be part of Treasury's TRIA-mandated study to assess the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risks after termination of the program.

As a result, as part of the response to the TRIA-mandated study, our report being released today recommends that the Secretary of the Treasury consult with the insurance industry and other interested parties and identify for Congress an array of alternatives that may exist for exploring the availability and affordability of terrorism insurance after TRIA expires. These alternatives could assist Congress during its deliberations on how best to insure the availability and affordability of terrorism insurance after December 2005.

Madam Chair, Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions.

[The prepared statement of Richard J. Hillman can be found on page 57 in the appendix.]

Chairwoman KELLY. Thank you very much.

Just to keep you all amused in the audience, I am going to pass the gavel back to my colleague, Mr. Baker.

Chairman BAKER. [Presiding.] I thank the gentlelady for her distinguished leadership of the committee. You have set a high standard for me to emulate, so I will do my best.

Ms. Kelly does have obligations on the floor and I am going to yield my time for her to be recognized to go first to questions. Ms. Kelly?

Chairwoman KELLY. Thank you very much.

One of the problems that we know that the market is experiencing, Mr. Abernathy, is the fact that policyholders are having to make decisions about their policies this year, rather than next year for next year. I am concerned that this creates an uncertainty for many people. That uncertainty needs to be addressed.

The "make available" provision is crucial, I believe, to our economic security. We need this decision as soon as possible to create a certainty in the market that people can deal with. How quickly will Treasury move on this issue?

Mr. ABERNATHY. Chairwoman Kelly, we concur with that entirely, your sentiment on that. The decision needs to be made as soon as we possibly can. We want to make sure that the decision is made, however, based not upon anecdotal information, which is all that we have up to this point, and rather unspecific information. We have received so far a wide array of very unspecific inputs with regard to that issue that expresses sentiment, and that is important. But what we would like to have is greater detail in the information that is being provided and to make sure that it is of a more comprehensive nature. We think that can be done fairly quickly.

Chairwoman KELLY. How quickly?

Mr. ABERNATHY. What we are planning to do as far as gathering what we would feel is a comprehensive set of information that would allow us to make a good decision as quickly as possible is put out in the Federal Register a request for information from everybody. We figure we can get that request out most widely through the Federal Register and we plan to publish that tomorrow.

Chairwoman KELLY. You are going to publish the request for comments tomorrow in the Federal Register. Is that what I understood you to say?

Mr. ABERNATHY. That is right. It is very specific, saying, please give us information in these following areas that allows us to make that decision. We are having a fairly contracted comment period of just 30 days.

Chairwoman KELLY. Since the Treasury has to complete this study, and you are going to get these comments, at the very least wouldn't it be prudent for Congress to think about extending, at least officially consider, extending TRIA for any policy that is written prior to 2005?

Mr. ABERNATHY. That is a separate issue from the "make available" issue.

Chairwoman KELLY. Right.

Mr. ABERNATHY. I do not know that we have any particular comment to make with regard to what happens after 2005, because in that particular case we have even less information on which to make any kind of determination. We are engaged already, as I outlined in my testimony, in a fairly elaborate information-gathering process that is designed to examine TRIA as the evolving statute that Congress intended.

I think a fair way of looking at TRIA is that it is actually three programs. It changes every year. In the first year, you had one particular program with certain parameters, which have changed this year, and which are scheduled to change next year. For that reason, we believe that in order to get the kind of information you need to make recommendations with regard to what happens after 2005, you have to gather information on each of those periods.

Chairwoman KELLY. I have a very short period of time left, but I would really like to hear very quickly from Mr. Serio and Mr. Hillman on those questions.

Mr. SERIO. On the "make available," we think that it needs to be decided sooner than later. I think waiting until September 1 probably does not serve anybody's interest here. I know that Treasury is doing what they can to find out firm information. I think, though, that just by seeing the nature of the businesses that have taken the offer to buy terrorism insurance under TRIA shows that there has been a demonstrable interest in the coverage. I think if you focus it on, like the Coalition for Insurance Against Terrorism, there is a wide range of industries that have taken this up either through direct coverages or through captives, showing that there has been a significant, but targeted, use of TRIA.

I think those same industries could well see the same need for that in a renewal period after September 1, and to that extent alone keeping it out there for them to buy we think is a worthwhile policy goal.

But there is a merging of the issue of "make available" and the continuation of TRIA in some form. Even the "make available," and if a decision was made by Treasury to move ahead with the "make available," because of the business cycle, you are already into the question about the continuation of the program itself. So there really would be a very small window with respect to the effectiveness of a decision to continue to "make available," which would then raise the question, particularly if you are in a 45-or 60-or 90-day renewal cycle, what will this get me in terms of terrorism protection for the year period of my policy that I am about to renew?

I am assuming that "make available" is still there between September and December of 2004. That raises the question that when the policy does come up for renewal and you have that rollover into 2006, a question that I know both the GAO and us and all of you have been looking at is this question of whether that coverage stops dead on December 31, 2005. Our opinion is that it does without further amplification or clarification of that issue. That is what raises so much of this question and this uncertainty in the economy.

If a business person is using their portion of business decision properly, they cannot simply take it as an article of faith that there may be a continuation into a 2006 policy year when they are in fact renewing that coverage. That will stop a business decision at the beginning of the process, not when the program expires.

Chairwoman KELLY. Thank you.

Mr. Hillman, did you want to add to that? My time is up, so if you could say something very quickly, I would appreciate it, if you would like to.

Mr. HILLMAN. Yes, the "make available" decision is a very important issue, particularly for insurers. Timing is a significant aspect. There are paperwork flows, there are rate and form reviews that need to take place. The sooner that Treasury acts, the better.

Chairwoman KELLY. Thank you.

Mr. Chairman, I thank you for allowing me to do this. I have floor obligations and I will be back, but thank you.

Chairman BAKER. I thank the gentlelady.

Mr. Kanjorski?

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Abernathy, I am going to take 30 seconds to review the history of terrorism reinsurance and to compliment the former member of the President's cabinet, Secretary O'Neill. I had the occasion within the first months of 9-11 to work with Mr. O'Neill in putting this package together with Mr. Baker and the Chairman. I think that he is an unsung hero, if you will; that he was here; he understood the problems of the industry, of the communities, of the economic development field. I think we moved expeditiously in the Congress within 3 months to structure a reinsurance bill, and then ran into some problems. Those problems I anticipate could occur again. I am leery of what may happen.

If you will recall, although the Congress was prepared with a piece of legislation within 3 months, we had the piece of legislation go over to the White House for review and of course Treasury and the White House saw the piece of legislation as an engine to carry tort reform. As a result thereof, we had a delay of almost a year before we had the enactment of this statute, which I think I have seen estimates that in the State of New York something like $20 billion of commercial development was held up and discouraged from occurring because of the lack of insurance coverage.

In anticipation that politics have not changed in this city and are not likely to change in the next several years, it seems to me that it is absolutely essential that the Congress and the Administration sends a message now to the insurance industry that we are going to take another 2-year extension or one-year extension of the Act as it exists, or even with some corrections, and one correction I think would be group insurance.

But to not do that and to wait until the report is finally filed 6 months before the expiration of the Act would only create another engine. I do not see that that would be in anyone's interest, either from the industry standpoint, the economic standpoint of the country, and even from a political standpoint. This is something that we had some great bipartisan effort on. I can speak for my side of the aisle that we did not expect or appreciate the attempt to use this as a vehicle to carry an entirely different issue to get enacted into law when we had something that was very vital.

Can you give us some assurances that you are going to be able to look at this in terms of whether or not we can get an extension of a year or 2 years and do it very quickly? I have discussed with the Chairman that I think we have a bipartisan agreement on this committee right now to enact an extension of at least 1 year, and possibly 2 years of the conditions that exist in the statute today. My own preference would be to see if we can perfect it and cover group insurance, but even if we cannot, we should act for two purposes, one to stabilize the market, as the New York Commissioner has indicated; and two, not to skew your eventual study, because at this point, with the shortness of the existence of this policy, things are going to change and the industry is going to change in anticipation of the end of the government program supporting reinsurance.

So I guess I am putting you on the spot, but purposely. Are we going to go through this song and dance again of using this as an engine at the end of the period of time, to carry some other unrelated piece of legislation or issue? Or are we going to direct ourselves to doing what is proper for American industry and the insurance industry and the American population in terms of getting good effective legislation into the field as soon as possible to make sure there is no hiatus that could occur or the fear thereof?

Mr. ABERNATHY. Thank you, Congressman. In a sense, you are putting me on the spot, but that is why I am here. I am here frankly to continue what I think has been a very successful cooperation between the executive branch and the Congress on the whole issue of Terrorism Risk Insurance.

Frankly, it was the hard work of President Bush to convince a lot of members of Congress about the importance of Terrorism Risk Insurance, and I think in the end——

Mr. KANJORSKI. I am going to interrupt you, Mr. Abernathy. I sat in the White House and on those conference committees. That was not the intent. It was the full intent of this Administration to pass tort reform and it held up this legislation for almost a year. To make some argument that the President was instrumental, I was there when Mr. Lindsey was there and other aides of the President, and they were putting the brakes on this unless they could get tort reform. It was only with embarrassment at the end that the American industry and the insurance industry came in and said we absolutely need this and we are losing all this construction that it ever occurred.

So it was not some magnificent leadership by the Administration, the President or anyone else. It was hardcore politics. I sat in the conference room for hours when it was debated, so do not give me the argument that it was the great leadership of the President putting this together and getting this done. It was almost in spite of the Administration's objectives and the use of this legislation for political purposes that held it up.

Mr. ABERNATHY. I respectfully disagree with that, Congressman. I was involved with that exercise. I was a witness to putting together the legislation. Frankly, I think with regard to the tort issues, the only question on the part of the Administration was to make sure that this effort to provide Terrorism Risk Insurance did not open up an avenue for abusive lawsuits to have a free rein and access to the Treasury and the taxpayer's pocket. The legislation as it was finally enacted, we believe, closed that opportunity, to make sure that the backstop is available only for providing compensation for real victims of terrorism, and not creating opportunities for abusive lawsuits.

I believe that it was only because President Bush pushed very hard against a number of people who were very skeptical about opening up a brand new federal program that in the end this program was able to be enacted. We look forward to continuing that cooperation with you throughout the life of this program and with a very careful and proper evaluation of what should take place after 2005 when the scheduled deadline of the Act is here.

Mr. KANJORSKI. If I may press you on that, what are we going to do? Is the Administration not going to take a position now in the next several months and are you going to leave it up to the Congress just to pass a reauthorization bill, or are you going to be supportive of a reauthorization bill for a limited period of time so that we can take this out of the political realm and get some certainty in the marketplace?

Mr. ABERNATHY. We certainly concur with your desire to keep this out of the political realm. In our view, there is no left or right, Republican or Democrat view with regard to terrorism and fighting terrorism and its consequences, and taking away from the terrorists the potential fruits of what they seek, which is a disruption of our economy. But at that same time, we think that whatever decision is made ought to be made upon the best information that can be gained and is available. There is a process that the Act laid out for us to follow, and we are following that and intend in that process to continue close consultations with the Congress.

Mr. KANJORSKI. That seems to me to say that you have no intention of taking a position until you complete the study, which is 6 months before the expiration of the Act. Let me ask you this simple question, if the Congress of the United States enacts reauthorization within the next several months, is the President prepared to sign it, do you believe? Or would there be a recommendation from the Secretary that the Act be signed into law?

Mr. ABERNATHY. Certainly, I am not in any position to make any statement with regard to that. Frankly, if Congress comes forward with proposals that Members seek the Administration's views on, we will be happy to enter into that discussion.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Abernathy, let me take a slightly different track, but with an eye toward a similar end goal as that of Mr. Kanjorski. In reviewing your written statement, you go, and this is really for the members's benefit so that they understand the scope of what is to be contemplated, the report to be issued by or before June 30, 2005 is assigned to assess the effectiveness of the program, likely capacity of the insurance industry, availability and affordability.

To seek out those general goals, Treasury has already contracted with an outside research firm. The first survey for data went out in the fall of 2002 and 2003. A second wave is planned for 2004, later this year. A last wave is for early 2005. The view is that in order to make the trustworthy and responsible evaluation called for, this process is necessary. You continue in this effort to consult with NAIC, a broad range of experts and on and on.

The Secretary has been insistent we draw upon as many sources as is possible. The completed results, based on the surveys and these consultations, will conclude with the effectiveness of TRIA in a proper professional assessment. In coordination with that, you have the authority and responsibility to make available the determination this year, but the study that you are engaging in really will go to the validity of extension of "make available" as well as the possible extension of TRIA, and will only be arrived at subject to that lengthy public vetting process which you have described in your testimony.

My point in coming to some conclusion on this matter is that the one thing the insurance industry has an abhorrence of is uncertainty and surprise. There is no apparent downside, in my view, to some extension, and we can talk about the time period later, because that only gives certainty that the current structure, which has received very positive comments from all participants. I have not heard criticism of the current methodology. So that it would seem to me that providing market assurance that current structures will continue until such time as the report is concluded, the Congress has the ability to understand and pass the statutory reforms, or to simply let TRIA dissipate, whatever the report may indicate.

If we were to take that view and then look at the calendar, we have an August recess and normally a November adjournment date. That really leaves Congress a 90-day effective legislative period to respond to whatever those recommendations may conclude. It would seem highly advisable to me in light of that, and uncertainties associated with that calendar, that for the sake of market function we should at least go out a year and maybe two, because there is no disadvantage to having a longer period of certainty, as long as we make it clear in this regard. There will be one and only one extension. The study will be determinative. We are not going to come back and make this an annual extension program. The Congress wants to do this appropriately after the professional study by folks who understand it, in consultation with all stakeholders. We are going to come to a conclusion and that, dear industry, is going to be it.

So we do not do it with the presumption that the Congress is in the business of insuring this risk in perpetuity, but that when we make the transition it shall be based on the most formal and comprehensive study possible.

Is there a counter-view to that that you would like to give to the committee today? Or do you think those presumptions are based in relatively sound facts?

Mr. ABERNATHY. I think those are concerns that we have heard from a number of sources. There are various different proposals that we have heard as to what should happen after 2005, whether there should be some kind of temporary extension. One of the proposals that Mr. Serio made today that requires some very careful looking at is if you continue with the same structure of the program, the deadlines that are built in there, maybe you should allow in the third year that any insurance policy that is written during the third year would still be able to extend with the particular backstop coverage beyond that third year. That is something that is worthwhile looking at.

Chairman BAKER. But that would mean any new start would then be prejudiced in the third year. If you were going to start a new project, you would not have the availability of the program and that would create a market disruption between somebody who met the deadline and a new start. I cannot see that being helpful for economic growth.

Mr. ABERNATHY. I think the suggestion is that that coverage would continue even beyond the third year if the insurance coverage were written during the third year. So that you would be starting the third year; your coverage would continue beyond there. I think that is something worthwhile looking at.

Frankly, the problem that we have is, we do not have enough of a factual basis to be able to say which of these ideas really carry the most merit.

Chairman BAKER. That makes my point exactly. We have dealt the card to the Administration's efforts to do the thoughtful analysis, to come back to us with a report. What I am suggesting to you is that a 90-day legislative clock, subject to such a comprehensive study, is really not a clock that makes legislative sense. We need to remove the volatility and uncertainty from the markets. There is no apparent downside to at least a 1 year, and maybe longer extension, to make sure we have the legislative time to respond.

I am to this extent agreeing with Mr. Kanjorski that there is no downside to making this determination in this Congress to provide that 1-year extension solely for the purpose of receiving your work, and that the downside of not doing that is to throw markets in some degree of uncertainty either in the near term or certainly by the end of 2005.

I have used my time, so I will come back to you if circumstances permit us.

Mr. Scott, you would be next.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Let me ask this question first. The Consumer Federation of America believes that there are only nine major cities that will not be covered by the private insurance market after the 2005 expiration of TRIA. Is there a need to curtail and limit future extension of TRIA to just nine cities? And could you tell us who those nine cities are?

Mr. ABERNATHY. Are you asking me, Mr. Scott?

Mr. SCOTT. Yes, I am sorry.

Mr. ABERNATHY. That is one of the suggestions that has been made. The CFA has made it. Others have made it. One of the questions of the program is, is Terrorism Risk Insurance availability really just an issue for certain parts of the country and not other parts of the country? That is one of the questions that is begged by the fact that the take-up rates, the participation rates in the program are so relatively low.

Some questions are even asked as to whether it is an issue for entire cities? I think Mr. Serio could point out there are people in Manhattan that are not buying insurance. They just do not feel that there is a need. They might be right, they may be wrong. Who knows? There are some who say, well, we ought to make it mandatory for everybody and then have people whether they feel they are at risk or not participate in the pool because the bigger the pool, the more we are able to spread the risk.

There are some who would say, well, why should I have to participate in somebody else's risk? These are all the kinds of questions that we need to address. Unfortunately, we have right now more questions than we have information to answer those questions.

Mr. SCOTT. Could you share with us for the record what those nine cities are? Would you have that information?

Mr. ABERNATHY. We do not have any list of any particular nine cities. I do not recall whether the CFA mentions the nine cities or not, that they recommend.

Mr. SCOTT. Okay. The other part of my question is, if the Treasury has until September 1, 2004 to determine if it will extend the "make available" provision, how will that affect an insurer's ability to offer products for future terms?

Mr. ABERNATHY. Thank you for asking that, because there has been a fair amount of confusion as to how the "make available" requirement will operate with regard to time frame. The law requires that any insurance policy offered during the whole year, through the end of the calendar year 2004, must make Terrorism Risk Insurance available regardless of what the decision is on September 1. So if on September 1 the decision is not to extend, people still under the statute are required throughout this calendar year to make their product available for their policies that extend beyond that.

That is without prejudice to what that decision might be. If the decision on September 1 is, or before September 1, whenever we make that decision, and again I want to emphasize we are committed to making it as soon as we can gather enough information to do that, to make an informed decision. Should the decision be yea, extend it into the third year, that would then begin with January 1 and that requirement would continue throughout the remainder of the program.

Mr. SCOTT. And one more, if I may, Mr. Chairman. Should the Treasury Department reconsider its decision to include group life insurance in TRIA, given that it is a basic benefit for venerable, highly concentrated workers?

Mr. ABERNATHY. That was one of the early mandated questions that was put to Treasury. That was one where our hands were fairly tied. The Act did not say whether we thought it was advisable or not to extend coverage to group life. The Act said investigate whether or not two specific things are happening: Is insurance available for group life, initially primary insurance?; and is insurance group life reinsurance available? Our study verified that group life reinsurance coverage had by and large receded. There was little if any reinsurance being made available for group life.

On the other hand, primary group life insurance has shown no significant receding from the markets. That still seems to be as available to day, with little change, as it was on September 10. Because of that, the test under the statute was not made, so we could not include it in the program.

Mr. SCOTT. A question on the timing of the Treasury survey wave. If the last Treasury survey wave is sent to stakeholders in February 2005, in your opinion does that provide enough information for analysis to be made to make a recommendation regarding the expiration of TRIA later that same year?

Mr. ABERNATHY. That is a very good question. We hope so. We felt because of the structure of TRIA, it is really three separate programs. We are right now in program two of TRIA that operates under different numbers than last year. Next year, it will be operating under yet a different set of numbers. The purpose for that is to try to increase the space within which the private markets operate.

So in order to be able to evaluate, as the law says, what is going on on the ground, we need to test in each of those years. We are hoping that we will get enough of a test in January and February that we will be able to make some determination as to how the program is operating in its third year and whether the take-up rates, the market participation rates are changing at all. That is early in the year, but I think that is the best we can do, given the time frames provided for under the Act.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Chairman BAKER. Thank you, Mr. Scott.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

As I often do, I find myself concurring with Chairman Baker with respect to the need for certainty. No editorial comment from my colleague there.

[Laughter.]

Chairman BAKER. I did not want to interrupt.

[Laughter.]

Mr. HENSARLING. The need to bring certainty into this facet of the insurance market, the need for quick action, and also the need to ensure that Congress is not faced with a series of renewals or extensions is important because I have a concern about the federal government becoming a permanent fixture in the property and casualty reinsurance business, and giving the taxpayer this type of exposure.

Can anybody give me at this point, any of you gentlemen, some sliver of hope that, particularly with respect to the latter concern of the federal government being a permanent fixture in this market, any sliver of hope that this will not be the case? Starting with you, Mr. Abernathy?

Mr. ABERNATHY. That was the design of the statute. When the statute was enacted, there was the concern that we might be creating a permanent federal program. For that reason, it is structured so that each year the coverage provided by the federal government declines. The space that is not insured by the federal government increases, with the hope that that would be a glide-path to get the federal government out of the program, particularly in the third year.

In fact, the design of the third year is to have as little effective federal involvement in the marketplace as possible. I have met with some insurance people who already say they think under the second year, there really is not any federal program. Some of the major insurers, they say, act as if there is no TRIA now because of the various deductibles that would pretty much cover anything they are doing anyway and they are carrying significant risk on their own.

Mr. HENSARLING. Any comment, Mr. Serio?

Mr. SERIO. I do not know that anybody has an interest in having the federal government as a permanent fixture in this business either. But I think, as Mr. Abernathy said, it is that glide-path that we are working on. When you get back into the insurance economics of this, there has to be enough capacity that has been built up in this marketplace not just to pay for an event, they handled 9-11 very well, the problem was having enough capacity to cover a future risk that they have to be responsible for up front because the financial regulator requires that.

So depending up what other things we can put in place working with private industry in terms of giving them the opportunity to build that kind of capital base, that they are not currently allowed to build, will go a long way towards allowing the federal government to glide out of and to get out of this reinsurance program.

Mr. HENSARLING. On a slight refinement on the question, if I understood your testimony correctly, I think you stated that there was really not much progress in establishing a viable terrorism reinsurance market and that so far there has not been a reliable way in which to assess the risk. We have obviously had some passage of time since 9-11, so my question is what has to happen to be able for the participants to be able to assess this risk and when might this happen?

Mr. HILLMAN. Based upon the results of our work, what we have generally come to the conclusion is that the problem that insurers and reinsurers are having right after the terrorist attacks on September 11 are the same problems that they are having today. They simply have an inability to determine the frequency or severity of another terrorist attack. Understanding the enormity of possible losses associated with such an event, they are pulling themselves away from the market and will be unable to do so until such time that there would be reliable information for them to be able to make some of those assessments. Hopefully, that information will never come to bear.

Mr. HENSARLING. I think all you gentleman have given evidence about the low take-up rates. Obviously, there are primarily a couple of reasons why somebody does not purchase a service or a product. I do not care what a set of golf clubs costs because I am not a golfer, so I am not going to buy a set of golf clubs. Which I guess begs the question why Chairman Oxley allowed me on this committee, but I do not have time to pursue that.

[Laughter.]

Another reason I might not buy something is because I do not like the price. As much as I may want a new pickup truck, they just might have priced me out of the market. I think several of you gentlemen gave evidence that supposedly now with TRIA in place that relative to the risk, this insurance is affordable. So why aren't people taking it up? Obviously right after 9-11, a number of real estate developments and projects and construction were held up, but is that true today and why do we see such a low participation rate?

Mr. ABERNATHY. We do not have any evidence that has been brought to our attention that development projects are now being put on ice because of lack of Terrorism Risk Insurance. So far as we can tell, that phenomenon has now disappeared with the current availability of the insurance coverage. With regard to why the take-up rates are so low, that is a very interesting issue. I think we can only speculate. We have a number of anecdotal pieces of evidence as to why people are not picking up the coverage, but we want to get a more comprehensive view and that is why we are engaging in our various surveys.

Mr. SERIO. Again, maybe it is a mistake to call it a low take-up rate. I think the take-up rate has been appropriate to those who either feel they need it or want it. Some have been very comfortable with the protections that are afforded in the standard fire policy that has been on the market for years. That does provide some terrorism coverage. But for those who have a contractual obligation to have this all-risk coverage need access to a terrorism risk coverage. That is what TRIA has provided.

Going back to Mr. Scott's question, it is not just a question of geography of those who may need it. It is not just businesses in New York City, but there are some businesses in New York who do not have it. But depending upon the nature of the business they are in, if they were neighbors to that Army base in greater Atlanta, they may well need access to coverage because they do not have other market alternatives. It goes both to the location of the risk, as well as to the nature of the risk and where they are relative to other trophy or sensitive locations, as they call them, that you want to make sure they have equal access to insurance coverage as somebody who is not in that type of sensitive location.

Mr. HILLMAN. I think that is important to not understate the importance of TRIA being able to provide for terrorism coverage for high-risk target properties. That is exactly what the Act has done and it has been extremely successful from that standpoint. Why other commercial policyholders are not accepting terrorism insurance could be for a variety of reasons. As the Assistant Secretary from Treasury said, we have anecdotal information ourselves which suggests that they may just perceive their overall risk exposure to be such that any amount that they might pay might be too high.

Mr. HENSARLING. My time is up. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Gentlemen, I am not going to repeat a lot of things that have been said. We have had a lot of good questions and a lot of good answers already. But Mr. Abernathy, I would like to make sure that I understand what the law was when we passed it. There is nothing in the law that I remember that says you cannot make interim reports or other reports prior to the June 2005 deadline. Is that correct?

Mr. ABERNATHY. That is correct, sir.

Mr. CAPUANO. So there is nothing here that I am aware of that would prohibit you or your agency from making recommendations or taking actions today.

Mr. ABERNATHY. Nothing whatsoever.

Mr. CAPUANO. Okay. If that is the case, I feel the same way, we all agree, I think, that business decisions will have to be made before we have the answers to all of the questions that have been asked today that no one can be expected to have the answers to. Do we agree on that?

Mr. ABERNATHY. I think those types of business decisions are made all the time. There is always an element of uncertainty that you have to cope with.

Mr. CAPUANO. I agree with you. But with all the questions that you are looking for answers for, which I do not disagree with you, I think your approach to it on some levels is 100 percent correct. We would like to get as many answers as we can before we make decisions. I totally agree. But there is no hope of that before certain decisions relative to terrorism insurance have to be made by the end of this year. Is that a wrong assumption?

Mr. ABERNATHY. We are going to do our best to have a good body of evidence that is focused on the specific “make available” issue as soon as we possibly can. Fortunately, that is a very narrow question and we are confident that we can get enough information to make a reasonably sound decision well in advance.

Mr. CAPUANO. Would you also be able to make available information that is also tied directly to the existence or extension of TRIA? Or do you think that they are two completely separate issues?

Mr. ABERNATHY. They are not completely separate, because as we make that decision with regard to “make available,” the Act says we are to look at the same factors that we are supposed to evaluate in connection with the June 2005 report.

Mr. CAPUANO. Okay. So there is a fair amount of overlap both in your provisions and into the business decisions that have to be made by insurers and people who are looking to buy insurance.

Mr. ABERNATHY. There is some overlap, but again the “make available” decision is a very narrow decision, and whatever that decision is I do not think should be seen as in any way suggesting what recommendations we might make next year.

Mr. CAPUANO. Okay, fair enough. I think we just disagree, because I would argue that there is a lot more overlap relative to business decisions that have to be made than you seem to agree. But that is fair enough. At least there is some, we agree with that.

All that being said, I have been actually happily surprised at the general consensus that I have heard today by the members of the committee that we are all in agreement that we have to head towards extending this provision. I would have to agree with some of the concerns that were made that I am not sure that I want this permanent. I am not so sure that I like all the provisions. I am sure I do not like all the provisions that are there. But I also am not sure that it is time to tinker with it because we have so many questions that are left unanswered. If we tinker with it, you skew the answers and maybe changing something that you do not want to change, et cetera, et cetera.

So I would urge you in your agency to look at this a little bit more quickly and to take back what you have heard here today that we went ahead on a general consensus, again not by a vote, but a general consensus is I think it is fair to say that we want to head towards extending TRIA for at least a year, maybe longer, not because we love every aspect of it. We still have questions and concerns, and I think we will have some serious disagreement when the time comes because we do not have the answers to those questions.

I would particularly urge you, though I know that your agency would never be influenced by politics, it is an election year, and not that those things would ever have an influence on a decision such as this, but in an election year when you have a bipartisan consensus, take advantage of it. All the things can be lining up to get this thing done reasonably smoothly so that we can get to the arguments.

I do think that there will be a time for us to have these discussions and arguments and I hope it will be next year, if you want the truth, but I think it is important that we get beyond all the internal problems we have, allow people to make business decisions so it will give people like you and us the time to make thoughtful reads of the information we get, maybe a lot of the information, as you know, will lead to more questions that we will have to search out.

I look at a consensus here. I look at the fact that the Sox just beat the Yankees six out of seven, and I have to tell you——

UNKNOWN. Mr. Chairman, Mr. Chairman. Could we get back to the subject at hand, Mr. Chairman?

[Laughter.]

Mr. CAPUANO. It just tells me that everything is lined up right.

[Laughter.]

And if everything is lined up right, we should take advantage of it.

UNKNOWN. I object, Mr. Chairman.

[Laughter.]

Mr. CAPUANO. Thank you, Mr. Chairman. I yield back.

Chairman BAKER. Mr. Capuano, that is y'all's problem.

[Laughter.]

Mr. Royce?

Mr. CAPUANO. Mr. Chairman, could I get a translation of that "y'all" thing?

[Laughter.]

Chairman BAKER. It would take longer than you have for me to explain.

[Laughter.]

Mr. Royce?

Mr. ROYCE. Thank you, Chairman Baker.

Unfortunately, I believe that we are in the beginning stages of a very long and protracted war against radical terrorists of the Wahabi sect, of the most extreme branch of a sect that are very nihilistic in terms of how they are going to conduct a war that they have declared, basically. I think it is critical that we think about how our economy and about how our financial system deals and prepares for such a reality over the long term.

The marketplace should and can be one of the greatest tools in mitigating our country's vulnerability to damaging terrorist attacks. By and large, I think the behavior in the market is rational. As a result, participants will make financial decisions based upon their expectations of a risk-weighted return. If the marketplace truly believes it would bear the brunt of losses due to terrorism, would it take some necessary precautions to limit downside risks over the long haul? In other words, maybe firms would strategically locate offices in various locations, instead of in one high-risk location.

Terrorism is a terrible problem we face, but we should not ignore its effects. I think the value of some assets change as a result of the threat of terrorism. Less attractive assets such as high-profile assets probably are going to have less value. Many I think out in the market probably see more value in technology firms producing homeland security products and services. So the marketplace can force society to better prepare and defend against terrorism if we are looking at this over the long haul.

If Congress were to reauthorize TRIA, would it be signaling to the market that business could continue as usual? Is this an acceptable outcome? Congress would be inviting moral hazard through adverse selection. Behavior would change as a result of the taxpayer backstopping losses that this legislation, if it is permanent, would constitute.

At the time of its creation, I believed that some form of a federally guaranteed insurance backstop for terrorism was an acceptable step. It was. Today, however, by extending this, would we signal permanence? In the long run, would this create serious distortions in the economy and would it basically, looking out over time, assuming the premise is right that this is a 20-year struggle, would it increase our vulnerability to terrorism? Could this harm our ability to absorb economic shocks over the next 20 years, resulting from an attack?

I appreciate that this subject presents many, many problems. I know there are no easy answers to this. But Mr. Abernathy, those are just some of the thoughts that I have as I try to contemplate what is in store for us over the next generation. But getting back to a question to you, are you concerned that extending TRIA could create the perception of a permanent government backstop? And could that create distortions in the marketplace?

Mr. ABERNATHY. I think all who stepped forward to create the very program that we have now carried with them the concern that by creating this federal program, are we creating some sort of moral hazard that will remove some of the motivation that people have to mitigate some of the risks that they have. We have certainly seen that with regard to the flood insurance program. We have gone through reform after reform to try to increase the incentive to mitigate the risk from flood insurance and there are continual concerns that people are still acting in ways that would be different if they did not have a federal flood insurance backstop program. That was the concern I think that everybody had when we were going forward with this Terrorism Risk Insurance. Are we taking away some of the incentive that people may have to mitigate their risks?

We take comfort that the Act as written makes it very clear that this is a temporary program. It is structured as a temporary program. When people come and present their various ideas for extending this or that aspect of the program, one of the questions that needs to be asked is, does the extension contemplate continuing along that glide-path that removes the federal government out of that or do you level off that glide-path?

I do not know what the answer is to that, frankly, because the discussions are continuing. But usually when I put that question to people, they do not have an answer. The last time I put it to someone, they said, well frankly, we think that the federal reinsurance is too little at this point. We think year two is too stingy in terms of federal support. So I do not know what the answer is to that question other than it is a continual risk that we have to work against.

Mr. ROYCE. Thank you, Mr. Abernathy.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. I apologize for getting here late and I do not know what kind of questions you may have answered before I got here, but Mr. Abernathy you talked for a moment about the two statutory analyses required for the Department of Treasury to extend TRIA to group life insurance.

Mr. ABERNATHY. Yes, sir.

Mr. MILLER OF NORTH CAROLINA. You said that Treasury's analysis was that there was a ready supply still of primary group life coverage, although there was not an adequate and affordable catastrophic reinsurance.

Mr. ABERNATHY. That is correct. That was our finding.

Mr. MILLER OF NORTH CAROLINA. So there was one step satisfied, one of the criteria satisfied, and not the other, and the statute requires that both be satisfied.

Mr. ABERNATHY. That is right.

Mr. MILLER OF NORTH CAROLINA. I am curious as to the effect of the lack of availability of catastrophic reinsurance. Are insurance regulators who are charged with concerns for solvency looking at the possibility of catastrophic loss and the effect it might have on group life insurance?

Mr. ABERNATHY. I am not sure I understand the question, Congressman.

Mr. MILLER OF NORTH CAROLINA. Solvency concerns are usually by the states.

Mr. ABERNATHY. Yes, that is right.

Mr. MILLER OF NORTH CAROLINA. Do you know if the regulators who are concerned with solvency are looking at the possibility now of catastrophic losses and effect they might have on the solvency of primary group life coverage?

Mr. ABERNATHY. I do not have any primary evidence or information on that. I would defer to Mr. Serio about that and his colleagues.

Mr. MILLER OF NORTH CAROLINA. Okay.

Mr. SERIO. Yes, we are in fact looking at that. That is what has given us so much concern about the decision. The group life industry's ability to continue to provide primary coverage was good. It shows you the internal strength of the life insurance industry, but it is putting that capital at risk for an extraordinary event like the terrorist event that has a large number of casualties.

That would be putting a lot of that capital at risk, and that does concern the financial regulators, which is why we have been promoting the idea, along with many of you here today, of including group life in it simply because without the reinsurance they are essentially assuming that risk themselves. They are keeping that risk and retaining that themselves as opposed to being given an opportunity to spread that risk like most other lines of insurance do. That is why it is critical that that be a part of the TRIA program.

Mr. MILLER OF NORTH CAROLINA. Okay. I am sorry. You are concerned about potential effect on solvency and also the ability to pay claims?

Mr. SERIO. Sure. Given the fact that it is so hard to make estimates as to what a possible size of an event might be or an impact might be, the whole point of the TRIA Act was to provide that definitive backstop on property-casualty, to evaluate its impact and possible benefit to group life. We think it is a necessary and appropriate backstop so we do not get into that question, of where you do have an event that had a significant life loss.

Group life has the same concentration of risk character that worker compensation has. That is what has given us so much concern about this, that you will have thousands of lives in one location that this could be affected at once.

Mr. MILLER OF NORTH CAROLINA. Okay. Is the concern that your Department has shared by the primary group life insurers themselves?

Mr. SERIO. We have in fact been in significant discussion with them. The NAIC commissioners have been very concerned about it. We have discussed it with them and they are concerned. The industry is concerned about not having been included within the TRIA provisions.

Mr. MILLER OF NORTH CAROLINA. Okay. Do you favor, then, changing the statutory criteria so it no longer requires that both criteria be met to include group life insurance in TRIA?

Mr. SERIO. I think to clarify those provisions to get TRIA back to its original purpose of being that reinsurance backstop I think would be adequate for including group life in any clarification, and the statutory language would go a long way to that.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Chairman BAKER. I thank the gentleman.

Mr. Shays?

Mr. SHAYS. Thank you all very much.

I want to just say that I disagree with Mr. Kanjorski's interpretation of the Administration's participation in this effort. I obviously was very concerned about this issue, being from one of the financial capitals of the world, the Fairfield County, New York area, with lots of reinsurers and so on. I felt the Administration was paying a tremendous amount of attention to this issue.

I also do not believe that trying to deal with tort reform has a political purpose. I think it is just essential that ultimately we deal with that issue, but I realize it related primarily to the issue of terrorism and tort reform, et cetera.

I want to be as clear as I can be, and I have a number of questions, but I believe Mr. Serio says we need to continue this, but we need to have the government and the insurance industry work this out. That is basically, I sense, the position of GAO.

Mr. HILLMAN. Our view is that it is important to look at alternatives as soon as possible because we see no viable alternative coming forth from the industry itself.

Mr. SHAYS. Right. And from New York we hear basically let's continue this, at least in the short run.

Mr. SERIO. Right. That is correct.

Mr. SHAYS. And from Treasury, I am getting an Alan Greenspan kind of answer. I am a little unclear. I get a sense you do not want it to be permanent, and you are kind of a little neutral here and we have to work it out.

Mr. ABERNATHY. We are trying to operate within the parameters that the statute sets forward. The statute declares in a multitude of places that this is a temporary program with a glide-path——

Mr. SHAYS. But you are not speaking definitively.

Mr. ABERNATHY. No, we are.

Mr. SHAYS. You are kind of still trying to sort this out yourselves.

Mr. ABERNATHY. That is correct, because the statute also says we should consider what should take place after 2005.

Mr. SHAYS. Right. I know what the statute says, but I also know the Administration has opinions——

Mr. ABERNATHY. Yes.

Mr. SHAYS.—and has never been electing to show them, as it should not.

Let me see, on GAO's statement basically it says, in summary it appears the Congress's first objective in creating TRIA was to ensure that business activity did not materially suffer from a lack of available terrorism insurance largely has been achieved. I agree with that. Then you say, while TRIA, on page three actually, has improved the availability of terrorism insurance particularly for high-risk properties in major metropolitan areas, most commercial policyholders are not buying the coverage. That interests me because I was told basically, and this speaks to why we need to continue to debate this issue, that the whole marketplace would literally fall apart; that new buildings would not be built; existing buildings would not get refinanced because there was no terrorism insurance available.

So explain to me how we are able to see so many not have to buy the terrorism insurance and still get the financing they need.

Mr. HILLMAN. That was an interesting outcome of our study as well, Congressman. It seems that perhaps most folks view their risk exposure to be so low that almost any price that they might have to pay for terrorism insurance would be too high.

Mr. SHAYS. Right. But I thought that those financing buildings, the banking community, would have demanded it. What that implies is the banking community did not demand it. Maybe Mr. Abernathy would speak to this.

Mr. ABERNATHY. I think the financing community, bankers or others who are providing funding for economic development projects are making those same sorts of assessments. In some cases where they believe there might be a significant terrorism risk because of the trophy nature of the project or where it may be located, they are looking to whether or not there is availability of insurance being applied. In other cases where they believe the risk is low or nonexistent, they are not demanding that there be that kind of coverage.

Mr. SHAYS. Is that somewhat a surprise to you? It is logical in hindsight, but is it surprising?

Mr. ABERNATHY. It is a surprise in the sense that we did not predict that before we got into the program. I do not know that we knew what to expect would be the market reaction.

Mr. SHAYS. Let me ask another question. I always had anticipated that this would not be permanent, but that we would basically allow a hand-off that there would be a building up of reserves by the insurance industry and therefore be able to deal with it through their own capabilities. But I am being told that they have not built up their reserves. I need that explained to me.

Mr. SERIO. Yes, this really goes to what happened as we came out of 9-11. When you have $40 billion in losses mostly paid within an 18-month period, still some left outstanding, you had a serious drain on the reserves in the capital of the marketplace. There are a number of estimates as to how much of the total commercial property-casualty market was absorbed by 9-11.

There are a couple of different ways to regain capital: investment income, the development of surpluses, a whole pulling back on writing new business, and rates. Frankly, they have had to go and replenish their rate structure or their reserves through rate alone, and that is why you have such pressure to raise rates.

Mr. SHAYS. I realize my light is out, so rates went up for non-terrorist coverage?

Mr. SERIO. Rates went up across the board. Absolutely.

Mr. SHAYS. Unrelated to terrorism coverage.

Mr. SERIO. That is correct, and related to terrorism because of the need to replenish that capacity. What we are suggesting is that if you give the industry an opportunity to create some ability to have catastrophe capacity in hand, you do not have that whipsaw effect on the market going forward after an event has occurred. Whether you are talking about a terrorism event or any other kind of catastrophic event, there is always a need to be able to replenish those reserves, unless you are allowed to maintain them on hand. What we are suggesting is that more should be allowed to be held on hand for those types of events.

Mr. SHAYS. Could I have a quick follow-up? It will be very short. I just need to be clear. Are we basically saying that companies that are not required, who are not buying terrorism insurance, then will not be covered for a terrorist act? That now there is written in the policy, you have no coverage for terrorism?

Mr. SERIO. It depends on where you are. There are some policies in some states that have general terrorism exclusions, particularly on domestic terrorism which is not covered by TRIA. There are others. I mentioned earlier the standard fire policy provides coverage for terrorism if it results in a fire type of loss. That terrorism will in fact be covered, but there are policies that do exclude terrorism.

Mr. SHAYS. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Hillman, in the event of a terrorist attack by a non-foreign-based group, TRIA will not apply. Is there any evidence that the private market, and I know that Mr. Serio just touched on this, but I would like you to explain it more. Is there any evidence that the private market is offering coverage for acts of domestic terrorism?

Mr. HILLMAN. To some extent in a limited degree insurance is being made available for those types of in-country events.

Ms. VELAZQUEZ. Mr. Serio, would you like to comment on that?

Mr. SERIO. We are seeing that it really depends upon the risk and the location of the risk, where there is some coverage being provided. That all-risk coverage has been provided. I think, in fact, TRIA probably has provided some relief by giving a backstop for international or foreign terrorism risks, and provided some capacity relief so that domestic coverage could be maintained.

Ms. VELAZQUEZ. Mr. Abernathy, I also understand that many insurers are excluding coverage for certain types of terrorist attacks. In the event of a nuclear, chemical or biological attack by a foreign interest, would losses generally be covered by TRIA?

Mr. ABERNATHY. They would be covered by TRIA, but we have left it up to the various states to determine whether or not those particular events can be excluded. In the administration of the Act, we have relied as much as we possibly can upon the state regulators. Where states allow those exclusions, we do not supersede that local decision.

Ms. VELAZQUEZ. Thank you.

Mr. Serio, given the variety of means in which property damage could be inflicted during a terrorist attack, are you seeing insurers in New York State offering insurance products that will carve out certain types of terrorist attacks? If so, what types and why is this happening?

Mr. SERIO. They have tried. I am not sure we have allowed it. We have allowed some exclusions in New York, but only so much that they are already being covered by TRIA. So yes, the carriers have come in. They have made application for exclusions on certain types of hazards, nuclear among others.

Ms. VELAZQUEZ. And there is an intervention on your part, your office?

Mr. SERIO. Thank you for your patience. If a policyholder wants coverage through TRIA, they have to be afforded that opportunity to have it. Okay? The exclusion is only essentially on a make available basis as well. They can essentially deny the coverage or a policyholder can pass on the coverage, if you will. So in that case, an exclusion will be allowed. But again, it is at the buyer's discretion, not at the company's discretion.

Ms. VELAZQUEZ. Thank you.

Mr. Hillman, I understand that the take-up rates of terrorism insurance have been low. Could you discuss whether the size of the business appears to be a determinant on whether it purchases terrorism insurance. For instance, are smaller businesses more or less likely to purchase this insurance than larger firms?

Mr. HILLMAN. We have limited information on why the take-up rate is as low as it is, but it does have an awful lot to do with the extent to which you see a tremendous risk from a geographical location standpoint, from a concentration standpoint, as to whether or not policyholders find themselves having to provide that coverage and, as we discussed, whether or not financiers are willing to provide funds for developments and the like.

Ms. VELAZQUEZ. Okay. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentlelady.

Ms. Maloney?

Mrs. MALONEY. Thank you so much, Mr. Chairman and Mr. Kanjorski for holding this hearing on truly one of the most important issues, I believe, before this body. I certainly join with all of my colleagues in representing from my home state, and applauding his testimony today, Superintendent of Insurance Greg Serio. He is a major leader in our own state, and actually has been a national leader by the amount of time that you have been willing to come to Congress and speak across the country on this. On behalf of my constituents, I thank you very, very much.

I just want to say that after 9-11 I have never seen this Congress so bipartisan. We came together. We passed a whole series of legislation reacting to the disaster. All of the initiatives were tremendously important. But the bill that has the most significant long-term recovery, the biggest impact on New York City's economy, the site of the terrorist attack, was terrorism insurance. You can ask any professional, any business, any person. Most professionals, most people, most people working at ground zero, everyone believes that this legislation is truly the economic stimulus bill for the New York region.

We could not move forward until we could get this insurance for our contractors, our legislators. I really compliment very much GAO, and I have in my testimony many of the examples that you had in that excellent report that you did, that showed the vital, vital need for this.

I am very proud to have been part of a letter that 30 Democratic members of this committee signed urging Treasury to extend the "make available" provisions of TRIA as soon as possible so that the insurers and consumers will know whether coverage will be available next year.

This is very, very important. We need it now. We need a confirmation that this is going forward, and we need it as soon as possible so that we do not experience another period where the construction cranes are on mothballs and the workers are not called to be at the job sites. It is absolutely critical. I applaud every member of Congress that supported it in a bipartisan way, and the President. I urge him to show some leadership for the country and the city and other targeted areas that have suffered and those that are threatened by terrorist attack. We cannot wait for the study in six months. We really need it now. Maybe we need another GAO study right away.

I just read one report that the original TRIA and the effort to extend it have been opposed by some consumer groups. I found this very, very unusual, because I have a great admiration for the Consumer Federation of America. My understanding is that this consumer group, a group that I regard very highly, has done an analysis where they use a model that quantifies possible future terrorist attacks, putting their likelihood at occurring every 6.9 years at a cost of $40 billion each. I just want to ask if anyone if familiar with this model, what do you think of this model that was done by the Consumer Federation. I would like to know, have private insurance companies been able to come up with models that can be used to underwrite future attacks?

All I can tell you is the City of New York's economic development office, the Mayor's office, the individual insurers, businesses, everyone said they could not do anything until they got the reinsurance program passed. Building did not start because people could not get insurance. If you could get it, it jumped 20, 30, 40, 50 percent, which is terribly, terribly unfair.

I heard you testify earlier, Mr. Abernathy, that you are not going to complete this study particularly fast. I think we need it right away. I want to add that my district, I represent New York, I lost 500 constituents in 9-11, including the former Commissioner of, I cannot even talk about it, of Insurance for New York. But my home workers were very affected by group life insurance policies that also are part of this. And also in my home state, we have many insurance companies that hold these risks. I am interested in the issue, not only the group life insurance issue, from both the insurer and the insuree perspective.

I was wondering also, Mr. Abernathy, if you could comment on the decision of Treasury not to include group life under TRIA last year, and your thoughts for this market going forward. So I would like those questions answered. Also, again, I cannot compliment enough your statements, and I quoted many of your statements in my opening statement which I would like to put in the record.

Thank you.

Mr. ABERNATHY. Yes, Congresswoman, I would be glad to comment. I believe there are two areas you want me to talk about, our group life decision and what our views are with regard to going forward with regard to the Act overall.

With regard to group life, that was a decision that the statute gave us that was very narrowly defined. The question that the statute put before us is, Treasury should determine, based upon the evidence, whether or not group life insurance, primary insurance is available, and whether or not group life reinsurance was available. The statute says if both are not available, then we must include them under the program.

We consulted with people in the industry, with supervisors around the nation, and the decision was pretty clear. There is very little evidence that there is much, or at least at the time of the decision, that there was much in the way of group life reinsurance available. At the same time, there was very little evidence that there had been any reduction in availability of primary group life insurance. So the test under the statute was not met, so we could not include them within the program.

With regard to going forward, our view is that the statute, while stating in many places that it is a temporary statute, also makes it clear that we should evaluate how it is doing. Not only how the Act is doing, but how is the marketplace faring, and that we should, based upon what is going on on the ground, make recommendations to the Congress no later than June of next year on the variety of issues that are involved. Frankly, the more we dig into this whole question, the more questions we find. We find more questions than answers, but we are going through a process that is trying to bring as much information together so we can start answering some of those questions.

Mrs. MALONEY. GAO, you testified that the take-up rate is only 10 to 30 percent. What steps might we take as a Congress or as an insurance superintendent to increase this and thereby spread the risk? I am surprised at that, but on the other hand there are only a few areas that are the terrorist risk areas, Chicago, New York, Washington, Detroit. These are the areas. But if we do not have it in New York, I think Serio and others can testify, you are not going to be able to build or do anything. It will just kill our economy.

We have been called to a vote and I would like, Mr. Serio, if you could answer the Consumer Federation question, and GAO, I may have to run out before you can even answer it, to vote.

Chairman BAKER. The gentlelady's time has expired. Mr. Shays want to get something on the record as well.

Mrs. MALONEY. Maybe he could answer in writing, if we do not have time, because I think these are important questions.

Mr. SHAYS. Just a quick question. Thank you, Mr. Chairman.

The 10 to 30 percent in the GAO study, I realize I did not ask a very needed question that was triggered by Ms. Maloney. Are we seeing insurance at 60 or 70 percent in the greater New York area and 5 percent elsewhere? How does it look geographically?

Mr. HILLMAN. The several studies that looked at this issue that we gathered information from did not provide specifics on this, but it is clear from the studies that we did see that there is a greater concentration of purchasing the insurance in the Northeast area than in other parts of the country.

Mr. SHAYS. Could we ask GAO to tell us, to nail that down a little better? It is very important.

Mrs. MALONEY. Will the gentleman yield for half a second?

Mr. SHAYS. I yield.

Mrs. MALONEY. What can we do to spread the risk?

I yield back.

Mr. SHAYS. That is another issue which I think you will need to answer in writing as well. But I just need to know, are we seeing a lot more terrorism insurance being written in the Northeast, and if so how much.

Mr. HILLMAN. We can provide that information for the record.

Mr. SHAYS. Thank you. I appreciate that.

Thank you, Mr. Chairman.

Chairman BAKER. For general membership purposes, I have been requested that we leave the hearing record open for at least 30 days for exactly these purposes, to have additional questions posed to our expert panel.

One thing I would like to get on the record which was not discussed today, in response to concern about a permanent reinsurance program, is the Act also has, and I recognize it is conditioned, but there is a conditioned repayment obligation which is unique to this particular extension of credit. The view was that it was as a result of a catastrophic event, the capital on hand may be impaired and that it would be a cyclical problem that hopefully over time markets would rebuild and then be able to face future obligations with more resiliency.

So that in essence, it is a short-term cash problem, and that the United States government would step in to keep economic function performing without interruption and advance the capital necessary to get us by the window. But at such future as the Treasury would determine that the industry had recovered, and that there was an ability to repay the funds advanced, with certain limitations on the premium increases that could be assessed, taxpayer money could be regained at the end of the day because we would not want to write a $10 billion check from the United States Treasury and have the industry show a $10 billion net profit. My constituents would understand that pretty quickly.

So it is unique in that regard, and were we to extend it, it would be my intent to make sure that that repayment provision is also revisited to ensure it has the necessary capabilities to be enforced in an appropriate window by Treasury determination. I think that was important to add to our consideration of this issue.

Having said that, we do have a vote pending. If there are no further comments by our panelists, I want to thank you for your time and participation. Each of you has helped immeasurably in the committee's consideration of this difficult issue.

Our meeting stands adjourned.

[Whereupon, at 12:03 p.m., the subcommittees adjourned.]

A P P E N D I X

April 28, 2004

Statement of Chairwoman Sue Kelly
Joint Hearing
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Subcommittee on Oversight and Investigations
"A Review of TRIA and its Effect on the Economy: Helping America Move Forward"
April 28, 2004

In the last two-and-a-half years, our country has been engaged in a war against terror that has permeated virtually every aspect of American life. Congress and the Administration have responded to our new realities with comprehensive reforms that seek to eradicate the threat posed by fanatical terror networks to our citizens, our economy and our way-of-life.

Today's hearing highlights a law that has made a significant contribution to this effort. The Terrorism Risk Insurance Act ensures the availability of terrorism insurance that is crucial to our economic security.

After 9/11, the marketplace for terrorism insurance vanished. With losses from the terrorist attacks exceeding $40 billion and uncertainty in the marketplace, insurers and reinsurers began to exclude terrorism coverage from commercial policies.

Hospitals, office buildings, malls, stadiums and museums – and even small businesses located near these large facilities – had difficulty finding terrorism insurance coverage. Without this insurance, commercial development stalled and workers missed out on jobs.

As the availability of coverage continued to disappear and threaten our economic security, it was clear that the market for terrorism insurance would not return on its own. Something needed to be done to provide stability and avoid market disruptions. Congress – with strong support from the Administration – passed legislation to address the uncertainty in the market, protect American jobs, and strengthen the resiliency of our economy.

TRIA established a three-year program to pay the federal share of compensation for insured losses resulting from foreign acts of terrorism.

In TRIA, our goals were clear: make terrorism insurance affordable and available to policyholders in the short term, while also giving the market time to develop resources and mechanisms to ensure viability beyond expiration of the Act.

Today, the Committee will examine the effectiveness of TRIA and its impact on the economy. Thus far, the results of TRIA have been positive. Terrorism insurance is widely available, and a growing number of businesses are accessing this coverage.

By enabling commercial policyholders to obtain terrorism insurance, TRIA has provided a boost to construction and job creation, strengthened economic growth and security, and reduced the impact of any future terrorist attack. Overall, TRIA has been an important stabilizing factor in the market, as we will hear from the General Accounting Office today.

But, as the program moves closer to expiration in 2005, we must examine the future of terrorism insurance and whether the private market will be able to make coverage available without a federal backstop. While there is no doubt that our country is better prepared today than it was prior to 9/11, we remain on heightened alert and still face the threat of terrorist activity. This uncertainty makes it difficult to determine methods to price coverage and to ensure a viable marketplace without a federal backstop. As a result, it remains unclear whether there will be sustainable marketplace after TRIA expires.

Given state of the insurance marketplace and the continued war against terror, there is compelling reason to continue a federal backstop for terrorism insurance until we can ensure a viable marketplace that enables businesses to receive coverage. To begin, it is crucial that the Treasury Department extend the requirement that private insurers continue to "make available" terrorism reinsurance.

This provision – which sunsets at the end of 2004 – guarantees that commercial policyholders have access to terrorism coverage. A wide range of businesses and organizations – from the transportation, energy and real estate industries to manufacturing, construction, entertainment and retail sectors – are rightfully concerned that the failure to extend the "make available" provision will ultimately impact their operations, business development and ability to create jobs. This clearly threatens both our economic growth and security.

When it comes to the security of our country and our economy, we must take every necessary precaution to defend the American people. The Administration is doing everything possible to strengthen our security, from efforts to secure our nation's borders, ports and major transportation systems to additional resources to dry up terrorist financing.

The TRIA program also is essential to the economic security of the American people. It helps stabilize the market prior to a terrorist attack and ensures that Americans have access to low-cost insurance, which prevents market disruptions that adversely impact businesses that fuel our economy.

The benefits that a federal backstop provides to the post-9/11 economic security of the American people far outweigh the costs of the program. Until there are meaningful alternatives in place, we should not function without a federal backstop. It is better to have a program in place and not need it, than to need a program and not have it.

I thank Chairman Oxley and Subcommittee Chairman Baker for their cooperation in holding this important and timely hearing on terrorism insurance. Their leadership and perseverance, along with that of the President, is the reason that Congress was initially able to pass this monumental legislation despite significant obstacles.

I also commend the Treasury Department and the National Association of Insurance Commissioners (NAIC) for their collaborative work on these important issues under extraordinary circumstances. The Treasury Department and state insurance commissioners have been faced with the extremely difficult task of developing a reinsurance marketplace through an unprecedented program.

As we speak, businesses and insurers are beginning to make decisions that impact operations beyond the potential sunset of the "make available" language and the expiration of TRIA. As a result of these operational realities, I urge the Treasury Department to provide Congress with information on the future of TRIA in a timely manner in order to help make informed decisions about the future of the program.

I look forward to continuing to work with the public and private sectors to protect and preserve the economic security of the American people.

Prepared, not delivered
Opening Statement
Chairman Mike Oxley
Committee on Financial Services

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
The Terrorism Risk Insurance Act of 2002
April 28, 2004

First let me thank Chairwoman and Kelly and Chairman Baker for holding today's hearing. They worked closely with Capital Markets subcommittee ranking member Paul Kanjorski and other Committee leaders to develop a terrorism insurance bill over two years ago that was signed into law by the President. It is because of their hard work that we are able to discuss this morning the great success of the Terrorism Risk Insurance Act.

The tragic terrorist attack on America on September 11, 2001 resulted in thousands of deaths, massive destruction and the start of our war against terrorism that continues to this day. No one knew what would become of the U.S. economy in the immediate aftermath of 9/11. Stock markets were shut down for days and experienced a broad sell-off when they reopened. Many Americans were unable to work because their businesses had been shut down and numerous construction projects were brought to a halt.

Insurers and reinsurers paid out record claims, but were no longer able to cover acts of terrorism in the future because no one knew when or where the next attack might come. As a result, Americans whose jobs depended on the availability of insurance coverage faced work stoppages and unemployment, and our economy faced a severe crunch.

President Bush immediately realized the significance of this problem and called on Congress to pass legislation that would prevent severe economic disruptions. This Committee worked closely with the President and the Senate to draft a strong bipartisan bill that is pro-consumer, pro-taxpayer, and pro-business. That legislation, the Terrorism Risk Insurance Act of 2002, or "TRIA", provides a temporary Federal backstop for Americans to protect against future catastrophic terrorist attacks.

By almost any measure, TRIA has been an unqualified success. Every American business that has wanted to purchase insurance against terrorism has been able to do so. Real estate projects across the U.S. that could have been delayed or cancelled because of their terrorism exposure have proceeded. The Department of the Treasury, which is charged with administering the Terrorism Risk Insurance Program, has developed a framework by which claims could be processed and paid should another attack occur on American soil.

The Treasury Department has done a great service to the nation by quickly establishing a terrorism reinsurance program that covers the entire United States. Treasury officials worked with the National Association of Insurance Commissioner and industry to provide consumers with mandatory availability of terrorism coverage and with significant disclosures to improve their competitive options. Although the GAO has found that Treasury still has some work to do towards full implementation of TRIA, there is every indication that the Department has made great progress in a short amount of time, and we should be proud of their efforts.

In addition to ensuring the availability of terrorism insurance, TRIA was designed to provide a transitional period during which the insurance industry could diversify their exposure and develop resources that would enable them to offer this insurance without a Federal backstop.

The Treasury Department is collecting information on TRIA and on the evolution of the terrorism insurance market as TRIA sunsets. I look forward to its analysis when it is completed. I also hope that we can follow through on GAO's recommendation that we continue working to find alternative means of terrorism coverage, to draft a better long-term solution to improving the availability of catastrophe insurance.

Finally, let me just mention that I support the extension through next year of the "make available" provision to TRIA that requires all insurers selling commercial lines of property and casualty insurance to make terrorism coverage available as well. Seventeen of my colleagues joined me in signing a letter to Secretary Snow last week urging extension, and I hope that we can work together to ensure full availability of coverage.

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April 28, 2004

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and Subcommittee on Oversight and Investigations
Joint Hearing entitled, "A Review of the Terrorism Risk Insurance Act of 2002 (TRIA) and its Effect on the Economy: Helping America Move Forward"

Thank you, Mr. Chairman and Ms. Chairwoman, for calling this important hearing and for your continued leadership on this issue.

Our committee passed the Terrorism Risk Insurance Act (TRIA) in 2002, to address serious concerns regarding the continued availability of insurance against acts of terrorism. Without this important federal backstop, such coverage may easily have ceased to exist, or certainly to be affordable, for commercial policies given the uncertainty surrounding the cost of possible losses. Architects, engineers, construction workers, realtors and other American jobs dependent on the availability of such insurance coverage faced a serious risk of unemployment.

TRIA addressed these issues by ensuring the widespread availability of affordable terrorism insurance for the duration of the Act and providing a transitional period during which insurance market participants could diversify their exposure and develop resources and mechanisms that would enable private industry to offer affordable terrorism insurance after TRIA expires on December 31, 2005.

I look forward to hearing from today's witnesses on their evaluations of the TRIA program and related reforms within the industry. I recently cosigned a letter with several of my committee colleagues and our Full Committee Chairman commending the Treasury Department for their diligent work in implementing TRIA and promoting the availability of insurance for economic development in the aftermath of September 11, 2001.

The letter also addressed the expiration of the important "make available" provision of TRIA at the end of this year, that would end the requirement that all insurers selling commercial lines of property and casualty insurance make available coverage for certain terrorist events. I feel it is important for the industry that this provision be extended while the remaining Treasury Department reports required under TRIA come due and private market solutions continue to be developed.

I would like to thank our distinguished Chairmen again for calling this hearing, and I look forward to an informative session.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

A REVIEW OF THE TERRORISM RISK INSURANCE ACT AND ITS EFFECT ON THE ECONOMY: HELPING AMERICA MOVE FORWARD

WEDNESDAY, APRIL 28, 2004

Mr. Chairman, we meet today for the first time in the 108th Congress to examine the effectiveness of the Terrorism Risk Insurance Act. As you know, I worked closely with you during the 107th Congress to enact this important economic stabilization law.

Prior to the terrorist attacks on the World Trade Center and the Pentagon, most Americans took their security for granted. These attacks, however, altered how we each assess risk. This adjustment was especially apparent in the insurance industry.

Prior to 2001, many insurers could not price for terrorism risk and offered it for free. Ultimately, the industry sustained approximately $40 billion in losses on September 11th as a result of its poor economic judgment. Subsequently, it turned to the Congress to seek assistance in protecting the American public against future terrorism attacks, particularly in the short term.

Terrorism insurance is critical to protecting jobs and promoting America's economic security. Unfortunately, reinsurers curtailed the supply of terrorism reinsurance and insurers began to exclude terrorism coverage from customers' policies in the wake of the 2001 terrorist attacks. Eventually, we belatedly approved the Terrorism Risk Insurance Act to address these pressing problems.

Seventeen months have now passed since the Terrorism Risk Insurance Act became law. It is therefore an appropriate time for us to begin to examine the effectiveness of this statute. Because we crafted the law to last just 37 months, it is also an appropriate time for us to begin deliberations over the program's future.

Today, Mr. Chairman, we will hear from several insurance experts on these important matters. I am especially pleased that our witnesses will report that the Terrorism Risk Insurance Act has worked to increase the availability of terrorism risk insurance. As I understand, it has also lowered the cost of such insurance, contributed significantly to stabilizing the overall insurance marketplace, and advanced delayed economic development projects.

We wisely designed the Terrorism Risk Insurance Act as a temporary backstop to get our Nation through a period of economic uncertainty until the private sector could develop the models to price for terrorism reinsurance. I agreed with this decision. The reinsurance industry is dynamic and we should not disrupt the development of new products.

Nevertheless, I now believe that we might have decided to sunset this program too soon. In designing the law, we sought to give insurers a transitional period. The General Accounting Office, however, has recently determined that the industry has made little progress to date in providing terrorism insurance without government involvement. This finding causes me significant concern.

Although the law will expire at the end of 2005, many industry participants have also already called upon the Congress to act expeditiously in 2004 to extend the life of the Terrorism Risk Insurance Program in order to prevent short-term market disruptions. I agree.

As I have previously noted, terrorism insurance plays an important role in the efficient functioning of our economy. We should therefore pursue appropriate action before the end of the 108th Congress to provide greater stability to our capital markets in the short term while they work to develop private sector solutions to these problems for the long term. It is also my expectation that the Treasury Department will decide as soon as possible to extend the "make available" provisions of the law that require companies to offer terrorism insurance on the same terms and conditions as other property-and-casualty products.

In debating any plan to extend the Terrorism Risk insurance Act, we additionally ought to work to incorporate group life insurance into the federal backstop program. Group life products have characteristics similar to commercial property-and-casualty insurance in that there is often an excessive concentration of risk within a small geographic area. Despite a lack of terrorism reinsurance, group life insurers have remained in the marketplace, fully exposed to future terrorism events. This reality has created significant anxiety in the life insurance industry and uncertainty for individuals who obtain life insurance through their employers.

In closing, Mr. Chairman, time is of the essence. I stand ready to work with you and all other interested parties on these matters in the upcoming months. I am also looking forward to hearing from each of our witnesses to learn of their insights on these matters.

OPENING STATEMENT
PETER T. KING
before the
COMMITTEE ON FINANCIAL SERVICES

April 28, 2004

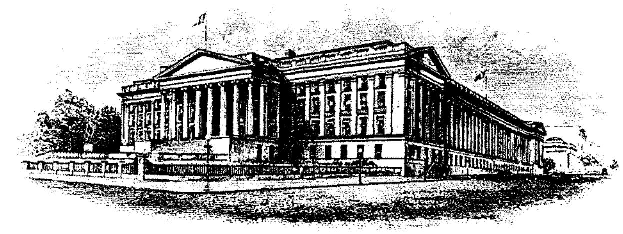
I'd like to thank Chairman Baker and Chairwoman Kelly for holding this important hearing on the future of terrorism risk insurance. Due to the cyclical nature of insurance polices, and the pending expiration of the Terrorism Risk Insurance Act (TRIA), their proactive approach toward this issue is commendable. I would also like to welcome our panel of witnesses, especially New York's Superintendent of Insurance Greg Serio. As a fellow New Yorker, he understands first-hand the importance of terrorism insurance in high-risk areas.

As we all know, the events of the September 11, 2001 exposed numerous concerns within our financial markets. The unpredictable risk associated with a terrorist attack posed an immediate problem for our economy because many insurers and reinsures stopped offering terrorism coverage in their commercial policies. This led to a halt, and even cancellation, of construction projects and potential real estate sales. Accordingly, Congress passed TRIA which provided a temporary backstop to share insured terrorism losses with insurers and policy holders. The bill served two important functions: (1) make terrorism insurance affordable and available to all commercial policy holders; and (2) allow the insurance industry time to diversify their exposure and determine how offer terrorism insurance without a federal backstop.

TRIA has done a good job providing stability in the marketplace by "making available" terrorism insurance to policyholders who seek it. However, according to a recently released GAO study on the effects of TRIA, the industry still has a long way to go in developing a reinsurance alternative to the government backstop. With TRIA set to expire at the end of 2005, this is very disconcerting because we could potentially find ourselves in a position similar to post 9/11. It's also been brought to my attention that group life insurers face significant losses in the event of a terrorist attack. Should they be included in any future reauthorization of TRIA? With risk managers assessing policies beyond the expiration of TRIA, we can not wait until next year to signal support for an extension of TRIA. At a minimum, Treasury should extend the "make available" provision subject to review in September 2004.

I look forward to the testimony from our witnesses, especially their opinions on whether a private market can develop in the near future.

Thank you, Mr. Chairman and Madam Chairwoman.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

FOR IMMEDIATE RELEASE
April 27, 2004

Contact: Anne Womack Kolton
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Testimony of
Wayne A. Abernathy
Assistant Secretary for Financial Institutions
Department of the Treasury
Before the
Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
and the
Subcommittee on Oversight and Investigations
Committee on Financial Services
United States House of Representatives

Thank you, Chairman Baker and Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez, and members of the Capital Markets and Oversight subcommittees for this opportunity to testify today on the implementation of the Terrorism Risk Insurance Act (TRIA) of 2002.

The market for property and casualty terrorism risk insurance was significantly affected by the terrorist attacks of September 11, 2001. In the aftermath of September 11, reinsurers by and large refrained from offering cover for property and casualty terrorism risk or offered reinsurance coverage at costs that were generally considered prohibitive. This then caused property and casualty insurers in general to respond by excluding terrorism coverage from commercial property and casualty insurance policies, leaving many American businesses exposed and uninsured. Perhaps the most notably negative impact of this development was the drag it created on businesses' ability to finance new job-creating economic activity in the midst of our economic downturn caused in part by the events of September 11.

To address this condition, Congress enacted TRIA in the fall of 2002. TRIA establishes a temporary Federal program of shared public and private compensation for insured commercial property and casualty losses resulting from acts of terrorism covered by the Act. TRIA in effect places the Federal government in the property and casualty terrorism risk reinsurance business through December 31, 2005.

By most indications TRIA has been successful in achieving the fundamental goal of enhancing the availability and affordability of property and casualty terrorism risk insurance, particularly for economic development purposes. No longer are heard the same level of concerns from real estate developers, for example, that new projects are on hold because financing has been frozen by a lack of terrorism risk insurance. In terms of affordability, while the information is still somewhat preliminary, accounts that we have seen indicate that premiums for terrorism risk insurance have decreased significantly throughout the early stages of TRIA and continue to do so.

There have been widespread reports that the "take up" rates for TRIA coverage have been low, or in other words, the demand for this coverage has been low. That is despite the fact that the "make available" provisions of the Act require property and casualty insurers to offer terrorism risk coverage to all of their customers, meaning that coverage is available and business and property owners that desire coverage for terrorism risk have been able to obtain such coverage. Whether this reflects a lack of interest in terrorism risk coverage at current prices even with the Federal backstop (prior to September 11, terrorism risk coverage was often provided at little or no additional cost to policyholders, while today in many cases it is being priced at a higher cost), a lack of awareness of the availability of coverage, an assessment by businesses of low terrorism loss risk, or some combination of the above will require careful study and analysis.

Treasury's Implementation of TRIA

Treasury has the chief responsibility for implementing the Federal reinsurance backstop that was established under TRIA. In broad terms, as Treasury has undertaken the overall implementation of TRIA, we have focused on five main administrative goals:

- First, to ensure that the program was operable and ready for use from the moment that it was signed into law by President Bush;
- Second, to implement TRIA in a transparent and effective manner that is fair and easily understood by all parties;
- Third, to rely as much as possible on the State insurance laws and regulatory structure by closely coordinating with the National Association of Insurance Commissioners (NAIC) in implementing the program;
- Fourth, to allow insurers to participate in the program in a manner consistent with their normal course of business by implementing TRIA's mandated requirements in the most efficient way and as most like standard reinsurance arrangements—consistent with the particular mandates of the law and its nature as a Federal government program that must be answerable to taxpayers; and

- Fifth, to ensure that in the event of insured losses, insurance benefits can be provided in the most expedited manner so as to relieve suffering and deny terrorists the achievement of their goals of economic disruption.

Perhaps the most daunting, immediate administrative task was to prioritize and undertake the actions needed to make the program operational right away. One of the key factors in this regard was that TRIA became effective immediately on November 26, 2002, when the President signed the Act into law. The immediate effective date of TRIA meant that terrorism exclusions on existing insurance policies were removed and all policyholders had the ability to secure coverage for terrorism risk. As I have often reflected, implementing TRIA has been like building a house by starting with the roof—the coverage came first.

In addition to the immediate effective date, Treasury also had to address the wide range of businesses, insurance companies, and types of policies that are affected by TRIA. The types of policyholders that fall under TRIA range from small businesses in rural America to large businesses that operate internationally. Likewise, the range of insurance companies that serve these policyholders is just as diverse, and many have unique characteristics that do not fit neatly under TRIA.

To address the immediate effective date of TRIA and provide the necessary guidance to the insurance industry to make the program operational, Treasury's first action was to issue promptly a series of three interim guidance notices. The first interim guidance notices were issued on December 3, 2002, about one week after TRIA was signed into law. Other interim guidance notices were issued on December 18, 2002, and January 22, 2003. Treasury relied on the process of issuing interim guidance notices because it provided us with the ability to respond quickly to implementation issues, and to prevent confusion prior to the issuance of formal regulations. These interim guidance notices, which were publicly released on Treasury's TRIA program website as well as published in the *Federal Register*, addressed the following implementation matters:

<ins>First Interim Guidance Notice - December 3, 2002:</ins> How insurers could comply with the required disclosures to policyholders, how the "make available" requirement could be met, and which lines of insurance are covered.
<ins>Second Interim Guidance Notice - December 18, 2002:</ins> Which entities must participate in the program and what the applicable requirements are, how affiliates would be treated, the scope of geographic coverage, how participating insurers could estimate their deductible, and additional guidance on complying with disclosure requirements.
<ins>Third Interim Guidance Notice - January 22, 2003:</ins> The timing and method of satisfying the required disclosures, further clarification on disclosure requirements, and questions concerning non-U.S. insurer participation.

This interim guidance provided the basis for insurance companies to proceed with offering coverage, the most immediate economic need. While there were many who participated in developing this guidance in such an expedited and effective way, particular mention should be made of Mario Ugoletti and Roy Woodall of the Treasury staff, who provided singularly dedicated and professional service in this effort.

Even while the interim guidance process went forward we began the next step in the implementation process, namely to move forward with formal rulemakings that would incorporate and supercede our interim guidance. The first rules were issued as interim final rules, as authorized in the statute, because of the immediate operational needs. The first interim final rule was issued on February 28, 2003. That rule took many of the issues that were addressed in interim guidance notices and transformed them into formal implementing regulations. Thus far, Treasury has published two interim final rules, and two proposed rules, and three of these rulemakings have been finalized. These can be summarized as follows:

First Interim Final Rule - February 28, 2003: This rule was effective immediately and set forth the purpose and scope of the program, key definitions, and certain other general provisions. We received over 40 comments on this rule from insurers, industry trade associations, the NAIC, and others. After review and careful consideration of the comments, Treasury revised the interim final rule and published it as a final regulation on July 11, 2003. A technical revision dealing with the definition of direct earned premium was subsequently published on August 13, 2003.

Second Interim Final Rule - April 18, 2003: This rule was effective immediately and addressed the requirements governing disclosures insurers must make to policyholders and the "make available" requirements. Treasury received 12 comments on this interim final rule and, after making appropriate revisions, published it as a final regulation on October 17, 2003.

First Proposed Rule - April 18, 2003: This proposed rule addressed issues involving State residual market insurance entities and State workers compensation funds. Treasury received 4 comments on this proposed rule and, after reviewing the comments submitted, revised the proposed rule and published it as a final rule on October 17, 2003.

Second Proposed Rule - December 1, 2003: This proposed rule set forth procedures for filing claims for payment of the Federal share of compensation for insured losses under the program. We have been reviewing comments submitted on the proposal, and we anticipate issuing the final rule in the very near future.

I believe that it is important to stress that while we have been moving progressively through the rule making process, the program from the beginning has been and continues to be fully operational. These rules have been put forward as refinements to and improvements on practices and operations, but from the earliest days of the program, we have had procedures and resources at the ready to respond to any covered insurable event that might arise.

In addition to the regulatory actions outlined above, Treasury has also created and staffed a Terrorism Risk Insurance Program (TRIP) office to administer the Act. We were very fortunate to bring on board as Director of the TRIP office, Jeffrey Bragg, who brings deep experience from the property and casualty insurance markets as well as experience as a former administrator of the Federal flood insurance, riot insurance, and crime insurance programs. Director Bragg in almost no time has assembled an outstanding team of insurance professionals, several of whom have been willing at some sacrifice to interrupt successful private careers to help administer this important program.

Among their accomplishments, the TRIP office has developed systems to handle claims processing, payment, and auditing of claims should a covered event occur. In addition to the December 1, 2003, proposed rule on the claims process, the TRIP office has also been hard at work providing detailed operating procedures for claims filing, processing and payment that are separate from the regulation.

For example, these operating procedures include developing actual claims forms, providing specific contacts for submitting forms and obtaining assistance, and providing information on the required account information for the payments to the insurers. In addition, the TRIP office has been consistently responding to requests for interpretation of the Act and its regulations from insurers; many of those interpretations have been made available to the general public on the TRIP website (www.treas.gov/trip).

TRIA is an interesting hybrid program jurisdictionally; it provides a Federal reinsurance backstop to insurance programs that are regulated almost exclusively at the State level. This type of program would likely be unmanageable without the cooperation of the State insurance regulators, both among themselves and with the Federal government. Throughout the implementation process, Treasury consulted and worked closely with the NAIC, and the NAIC's assistance has been invaluable in implementing TRIA. The NAIC's input was especially important in assisting Treasury with the interim guidance notices that we issued soon after TRIA was signed into law. We look forward to continuing to work closely with the NAIC regarding Treasury's remaining responsibilities under TRIA.

Comprehensive Market Information and Analysis Requirement

An important requirement of TRIA is to implement the Act with a careful eye on market conditions and developments, and report to Congress. In particular, Treasury is required to report to Congress by June 30, 2005, on specific issues associated with the Act and its purposes. Specifically, Treasury is required to assess—

- The "effectiveness of the Program;"
- The "likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program;" and
- The "availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit."

Together with this analysis, Treasury is also required under TRIA to compile information on premium rates for property and casualty terrorism risk insurance.

To assist in the evaluation of the Act's effectiveness and to meet TRIA's premium information collection requirement—and to ensure that we do so with as comprehensive a view of the markets as possible—Treasury has contracted with an outside survey research firm to conduct a comprehensive survey with a nationally representative sample of policyholders and insurers. In the process of developing the survey instruments, Treasury's Office of Economic Policy has worked closely with policyholder and insurer representatives. The Office of Economic Policy is also in the process of developing a separate survey instrument for reinsurers.

Some of the information being collected through the surveys includes the cost of terrorism risk insurance as compared to total insurance within eligible lines, basic financial data, insurance deductibles and limits for terrorism as compared to non-terrorism insurance, use of reinsurance and self insurance, and the types of risk management programs.

Each company that is chosen for the survey will be contacted at least twice and possibly three times (depending on their policy renewal dates) to capture effects of changes in TRIA's insurer deductibles in successive program years. The first survey wave collected data from 2002 and 2003. Surveys for the first wave were mailed out late in 2003 and early 2004 to over 30,000 policyholders and almost 500 insurers. A second survey wave to collect 2004 data is planned for early this fall, and the last survey wave is planned for January and February of 2005. This phased structure will allow us to move beyond snapshots and anecdotal evidence to obtain a broader and more dynamic view of the conditions in the market place. We believe that anything less would not provide to the Secretary the full and reliable information basis needed to make the sort of careful, trustworthy, and responsible evaluation called for by Congress in the statute.

To safeguard the confidentiality of the business information requested in these surveys, Treasury has taken great care to ensure that the data are assembled at arm's length from the government. All identifying information will be removed, transformed to ratios, or otherwise masked prior to analysis by Treasury officials. Treasury has also tried to minimize respondent burden by merging publicly-available financial data and data filed with NAIC sources.

In addition to the formal surveys that Treasury is undertaking, Treasury also continues to consult with the NAIC, and a broad range of experts representing the insurance industry, policyholders, taxpayer groups, and with Members of Congress. Indeed, Secretary Snow has been insistent that we draw upon as many sources of information and input as possible. The completed survey results, as well as these consultations, will form the basis for Treasury completing its report to Congress on the effectiveness of TRIA and the capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the program, by the June 30, 2005, deadline set by Congress in the 2002 legislation.

Determination on Extending the "Make Available" Requirement

The Secretary of the Treasury is required to determine by September 1, 2004, whether to extend TRIA's "make available" provisions into the third year of the program (i.e., through December 31, 2005). The "make available" provisions of TRIA require that, from the date of enactment (November 26, 2002) through the last day of the second year of the program (December 31, 2004), each insurer must make available, in all of its commercial property and casualty insurance policies, coverage for insured losses under the Act. In this regard, TRIA also requires that such insurance coverage must not differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism.

TRIA requires that Treasury's determination on whether to extend the "make available" requirements through the third year of the program is to be based on the same factors described above regarding Treasury's overall study of the effectiveness of TRIA.

Treasury is now developing a base of information from which the Secretary can make this required determination, consistent with the terms of the Act. Various trade groups and other interested parties have contacted Treasury regarding the "make available" decision. We encourage any who have views on this question to share those views with Treasury as soon as they can, with as much detail as they can provide.

In making this determination, however, while examining similar issues as those outlined for the larger examination due by June 2005, Treasury will be looking at those issues with the specific, narrow focus of the "make available" question, and with the use of much less information than will be available for the larger, broader study. Therefore, each examination will be conducted independently of the other.

Conclusion

We must all remember that the basic of goal of TRIA was to develop a temporary backstop for property and casualty terrorism risk insurance so that private markets would have a chance to adjust. We would encourage insurance companies, state insurance regulators, other financial services providers, and other interested parties to think creatively in this regard, and to consider what methods can be employed to allow for broader private sector involvement in the market for managing property and casualty terrorism risk. Treasury looks forward to completing our review of the effectiveness of TRIA and considering the many complicated issues presented to us in a thorough manner with the best information that can be obtained. Our obligations to the taxpayers, and the need for the long-term health and vitality of our financial markets, require nothing less.

In summary, while we hope that we will never be called upon to trigger coverage under TRIA, the program stands ready today—as it has from its earliest days—to meet its responsibilities. The extensive work done by Treasury in developing the basic framework of TRIA through interim guidance notices and regulations, the proposed claims regulations, the drafting of claims forms and review with industry organizations and the NAIC, and contingency procurement plans, all have contributed to an effective program that the Treasury will continue to refine over the life of the program. We look forward to moving forward with the implementation process and evaluating the effectiveness of the program in the weeks and months ahead.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises and the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

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TERRORISM INSURANCE

Effects of the Terrorism Risk Insurance Act of 2002

Statement of Richard J. Hillman, Director
Financial Markets and Community Investment

GAO

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Highlights

Highlights of GAO-04-720T, a testimony before the House Financial Services Committee, Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises and the Subcommittee on Oversight and Investigations.

TERRORISM INSURANCE

Effects of the Terrorism Risk Insurance Act of 2002

Why GAO Did This Study

After the terrorist attacks of September 11, 2001, insurance coverage for terrorism largely disappeared. Congress passed the Terrorism Risk Insurance Act (TRIA) in 2002 to help commercial property-casualty policyholders obtain terrorism insurance and give the insurance industry time to develop mechanisms to provide such insurance after the act expires on December 31, 2005. Under TRIA, the Department of Treasury (Treasury) caps insurer liability and would process claims and reimburse insurers for a large share of losses from terrorist acts that Treasury certified as meeting certain criteria. As Treasury and industry participants have operated under TRIA for more than a year, GAO was asked to describe how TRIA affected the terrorism insurance market.

What GAO Recommends

GAO recommends that the Secretary of the Treasury, as part of Treasury's study of the effectiveness of TRIA and after consultation with insurance industry participants, identify for Congress alternatives that may exist for expanding the availability and affordability of terrorism insurance after TRIA expires. These alternatives could assist Congress during deliberations on the insurance industry's capacity to provide terrorism insurance.

www.gao.gov/cgi-bin/getrpt?GAO-04-720T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard Hillman at 202-512-8678, hillmanr@gao.gov.

What GAO Found

TRIA has enhanced the availability of terrorism insurance for commercial policyholders, largely fulfilling a principal objective of the program. In particular, TRIA has benefited commercial policyholders in major metropolitan areas perceived to be at greater risk for a terrorist attack. Prior to TRIA, we reported concern that some development projects had already been delayed or cancelled because of the unavailability of insurance and continued fears that other projects also would be adversely impacted. We also conveyed the widespread concern that general economic growth and development could be slowed by a lack of available terrorism insurance. Since TRIA's enactment, terrorism insurance generally has been widely available, even for development projects in perceived high-risk areas, largely because of the requirement in TRIA that insurers "make available" coverage for terrorism on terms not differing materially from other coverage. Although the purpose of TRIA is to make terrorism insurance available, it does not directly address prices. As part of its assessment of TRIA's effectiveness, Treasury is engaged in gathering data through surveys that should provide useful information about terrorism insurance prices in the marketplace.

Despite increased availability of coverage, limited industry data suggest that most commercial policyholders are not buying terrorism insurance, perhaps because they perceive their risk of losses from a terrorist act as being relatively low. The potential negative effects of low purchase rates, in combination with the probability that those most likely to be the targets of terrorist attacks may also be the ones most likely to have purchased coverage, would become evident only in the aftermath of a terrorist attack and could include more difficult economic recovery for businesses without terrorism coverage or potentially significant financial problems for insurers. Moreover, those that have purchased terrorism insurance may still be exposed to significant risks that have been excluded by insurance companies, such as nuclear, biological, or chemical contamination. Meanwhile, although insurers and some reinsurers have cautiously reentered the terrorism risk market to cover insurers' remaining exposures, little progress has been observed within the private sector toward either finding a reliable method for pricing terrorism insurance or developing any viable reinsurance alternatives to TRIA once it expires.

Mr. Chairman, Madam Chairwoman, and Members of the Subcommittees:

I am pleased to be here today to discuss our report on the implementation of the Terrorism Risk Insurance Act of 2002 (TRIA) and the act's impact on the economy.[1] The terrorist attacks of September 11, 2001, drastically changed the way insurers viewed the risk of terrorism. An industry that had considered the risk of terrorism so low that it did not identify or price terrorism risk separate from property and casualty coverage will ultimately pay approximately $40 billion for losses arising from September 11, according to industry experts. Responding to terrorism risk after September 11, reinsurers began excluding terrorism from coverage as contracts between reinsurers and insurers came up for renewal.[2] Without reinsurance, insurers retained greater levels of risks than they could responsibly carry, and their reaction was to exclude these risks from commercial policies as they were renewed. In short, believing that neither the frequency nor magnitude of terrorism losses could be estimated, insurance companies withdrew from the market.

In the aftermath of September 11, we reported that terrorism insurance was disappearing in the marketplace, particularly for large businesses and those perceived to be at some risk.[3] We also reported significant concern that some development projects had already been delayed or cancelled because of the unavailability of insurance and fears that others would follow. Furthermore, there was widespread concern that general economic growth and development would be slowed by a lack of insurance availability and uncertainty in the marketplace. Because of concerns about the lack of available and affordable terrorism insurance, Congress passed TRIA, which took effect on November 26, 2002. TRIA is currently scheduled to expire at the end of 2005.

Our report on the implementation of TRIA has two objectives. First, we describe the progress made by Treasury and insurance industry participants in implementing TRIA. We found that Treasury has made significant progress in

[1]U.S. General Accounting Office, *Terrorism Insurance: Implementation of the Terrorism Risk Insurance Act of 2002*, GAO-04-307 (Washington, D.C.: Apr. 23, 2004).

[2]Reinsurance is a mechanism that insurance companies routinely use to spread risk associated with insurance policies. Simply put, it is insurance for insurance companies. Reinsurance is a normal business practice that satisfies a number of needs in the insurance marketplace, including the need to expand capacity and obtain protection against potential catastrophes.

[3]U.S. General Accounting Office, *Terrorism Insurance: Alternative Programs for Protecting Insurance Consumers*, GAO-02-175T (Washington, D.C.: Oct. 24, 2001), and *Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities*, GAO-02-472T (Washington, D.C.: Feb. 27, 2002).

implementing the provisions of TRIA, but has important work to complete in order to comply with all its responsibilities under the act. Second, we discuss the changes in the market for terrorism insurance coverage under TRIA. As requested, my testimony today focuses on the second of these two objectives. That is, how TRIA has affected the market for terrorism insurance and, more generally, the economy. Additionally, I have included appendixes to this statement that provide background information on TRIA and describe completed and ongoing engagements that GAO has undertaken for this Committee that relate to increasing the insurance industry's capacity to provide insurance for terrorism and natural catastrophe risks.

In summary, it appears that Congress's first objective in creating TRIA—to ensure that business activity did not materially suffer from a lack of available terrorism insurance—largely has been achieved. Since TRIA was enacted in November 2002, terrorism insurance generally has been available to businesses. But most commercial policyholders are not buying the coverage. According to insurance industry experts, purchases have been higher in areas considered to be at high risk of another terrorist attack. However, many policyholders with businesses or properties not located in perceived high-risk locations are not buying coverage because they view any price for terrorism insurance as high relative to their perceived risk exposure. Further, those that have bought terrorism insurance remain exposed to significant perils because insurers have broadened longstanding policy exclusions of nuclear, biological, and chemical (NBC) events. Congress's second objective—to give private industry a transitional period during which it could begin pricing terrorism insurance and develop ways to cover losses after TRIA expires—has not been achieved yet. Industry sources indicated that under TRIA, insurance market participants have made no progress to date toward the development of reliable methods for pricing terrorism risks and little movement toward any mechanism that would enable insurers to provide terrorism insurance to businesses without government involvement.

In conducting this work, we reviewed and analyzed relevant information concerning state legislation and publicly available and proprietary industry data and studies on the terrorism insurance market. We interviewed officials at Treasury, the National Association of Insurance Commissioners (NAIC), and state insurance regulators from six states with high insurance sales volumes. We also interviewed representatives of insurance companies, reinsurance companies, brokers for insurance and reinsurance companies, industry associations, property owners and developers, and insurance filing services and credit rating agencies.[4] In our discussions with these organizations, we endeavored to gain an understanding of their experience in implementing TRIA requirements, obtain their views on the effects of TRIA on the terrorism insurance market, and identify developments within the industry to address terrorism risks after TRIA expires. We conducted this work in Chicago, New York City, and Washington, D.C., from January 2003 through April 2004 in accordance with generally accepted government auditing standards.

Although Available, Few Are Buying Terrorism Insurance and the Industry Has Made Little Progress Toward Post-TRIA Coverage

While TRIA has improved the availability of terrorism insurance, particularly for high-risk properties in major metropolitan areas, most commercial policyholders are not buying the coverage. Limited industry data suggest that 10 - 30 percent of commercial policyholders are purchasing terrorism insurance, perhaps because most policyholders perceive themselves at relatively low risk for a terrorist event. Some industry experts are concerned that those most at risk from terrorism are generally the ones buying terrorism insurance. In combination with low purchase rates, these conditions could result in uninsured losses for those businesses without terrorism coverage or cause financial problems for insurers, should a terrorist event occur. Moreover, even policyholders who have purchased terrorism insurance may remain uninsured for significant risks arising from certified terrorist events—that is, those meeting statutory criteria for reimbursement under TRIA—such as those involving NBC agents or radioactive contamination. Finally, although insurers and some reinsurers have cautiously reentered the terrorism risk market, insurance industry participants have made little progress toward developing a mechanism that could permit the commercial insurance market to resume providing terrorism coverage without a government backstop.

[4] Filing services perform many services for insurance companies, including submitting to state insurance regulators the documents required to sell a line of insurance.

TRIA Has Improved the Availability of Terrorism Insurance, Particularly for Some High-Risk Policyholders

TRIA has improved the availability of terrorism insurance, especially for some high-risk policyholders. According to insurance and risk management experts, these were the policyholders who had difficulty finding coverage before TRIA. TRIA requires that insurers "make available" coverage for terrorism on terms not differing materially from other coverage.[5] Largely because of this requirement, terrorism insurance has been widely available, even for development projects in high-risk areas of the country. Although industry data on policyholder characteristics are limited and cannot be generalized to all policyholders in the United States, risk management and real estate representatives generally agree that after TRIA was passed, policyholders—including borrowers obtaining mortgages for "trophy" properties, owners and developers of high-risk properties in major city centers, and those in or near "trophy" properties—were able to purchase terrorism insurance.

Additionally, TRIA contributed to better credit ratings for some commercial mortgage-backed securities. For example, prior to TRIA's passage, the credit ratings of certain mortgage-backed securities, in which the underlying collateral consisted of a single high-risk commercial property, were downgraded because the property lacked or had inadequate terrorism insurance. The credit ratings for other types of mortgage-backed securities, in which the underlying assets were pools of many types of commercial properties, were also downgraded but not to the same extent because the number and variety of properties in the pool diversified their risk of terrorism. Because TRIA made terrorism insurance available for the underlying assets, thus reducing the risk of losses from terrorist events, it improved the overall credit ratings of mortgage-backed securities, particularly single-asset mortgage-backed securities. Credit ratings affect investment decisions that revolve around factors such as interest rates because higher credit ratings result in lower costs of capital. According to an industry expert, investors use credit ratings as guidance when evaluating the risk of mortgage-backed securities for investment purposes. Higher credit ratings reflect lower credit risks. The typical investor response to lower credit risks is to accept lower returns, thereby reducing the cost of capital, which translates into lower interest rates for the borrower.

[5]TRIA defines "make available" to mean that the coverage must be offered for insured losses arising from terrorist events and that coverage not differ materially from the terms, amounts, and limitations applicable to coverage for losses arising from other types of events. However, TRIA gives Treasury the option of determining whether the "make available" requirement should be extended through 2005, the third year of the act, and gives the agency until September 1, 2004, to do so.

To the extent that the widespread availability of terrorism insurance is a result of TRIA's "make available" requirement, Treasury's decision on whether to extend the requirement to year three of the program is vitally important. While TRIA has ensured the availability of terrorism insurance, we have little quantitative information on the prices charged for this insurance. Treasury is engaged in gathering data through surveys that should provide useful information about terrorism insurance prices. TRIA requires that they make the information available to Congress upon request. In addition, TRIA also requires Treasury to assess the effectiveness of the act and evaluate the capacity of the industry to offer terrorism insurance after its expiration. This report is to be delivered to Congress no later than June 30, 2005.

Most Policyholders Have Not Bought Terrorism Insurance

Although TRIA improved the availability of terrorism insurance, relatively few policyholders have purchased terrorism coverage. We testified previously that prior to September 11, 2001, policyholders enjoyed "free" coverage for terrorism risks because insurers believed that this risk was so low that they provided the coverage without additional premiums as part of the policyholder's general property insurance policy. After September 11, prices for coverage increased rapidly and, in some cases, insurance became very difficult to find at any price. Although a purpose of TRIA is to make terrorism insurance available and affordable, the act does not specify a price structure.

However, experts in the insurance industry generally agree that after the passage of TRIA, low-risk policyholders (for example, those not in major urban centers) received relatively low-priced offers for terrorism insurance compared to high-risk policyholders, and some policyholders received terrorism coverage without additional premium charges.[6] Yet according to insurance experts, despite low premiums, many businesses (especially those not in "target" localities or industries) did not buy terrorism insurance. Some simply may not have perceived themselves at risk from terrorist events and considered terrorism insurance, even at low premiums (relative to high-risk areas), a bad investment.[7] According to insurance sources, other policyholders may have deferred their decision to buy terrorism insurance until their policy renewal date.

[6]According to industry experts, the insurers that provided "free" terrorism insurance likely did so for policies already in place at the time TRIA was enacted and may have deferred operational changes and difficult pricing decisions because they lacked the resources to do so.

[7]Howard Kunreuther, Erwann Michel-Kerjan, and Beverly Porter, *Assessing, Managing and Financing Extreme Events: Dealing with Terrorism* (National Bureau of Economic Research: December 2003), 13.

Some industry experts have voiced concerns that low purchase rates may indicate adverse selection—where those at the most risk from terrorism are generally the only ones buying terrorism insurance. Although industry surveys are limited in their scope and not appropriate for market-wide projections, the surveys are consistent with each other in finding low "take-up" rates, the percentage of policyholders buying terrorism insurance, ranging from 10 to 30 percent. According to one industry survey, the highest take-up rates have occurred in the Northeast, where premiums were generally higher than the rest of the country.

The combination of low take-up rates and high concentration of purchases in an area thought to be most at risk raises concerns that, depending on its location, a terrorist event could have additional negative effects.

- If a terrorist event took place in a location not thought to be a terrorist "target," where most businesses had chosen not to purchase terrorism insurance, then businesses would receive little funding from insurance claims for business recovery efforts, with consequent negative effects on owners, employers, suppliers, and customers.
- Alternatively, if the terrorist event took place in a location deemed to be a "target," where most businesses had purchased terrorism insurance, then adverse selection could result in significant financial problems for insurers. A small customer base of geographically concentrated, high-risk policyholders could leave insurers unable to cover potential losses facing possible insolvency. If, however, a higher percentage of business owners had chosen to buy the coverage, the increased number of policyholders would have reduced the chance that losses in any one geographic location would create a significant financial problem for an insurer.[8]

Tighter Exclusions Leave Policyholders Exposed to Significant Perils

Since September 11, 2001, the insurance industry has moved to tighten long-standing exclusions from coverage for losses resulting from NBC attacks and radiation contamination. As a result of these exclusions and the actions of a growing number of state legislatures to exclude losses from fire following a terrorist attack, even those policyholders who choose to buy terrorism insurance may be exposed to potentially significant losses. Although NBC coverage was generally not available before September 11, after that event insurers and reinsurers recognized the enormity of potential losses from terrorist events and

[8]Casualty Actuarial Society, *Foundations of Casualty Actuarial Science,* 4th ed. (United Book Press, Inc.: 2001), 51, 86.

introduced new practices and tightened treaty language to further limit as much of their loss exposures as possible. (We discuss some of these practices and exclusions in more detail in the next section.) State regulators and legislatures have approved these exclusions, allowing insurers to restrict the terms and conditions of coverage for these perils. Moreover, because TRIA's "make available" requirements state that terms for terrorism coverage be similar to those offered for other types of policies, insurers may choose to exclude the perils from terrorism coverage just as they have in other types of coverage. According to Treasury officials, TRIA does not preclude Treasury from providing reimbursement for NBC events, if insurers offered this coverage. However, policyholder losses from perils excluded from coverage, such as NBCs, would not be "insured losses" as defined by TRIA and would not be covered even in the event of a certified terrorist attack.

In an increasing number of states, policyholders may not be able to recover losses from fire following a terrorist event if the coverage in those states is not purchased as part of the offered terrorism coverage. We have previously reported that approximately 30 states had laws requiring coverage for "fire-following" an event—known as the standard fire policy (SFP)—irrespective of the fire's cause. Therefore, in SFP states fire following a terrorist event is covered whether there is insurance coverage for terrorism or not. After the terrorist attacks of September 11, 2001, some legislatures in SFP states amended their laws to allow the exclusion of fire following a terrorist event from coverage. As of March 1, 2004, 7 of the 30 SFP states had amended their laws to allow for the exclusion of acts of terrorism from statutory coverage requirements.[9] However as discussed previously, the "make available" provision requires coverage terms offered for terrorist events to be similar to coverage for other events. Treasury officials explained that in all non-SFP states, and the 7 states with modified SFPs, insurers must include in their offer of terrorism insurance coverage for fire following a certified terrorist event because coverage for fire is part of the property coverage for all other risks. Thus, policyholders who have accepted the offer would be covered for fire following a terrorist event, even though their state allows exclusion of the coverage. However, policyholders who have rejected their offer of coverage for terrorism insurance would not be covered for fire following a terrorist event. According to insurance experts, losses from fire damage can be a relatively large proportion of the total property loss. As a result, excluding terrorist events from SFP requirements could result in potentially large losses that

[9]According to the National Association of Mutual Insurance Companies, Louisiana, Michigan, Minnesota, Nebraska, New Hampshire, Oklahoma, and Virginia have amended their standard fire policies to allow for exclusion of terrorism from statutory fire coverage. State legislators in Massachusetts have introduced a similar bill.

cannot be recovered if the policyholder did not purchase terrorism coverage. For example, following the 1994 Northridge earthquake in California, total insured losses for the earthquake were $15 billion—$12.5 billion of which were for fire damage. According to an insurance expert, policyholders were able to recover losses from fire damage because California is an SFP state, even though most policies had excluded coverage for earthquakes.

Reinsurers Have Cautiously Returned to the Market, but Many Insurers Have Not Bought Reinsurance

Under TRIA, reinsurers are offering a limited amount of coverage for terrorist events for insurers' remaining exposures, but insurers have not been buying much of this reinsurance. According to insurance industry sources, TRIA's ceiling on potential losses has enabled reinsurers to return cautiously to the market. That is, reinsurers generally are not offering coverage for terrorism risk beyond the limits of the insurer deductibles and the 10 percent share that insurers would pay under TRIA. In spite of reinsurers' willingness to offer this coverage, company representatives have said that many insurers have not purchased reinsurance. Insurance experts suggested that the low demand for the reinsurance might reflect, in part, commercial policyholders' generally low take-up rates for terrorism insurance. Moreover, insurance experts also have suggested that insurers may believe that the price of reinsurance is too high relative to the premiums they are earning from policyholders for terrorism insurance.

The relatively high prices charged for the limited amounts of terrorism reinsurance available are probably the result of interrelated factors. First, even before September 11 both insurance and reinsurance markets were beginning to harden; that is, prices were beginning to increase after several years of lower prices. Reinsurance losses resulting from September 11 also depressed reinsurance capacity and accelerated the rise in prices.[10] The resulting hard market for property-casualty insurance affected the price of most lines of insurance and reinsurance. A notable example has been the market for medical malpractice insurance.[11] The hard market is only now showing signs of coming to an end, with a resulting stabilization of prices for most lines of insurance. In addition to the effects of the hard market, reinsurer awareness of the adverse selection that may be occurring in the commercial insurance market could be another factor contributing to higher reinsurance prices. Adverse selection usually represents a larger-than-expected exposure to loss. Reinsurers are likely to react by increasing prices for the terrorism coverage that they do sell.

[10]Capacity is the amount of reinsurance or insurance that is available for a defined risk.

[11]U.S. General Accounting Office, *Medical Malpractice Insurance: Multiple Factors Have Contributed to Increased Premium Rates*, GAO-03-702 (Washington, D.C.: June 27, 2003).

In spite of the reentry of reinsurers into the terrorism market, insurance experts said that without TRIA caps on potential losses, both insurers and reinsurers likely still would be unwilling to sell terrorism coverage because they have not found a reliable way to price their exposure to terrorist losses. According to industry representatives, neither insurers nor reinsurers can estimate potential losses from terrorism or determine prices for terrorism insurance without a pricing model that can estimate both the frequency and the severity of terrorist events. Reinsurance experts said that current models of risks for terrorist events do not have enough historical data to dependably estimate the frequency or severity of terrorist events, and therefore cannot be relied upon for pricing terrorism insurance. According to the experts, the models can predict a likely range of insured losses resulting from the damage if specific event parameters such as type and size of weapon and location are specified. However, the models are unable to predict the probability of such an attack.

Even as they are charging high prices, reinsurers are covering less. In response to the losses of September 11, industry sources have said that reinsurers have changed some practices to limit their exposures to acts of terrorism. For example, reinsurers have begun monitoring their exposures by geographic area, requiring more detailed information from insurers, introducing annual aggregate and event limits, excluding large insurable values, and requiring stricter measures to safeguard assets and lives where risks are high.[12] And as discussed previously, almost immediately after September 11 reinsurers began broadening NBC exclusions beyond scenarios involving industrial accidents, such as nuclear plant accidents and chemical spills, to encompass intentional destruction from terrorists. For example, post-September 11 exclusions for nuclear risks include losses from radioactive contamination to property and radiation sickness from dirty bombs.

As of March 1, 2004, industry sources indicated that there has been little development or movement among insurers or reinsurers toward developing a private-sector mechanism that could provide capacity, without government involvement, to absorb losses from terrorist events. Industry officials have said that their level of willingness to participate more fully in the terrorism insurance market in the future will be determined, in part, by whether any more events occur. Industry sources could not predict if reinsurers would return to the terrorism insurance market after TRIA expires, even after several years and the absence of further major terrorist attacks in the United States. They explained

[12] Christian Brauner and Georges Galey, "Terrorism Risks in Property Insurance and Their Insurability after 11 September 2001," (Swiss Reinsurance Company: 2003), 25.

that reinsurers are still recovering from the enormous losses of September 11 and still cannot price terrorism coverage. In the long term and without another major terrorist attack, insurance and reinsurance companies might eventually return. However, should another major terrorist attack take place, reinsurers told us that they would not return to this market—with or without TRIA.

Conclusions

Congress had two major objectives in establishing TRIA. The first was to ensure that business activity did not suffer from the lack of insurance by requiring insurers to continue to provide protection from the financial consequences of another terrorist attack. Since TRIA was enacted in November 2002, terrorism insurance generally has been widely available even for development projects in high-risk areas of the country, in large part because of TRIA's "make available" requirement. Although most businesses are not buying coverage, there is little evidence that development has suffered to a great extent—even in lower-risk areas of the county, where purchases of coverage may be lowest. Further, although quantifiable evidence is lacking on whether the availability of terrorism coverage under TRIA has contributed to the economy, the current revival of economic activity suggests that the decision of most commercial policyholders to decline terrorism coverage has not resulted in widespread, negative economic effects. As a result, the first objective of TRIA appears largely to have been achieved.

Congress's second objective was to give the insurance industry a transitional period during which it could begin pricing terrorism risks and developing ways to provide such insurance after TRIA expires. The insurance industry has not yet achieved this goal. We observed after September 11 the crucial importance of reinsurers for the survival of the terrorism insurance market and reported that reinsurers' inability to price terrorism risks was a major factor in their departure from the market. Additionally, most industry experts are tentative about predictions of the level of reinsurer and insurer participation in the terrorism insurance market after TRIA expires. Unfortunately, insurers and reinsurers still have not found a reliable method for pricing terrorism insurance, and although TRIA has provided reinsurers the opportunity to reenter the market to a limited extent, industry participants have not developed a mechanism to replace TRIA. As a result, reinsurer and consequently, insurer, participation in the terrorism insurance market likely will decline significantly after TRIA expires.

Not only has no private-sector mechanism emerged for supplying terrorism insurance after TRIA expires, but to date there also has been little discussion of possible alternatives for ensuring the availability and affordability of terrorism coverage after TRIA expires. Congress may benefit from an informed assessment of possible alternatives—including both wholly private alternatives and alternatives that could involve some government participation or action. Such an assessment could be a part of Treasury's TRIA-mandated study to "assess…the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program."

Recommendation for Executive Action

As part of the response to the TRIA-mandated study that requires Treasury to assess the effectiveness of TRIA and evaluate the capacity of the industry to offer terrorism insurance after TRIA expires, we recommend that the Secretary of the Treasury, after consulting with the insurance industry and other interested parties, identify for Congress an array of alternatives that may exist for expanding the availability and affordability of terrorism insurance after TRIA expires. These alternatives could assist Congress during its deliberations on how best to ensure the availability and affordability of terrorism insurance after December 2005.

Mr. Chairman, Madam Chairwoman, this concludes my statement. I would be pleased to respond to any questions that you or other members of the Subcommittees may have.

Contacts and Acknowledgements

For further information regarding this testimony please contact Richard J. Hillman or Davi M. D'Agostino, Directors, or Lawrence D. Cluff or Wesley M. Phillips, Assistant Directors, Financial Markets and Community Investment, (202) 512-8678. Individuals making key contributions to this testimony include Sonja Bensen, Rachel DeMarcus, Tom Givens III, Jill Johnson, Barry Kirby, Caitlyn Lam, Tarek Mahmassani, Angela Pun, and Barbara Roesmann.

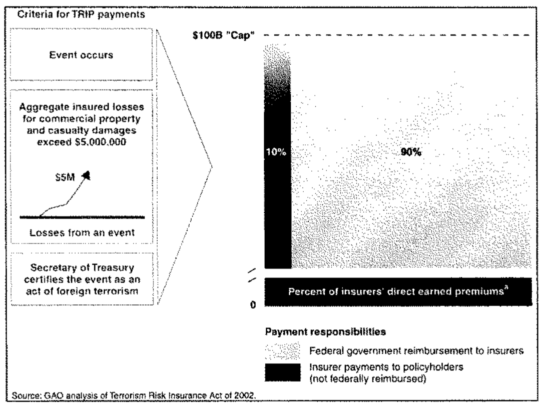
Appendix I: TRIA Background

Under TRIA, Treasury is responsible for reimbursing insurers for a portion of terrorism losses under certain conditions. Payments are triggered when (1) the Secretary of the Treasury certifies that terrorists acting on behalf of foreign interests have carried out an act of terrorism and (2) aggregate insured losses for commercial property and casualty damages exceed $5,000,000 for a single event.[1] TRIA specifies that an insurer is responsible (that is, will not be reimbursed) for the first dollars of its insured losses—its deductible amount. TRIA sets the deductible amount for each insurer equal to a percentage of its direct earned premiums for the previous year.[2] Beyond the deductible, insurers also are responsible for paying a percentage of insured losses. Specifically, TRIA structures pay-out provisions so that the federal government shares the payment of insured losses with insurers at a 9:1 ratio—the federal government pays 90 percent of insured losses and insurers pay 10 percent—until aggregate insured losses from all insurers reach $100 billion in a calendar year (see fig. 1). Thus, under TRIA's formula for sharing losses, insurers are reimbursed for portions of the claims they have paid to policyholders. Furthermore, TRIA then releases insurers who have paid their deductibles from any further liability for losses that exceed aggregate insured losses of $100 billion in any one year. Congress is charged with determining how losses in excess of $100 billion will be paid.

[1]Aggregate insured losses are the sum of insured property and casualty losses from all commercial policyholders that result from a certified act of terrorism.

[2]Section 102(4) of TRIA defines direct earned premiums as "a direct earned premium for property and casualty insurance issued by any insurer for insurance against losses ..." Treasury provided further clarification that direct earned premiums are "earned as reported to the NAIC in the Annual Statement in column 2 of Exhibit of Premiums and Losses (commonly known as Statutory Page 14)" and cover all risks, not only for risks from terrorism. The percentage of the direct earned premium allowed as an insurer deductible varies over the program years: 7 percent in 2003, 10 percent in 2004, and 15 percent in 2005.

Figure 1: Prerequisites for and Limits of Coverage Under TRIA



Source: GAO analysis of Terrorism Risk Insurance Act of 2002.

[a]The percentage of direct earned premiums increases each year: 7 percent in 2003, 10 percent in 2004, and 15 percent in 2005.

TRIA also contains provisions and a formula requiring Treasury to recoup part of the federal share if the aggregate sum of all insurers' deductibles and 10 percent share is less than the amount prescribed in the act—the "insurance marketplace aggregate retention amount." TRIA also gives the Secretary of the Treasury discretion to recoup more of the federal payment if deemed appropriate.[3] Commercial property-casualty policyholders would pay for the recoupment through a surcharge on premiums for all the property-casualty policies in force after Treasury established the surcharge amount; the insurers would collect the surcharge. TRIA limits the surcharge to a maximum of 3 percent of annual

[3]According to Treasury officials, the formula for the mandatory portion of the recoupment is intended to ensure that the insurance industry is financially responsible for a prescribed level of the first dollars of losses. The prescribed loss levels are as follows: $10 billion in 2003, $12.5 billion in 2004, and $15 billion in 2005. Therefore, if the sum of insurers' aggregate payments for deductibles and the 10 percent share—the amounts paid by industry—is less than the level prescribed for that year, then a recoupment would be required to collect the difference. On the other hand, if the amounts paid by industry exceed the prescribed level, then a recoupment would not be needed.

premiums, to be assessed for as many years as necessary to recoup the mandatory amount. TRIA also gives the Secretary of the Treasury discretion to reduce the annual surcharge in consideration of various factors such as the economic impact on urban centers. However, if Treasury makes such adjustments, it has to extend the surcharges for additional years to collect the remainder of the recoupment.

Treasury is funding the Terrorism Risk Insurance Program (TRIP) office operations—through which it administers TRIA provisions and would pay claims—with "no-year money" under a TRIA provision that gives Treasury authority to utilize funds necessary to set up and run the program.[4] The TRIP office had a budget of $8.97 million for fiscal year 2003 (of which TRIP spent $4 million), $9 million for fiscal year 2004, and a projected budget of $10.56 million for fiscal year 2005—a total of $28.53 million over 3 years. The funding levels incorporate the estimated costs of running a claims-processing operation in the aftermath of a terrorist event: $5 million in fiscal years 2003 and 2004 and $6.5 million in fiscal year 2005, representing about 55 - 60 percent of the budget for each fiscal year. If no certified terrorist event occurred, the claims-processing function would be maintained at a standby level, reducing the projected costs to $1.2 million annually, or about 23 percent of the office's budget in each fiscal year. Any funds ultimately used to pay the federal share after a certified terrorist event would be in addition to these budgeted amounts.

[4]"No-year money" is budget authority that remains available for obligation until expended, usually until the objectives for which the authority was made available are attained.

Appendix II: Summary of Completed and Ongoing GAO Work Related to Insurance for Terrorism and Natural Catastrophe Risks

Terrorist attacks and natural catastrophes—such as hurricanes and earthquakes—pose unique challenges to insurers. Forecasting the timing and severity of such events is difficult and the large losses associated with catastrophes can threaten insurer safety and soundness. Insurers also frequently respond to catastrophic events by cutting back coverage significantly or substantially increasing premiums for policyholders. Over the years, several approaches have been suggested to expand the capacity of the insurance industry to cover catastrophic events. These approaches include securitization of catastrophe risk, changing tax and accounting treatment of catastrophe risk, and permitting risk-retention groups to cover property as well as liability exposures. At the request of the Chairman of the House Financial Services Committee and others, we have completed reports that address some of these issues or have work ongoing in these areas. Our work may assist the Committee in its oversight of the insurance industry and consideration of the industry's ability to both insure against and respond to catastrophic events.

Securitization of Catastrophe Risk

Given the enormous financial losses associated with catastrophic events and questions about insurers' ability to cover such losses, interest has been generated in transferring some of these risks to the capital markets, which had total value of about $29 trillion as of the first quarter of 2003. Since the mid-1990s, some insurance companies, reinsurance companies, and capital market participants have developed various financial instruments, the most prevalent of which are catastrophe bonds. [1] These bonds offer a relatively high rate of return to investors that are willing to accept some of the substantial risks associated with catastrophes.

In two previous reports, we assessed the development of the catastrophe bond market.[2] We found that some insurance companies view catastrophe bonds as an important component of their overall strategy for managing natural catastrophe financial risks. In addition, representatives from some institutional investors we contacted expressed positive views about catastrophe bonds because they offer

[1] Catastrophe bonds are an example of risk-linked securities. This statement focuses on catastrophe bonds that are privately placed securities sold to institutional investors under Securities and Exchange Commission Rule 144A. In general, a qualified institutional investor under Rule 144A owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the investor.

[2] See U.S. General Accounting Office, *Catastrophe Insurance Risks: Status of Efforts to Securitize Natural Catastrophe and Terrorism Risk*, GAO-03-1033 (Washington, D.C.: Sep. 24, 2003) and *Catastrophe Insurance Risks: The Role of Risk-Linked Securities and Factors Affecting Their Use*, GAO-02-941 (Washington, D.C.: Sep. 24, 2002).

attractive yields compared to traditional investments and help diversify investment risks. However, other insurers and investors are not willing to issue or purchase catastrophe bonds because they are more costly than traditional reinsurance, too risky, or illiquid. We also reported that developing catastrophe bonds to cover terrorism risks in the United States is considered challenging for many reasons, including the difficulties associated with developing computer models to predict the frequency and severity of terrorist attacks. Sophisticated models have been developed to predict the frequency and severity of natural catastrophes—particularly hurricanes—that have facilitated the development of catastrophe bonds covering such risks.

Tax and Accounting Treatment of Catastrophe Risk

We are currently conducting follow-up work on potential tax and accounting issues raised in our previous reports that might affect the use of catastrophe bonds. As we reported in September 2002, most catastrophe bonds are issued offshore—for example, in Bermuda—rather than in the United States due to favorable tax considerations. Some insurance industry groups have argued for changes in U.S. tax laws to encourage insurers to issue catastrophe bonds onshore to lessen transaction costs and afford regulators greater scrutiny over these activities. As part of our ongoing work, we are reviewing the tax treatment of catastrophe risk coverage in selected European countries. Furthermore, in 2003 we reported that the Financial Accounting Standards Board had issued guidance that may require insurers or investors to list catastrophe bond assets and liabilities on their balance sheets. We reported that this guidance had the potential to limit the appeal of issuing catastrophe bonds but that insurers and financial market participants were not certain of the impact of this guidance. We are continuing to investigate developments on these tax and accounting issues and will discuss them in an upcoming report.

Some believe removing accounting and tax barriers that prevent U.S. insurance companies from establishing tax-deductible reserves to cover the financial risks associated with potential natural catastrophes and terrorist attacks would supplement private-sector capacity. Under current U.S. accounting standards and tax law, insurers must build any reserves for events that have not yet occurred from after-tax income (retained earnings). As a result, insurers do not usually establish reserves in anticipation of catastrophic events, such as hurricanes. Therefore, insurers attempt to limit their exposure to catastrophic risks through the underwriting process, the purchase of reinsurance, or issuance of catastrophe bonds, among other alternatives.

There is considerable disagreement about the appropriateness and effectiveness of tax-deductible reserving. Advocates believe that allowing insurers to establish such reserves would provide increased capacity at lower cost. On the other hand, critics of tax-deductible reserving have argued that, in addition to lowering federal tax receipts, there is no assurance that insurers would actually increase their catastrophe insurance capacity, but rather either shield existing capital from taxes or substitute tax-deductible reserves for reinsurance.

At the Chairman's request, we are currently reviewing the tax treatment of catastrophe risk reserves in selected European countries—-France, Spain, Germany, Switzerland, and Italy. We continue to review these practices and will comment on them in a forthcoming report. In addition to discussing reserving practices, we are gathering information on general approaches to insuring against catastrophic risks in these countries.

Implementation of the Liability Risk Retention Act

Congress enacted the Liability Risk Retention Act of 1986 (Act) to facilitate the formation of risk-retention groups (RRGs) and risk-purchasing groups (RPGs), insurance entities initially established to increase the availability and affordability of liability insurance during the 1980s.[3] As authorized by the Act, these groups may only provide commercial liability insurance. An RRG is simply a group of businesses with similar risks that join to create an insurance company to self-insure their risks. An RPG, on the other hand, is a group formed to purchase insurance as a single entity from a traditional insurer. The majority of our ongoing work focuses on RRGs because, as insurers, they have the potential to provide new insurance capacity. A wide variety of groups, such as professional groups (doctors, attorneys), institutions (universities, hospitals), and businesses (trucking firms, homebuilders) have created RRGs. As of mid-April 2004, about 150 RRGs were operational and approximately 72 were formed in the last year and half.[4] In contrast to most other insurers, an RRG can sell insurance in as many states as it chooses but is to be regulated by only one state—the state in which it is chartered. [5]

[3] The Product Liability Risk Retention Act of 1981 established these groups but limited them to providing product liability insurance. In 1986, in response to another shortage of liability insurance, Congress amended the Act and allowed these groups to offer most types of commercial liability insurance.

[4] Data estimates were provided by the Managing Editor, *Risk Retention Reporter*.

[5]The McCarran-Ferguson Act of 1945 left regulation and taxation of the insurance market to the states. (15 U.S.C. 1011) As a result, states have primary responsibility for regulating the insurers operating in their states and each state has its own insurance department.

Our ongoing work focuses on assessing the extent to which RRGs have met the Act's intent that they increase the availability and affordability of liability insurance. We will also assess how the unique regulatory structure of RRGs—where only one state serves as regulator—has promoted the establishment of RRGs and if this structure has resulted in uneven or ineffective regulation. The recent failure of four RRGs has resulted in some regulators questioning the efficacy of having a single-state regulator and the standards used by some states to charter and regulate RRGs. If we identify any problems as part of our work, we will evaluate what legislative or regulatory changes might be needed. These changes, if needed, could be important whether or not, as some advocates have suggested, the Act is expanded to include commercial property insurance. Finally, in the event the Act were expanded to include property insurance, we also are exploring the potential of RRGs to provide additional capacity for terrorism insurance.

Appendix III: Prior GAO Reports and Testimonies Related to Insurance for Terrorism and Natural Catastrophe Risks

U.S. General Accounting Office, Terrorism Insurance: Implementation of the Terrorism Risk Insurance Act of 2002, GAO-04-307 (Washington, D.C.: Apr. 23, 2004).

U.S. General Accounting Office, Catastrophe Insurance Risks: Status of Efforts to Securitize Natural Catastrophe and Terrorism Risk, GAO-03-1033 (Washington, D.C.: Sep. 24, 2003).

U.S. General Accounting Office, Catastrophe Insurance Risks: The Role of Risk-Linked Securities, GAO-03-195T (Washington, D.C.: Oct. 8, 2002).

U.S. General Accounting Office, Catastrophe Insurance Risks: The Role of Risk-Linked Securities and Factors Affecting Their Use, GAO-02-941 (Washington, D.C.: Sep. 24, 2002).

U.S. General Accounting Office, Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities, GAO-02-472T (Washington, D.C.: Feb. 27, 2002).

U. S. General Accounting Office, Terrorism Insurance: Alternative Programs for Protecting Insurance Consumers, GAO-02-199T (Washington, D.C.: Oct. 24, 2001).

U.S. General Accounting Office, Terrorism Insurance: Alternative Programs for Protecting Insurance Consumers, GAO-02-175T (Washington, D.C.: Oct. 24, 2001).

U.S. General Accounting Office, Insurers' Ability to Pay Catastrophe Claims, GAO/GGD-00-57R (Washington, D.C.: Feb. 8, 2000).

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STATEMENT OF
NEW YORK STATE INSURANCE DEPARTMENT

BEFORE

U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE
ON CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES AND THE
SUBCOMMITTEE ON OVERSIGHT AND
INVESTIGATIONS

APRIL 28, 2004

BY GREGORY V. SERIO
SUPERINTENDENT OF INSURANCE

I. Introduction

There is no question that the world we live in today is vastly different than the one we lived in only a few years ago. What was once possible only in a Tom Clancy novel or a Hollywood production is now being seen on the nightly news on a daily basis. Individuals, groups, networks and tactics that were previously unknown to us are now part of our daily vocabulary. And this is true not just for the citizens of the United States; it is a global phenomenon. Individuals such as Ayman al-Zawahri, groups such as the Moroccan Islamic Combatant Group, alleged to have carried out the Madrid train bombings, concepts of fatwas and jihad, and places such as Fallujah, Iraq and Kandahar, Afghanistan are now household words around the world.

Recognition of this new world that we live in has been acknowledged by Congress through the passage of the Patriot Act and by the President through the creation of the Department of Homeland Security, among other initiatives taken in the last several years. While national security is clearly of paramount importance, Congress and President Bush also recognized, through the passage of the Air Transportation Safety and System Stabilization Act, the September 11th Victim Compensation Fund and the Terrorism Risk Insurance Act (TRIA), the need to protect our critical financial infrastructure in new, and previously unforeseen ways. I applaud the efforts of President Bush and Congress, working together on a bi-partisan basis during this period of national crisis, in successfully delivering the necessary measures to bring about a sense of security and stability to our individual and corporate citizens. While all the actions taken in Washington, D.C.—together with the action of our governors on the state level, are indeed a move in the right direction, we have not yet reached our final destination. Our nation is still in the midst of searching for appropriate and permanent solutions to the challenges brought about by recent events and the rapidly changing dynamics of political and economic risk. We must be steadfast in our mission to protect our way of life, which at times, such as now, requires the making of short and long-term commitments of time and resources, both from the public and private sectors. From a public sector standpoint, it is critical that we address, on a timely basis, any issue that may cause instability to our nation or our national markets. Just as President Bush is advocating for renewal of the Patriot Act to protect the nation from physical threats, our responsibility as legislators and regulators of the financial services sectors is to ensure a timely resolution to the debate surrounding TRIA in order to stabilize and protect our financial marketplace.

Terrorism is a relatively new exposure for the homeland, but not for many other countries in the world. These countries have found permanent solutions to the terrorism exposure and most solutions include some level of public participation. As we deliberate the various alternatives and approaches to taming this exposure, we too need to consider the appropriate role and involvement of the public sector, be it federal, state or local governments.

Today, I will discuss the important provisions and key dates contained within TRIA and its impact on the marketplace. I will also focus on the implications of TRIA expiring at the end of 2005 and discuss alternatives to building capacity in the marketplace.

II. Impact of the Terrorism Risk Insurance Act on the Marketplace

The Terrorism Risk Insurance Act (Public Law No. 107-297), signed by the President in November 2002, was enacted to bolster a private insurance marketplace failing to provide adequate terrorism insurance coverage following the enormous losses of the September 11th atrocities. TRIA was designed to provide a bridge to a time when the private insurance markets were functional again; that is, when the risk from terrorism had abated and/or more long-term private market mechanisms were implemented to better manage the risk of loss from catastrophic hostile events. It was clearly understood that TRIA was intended to be a temporary program designed to stabilize the sectors of the economy that need terrorism coverages to be available at adequate coverage limits and at manageable rates, and stabilize the insurance market by giving the insurance industry an adequate amount of time to redevelop capacity and develop, with government, reliable alternatives in managing these risks. Following TRIA's enactment, terrorism insurance coverage became readily available. The primary reasons TRIA successfully improved the availability of terrorism insurance are:

(1) the program requires that insurers offer terrorism insurance coverage to policyholders on the same terms and conditions as other property and casualty insurance ("make available" provision).

(2) the program requires that the federal government share the risk of loss from certified terrorist attacks with the insurance industry.

Not only has TRIA improved the availability of terrorism coverage, it has contributed significantly to the stabilization of the overall insurance marketplace in the wake of September 11th. While the market has not yet returned to pre-September 11th levels in terms of rates, coverage limits or the balance of admitted and non-admitted market capacity, without TRIA the economic fallout from insurance coverage disruption would have been disastrous. Insurers would have faced the dilemma of either not writing terrorism coverage or exposing their capital to the potentially catastrophic risk of terrorism. TRIA allowed billions of dollars in stalled construction projects to proceed by allowing the project owners to satisfy the insurance coverage requirements imposed by their lending institutions. TRIA also allowed many small businesses to avoid making the difficult choice between "going bare" or closing their doors altogether. However, the crisis is far from over. Businesses that were forced to migrate to the surplus lines market after September 11th and before enactment of TRIA have not yet returned to the admitted market where rates and forms are subject to state supervision. The latest figures demonstrate that these businesses remain in the surplus lines market as excess line premium writings have tripled in New York over the last three years, from about $685 million in 2001 to over $2 billion in 2003.

We have also seen specific instances of businesses written in the surplus lines market where the entire annual premium was deemed by insurers to be fully earned at inception, which prevented such insureds from canceling their policies and shopping for cheaper TRIA coverage (when a premium is fully earned at inception, an insured is not entitled to any refund in the event of cancellation regardless of the length of time the policy is in force). Policies imposing a fully earned premium penalty at inception are not permitted on the admitted side because of state regulation. In New York, the Insurance Department ultimately succeeded in securing a recommendation from the Excess Lines Association of New York that surplus lines carriers would not earn more than 25% of the premium at the inception of the policy, with the exception of premium finance policies which would be subject to the statutory 10% minimum earned premium. It should be noted that the statutory 10% minimum earned premium applies to policies where the premium is financed regardless of whether the policies are placed in the admitted market or the surplus lines market.

As you will recall, the events of September 11th, coupled with an already hardening market, created a sharp constriction in writings of insurance coverages across the property/casualty spectrum. These dynamics were compounded by the fact that reinsurers largely vacated the market for terrorism insurance coverage, creating an acute drain on capacity at the primary level. The market for reinsurance, essential for stability in the primary insurance market, had already begun to tighten prior to the events of September 11th, and, practically speaking, closed down entirely for terrorism coverage thereafter. Primary insurers, unable to spread the risk to reinsurers, resorted to either declining coverage or retaining the risk but charging exorbitant premiums. Commercial risks such as office towers, sports stadiums, government facilities, landmark buildings and other "trophy properties," as well as businesses in close proximity thereto, were unable to procure the necessary coverages at any price. Further, risks located in places like New York, Boston, Washington, Chicago, and other major cities with the most concentration-of-risk issues were hardest hit by the lack of availability of coverage. Most of these risks had to resort to finding limited and overpriced coverage in the surplus lines market.

Lack of coverage also directly impacted the banking, securities and real estate industries as well. Construction projects stalled because project owners were unable to secure appropriate insurance. As a result, lending activities came to a halt.

Concentration of risk issues post-September 11th came to the forefront in the workers compensation area. Workers' compensation carriers, statutorily required to provide "all risk" coverage, are now compelled to consider the affect of a single large employer located in a single facility falling victim to a terrorist attack involving nuclear, biological, chemical or radiological weapons. The realization of this vast and catastrophic loss exposure over an extended period of time has resulted in some stark reversals in the approach to underwriting this coverage. TRIA did not address this issue to the extent it was hoped for by the industry.

Similarly, the Treasury's decision excluding group life insurance from TRIA coverage left a wide gap in TRIA's applicability, as group life insurance shares many of the same concentration of risk characteristics as workers' compensation. While TRIA did not specifically provide coverage for group life insurance, it directed the Secretary to conduct a study, on an expedited basis, to determine whether group life insurance should be included under TRIA. The Secretary, in August 2003, decided against extending coverage, citing no appreciable reduction in the availability of group life insurance coverage for consumers. It is worth pointing out though that, at the same time the Secretary made this finding, he noted that there was a general lack of catastrophic reinsurance coverage for companies that offer group life insurance. This general lack of catastrophic reinsurance cover continues to this day. Without this catastrophic reinsurance cover, carriers will find it increasingly difficult to assume this risk on their own. Therefore, Congress needs to seriously consider mandatory inclusion of group life insurance policies under TRIA in any discussions surrounding its reauthorization.

The immediate effect of TRIA, and for many the singular purpose of TRIA, was that it made terrorism coverage available in the marketplace. The "make available" provision ensured that primary insurers offered terrorism coverage to their commercial insureds and it enabled commercial insureds to make an appropriate business decision as to whether or not to purchase such coverage. TRIA, by appropriately focusing on the insured deciding on whether to buy terrorism insurance rather than the insurer deciding whether to sell it, provided the economy and the industry with a balanced framework to sensibly underwrite the terrorism exposure.

Concerns that have been raised about the level of participation in TRIA may be misplaced for the following reasons. First and foremost, the take-up rate for purposes of terrorism insurance under TRIA is not the proper unit for measurement of its effectiveness or success. Commercial insureds located in low-risk areas, such as rural communities, will naturally decline coverage because the risk of a terrorist event is low. While some may call this adverse selection, this phenomenon is not unique to terrorism coverage and exists in all lines of insurance. Generally speaking, just as a building owner in Manhattan should have no need for crop insurance, a small farmer in an upstate rural community may have no need for terrorism insurance.

Another reason for electing not to purchase terrorism coverage is driven by the cost of the coverage. Businesses typically do a cost-benefit analysis in determining whether or not to purchase any product or service and in this respect, the decision to purchase or decline terrorism coverage is no different. In order for a business to purchase this coverage, the cost of the coverage must be commensurate with the risk of a terrorist event.

Finally, in states that use the Standard Fire Policy, such as New York, any fire loss ensuing from a terrorist attack, whether certified or not, would be covered under the policy, even in situations where the insured has opted not to purchase the TRIA terrorism coverage. The practical effect of some ensuing terrorism losses being covered under the Standard Fire Policy has lessened the demand for TRIA coverage in such states.

For these reasons and as expected, participation in TRIA has been directly proportionate to the perceived need for the coverage. TRIA has operated exactly as Congress intended; those who needed the coverage purchased it; those who did not need the coverage declined it. Those who did take it up represent a significant segment of the economy of each major city in the country.

The participation level in TRIA does not in any way diminish the importance of the "make available" provision and its impact on market stability. During calendar years 2002, 2003 and the first quarter of 2004, mandatory availability of terrorism coverage paved the way for some capacity to return to the marketplace for all lines, not just the property lines. In fact, many in the industry believe that the hard market has peaked and that we are experiencing the beginning of a soft market cycle. I concur with this assessment, but only in part. The rate of premium increases has started to decrease and many lines are beginning to see rate stabilization or decreases. Availability of coverage across all property and casualty lines is easing and underwriting standards are becoming more relaxed, and property insurers are again posting positive operating results.

Policyholders, however, are increasingly concerned that terrorism insurance will again become scarce this year because, even though the terrorism insurance program does not technically expire until December 31, 2005, there are other provisions in TRIA that could result in the program expiring in fact a year earlier than its statutorily prescribed termination date.

TRIA is in its final year of mandatory availability. The "make available" provision, which played no small part in restoring availability to the marketplace, does not apply to calendar year 2005, unless the provision is extended by the Secretary of the Treasury, no later than September 1, 2004, through the final year of the program. Accordingly, I strongly urge the Secretary to extend the "make available" provision through 2005. Current speculation on how the Secretary will rule on this issue is rampant in the industry and the trade press and waiting until September 1, 2004 will cause further uncertainty in, and disruptions to, the marketplace. Moreover, the September 1, 2004 deadline is inconsistent with the operational needs of insurers who may be unable to comply with state mandated timeframes applicable to non-renewal or conditional renewals. Therefore, insurers, unsure about the statutory landscape, are already considering a variety of measures to address this dilemma, including attaching outright terrorism exclusions and conditional or pop-up endorsements to new and renewal policies. I, and my colleagues at the NAIC, stand ready to provide any and all assistance to the Secretary in quickly and effectively resolving this matter. In conjunction with extending the "make available" provision for the final year of the program, the other critical issue that needs to be addressed as soon as possible, and preferably by the end of the year, is Congressional decision on whether or not to reauthorize TRIA and if reauthorized, in what form.

In this regard, TRIA directs the Treasury, in consultation with the NAIC, representatives of the insurance industry and of policyholders, to conduct a study to assess the effectiveness of TRIA and the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of TRIA. To be sure directing a comprehensive analysis of the TRIA program is not only a sound public policy but a very worthwhile market study. The statute, however, requires the Secretary to submit a report to Congress no later than June 30, 2005. The timing of this report is inconsistent with the commercial insurance business cycle and the operational needs of the industry and its customers. Insurers and their commercial policyholders will be required to make underwriting and purchasing decisions as early as the fall of 2004, without the knowledge of whether TRIA will be reauthorized, modified or allowed to expire. Therefore, I urge the Secretary, to expedite the study and issue his report to Congress as soon as possible. Again, I offer my full cooperation and that of the NAIC to the Secretary so that this vital report can be published in time to enable Congress to take meaningful action that will coincide with the market cycle. Again, irrespective of whether TRIA is reauthorized, modified or allowed to sunset, a timely and firm decision from Congress will bring decisiveness to actions in the marketplace.

It should be noted that extending the "make available" provision to the final year of the program without reauthorizing TRIA in some form will create uncertainty in the marketplace. This situation will result in mandatory coverage being offered in policies issued in 2005 that extend into 2006 without the benefit of a federal backstop because the program expires on December 31, 2005. Beginning in 2005, insurers will be compelled to make difficult choices such as excluding terrorism coverage in 2006 through the use of conditional endorsements, not write any property coverage at all, or in states like New

York which have not permitted terrorism exclusions outside the scope of TRIA, write the coverage and expose capital to catastrophic risk.

As I stated earlier, TRIA has fulfilled its overarching purpose of stabilizing the marketplace. Market disruptions have gradually diminished over the 17 months TRIA has been in existence. Coverages have become more affordable. However, pricing for terrorism coverage remains arbitrary and high in many instances. TRIA, by imposing discrete and industry-wide retention levels, should have improved the predictability of rates for the terrorism exposure, however, this is not in evidence in the marketplace. Also, reinsurance for the retention amounts mandated by TRIA continues to be largely unavailable.

Another intended purpose of TRIA was to allow the private market to rebuild capacity to absorb future losses. While most, if not all, of the capital lost on September 11th has been reintroduced into the marketplace, much of that new capital is discriminating capital, not available for underwriting traditional commercial lines, including terrorism. A variety of insurers filed to raise capital by issuing common and preferred stocks and bonds. New capital also began pouring in from investment bankers who traditionally target sectors with the potential for aggressive returns. The post-September 11th environment was a fertile breeding ground for new insurance companies. These companies, not burdened with September 11th losses, benefited from the higher rate levels that prevailed over the last few years. The estimated new capital raised is as much as $40 billion, if not more, with roughly an equal distribution between the primary and reinsurance markets. As the market softens, I expect some capital to shift from niche to traditional markets, but not to cover the risk of terrorism because of its catastrophic nature. And it will be some time before market capacity for traditional lines and a more proportionate allocation of capital between admitted and non-admitted markets are restored to pre-September 11th levels.

The industry itself has failed to use the "breathing room" offered by TRIA to devise innovative, private solutions to address the problems in the marketplace. For example, neither state nor federal law prevents carriers from forming reinsurance pools to address their concerns regarding the deductible and coinsurance requirements specified in TRIA. No such pools have been formed to date. Other pooling arrangements, such as voluntary joint underwriting associations, would have enabled carriers to share the insured exposure, thereby alleviating concentration of exposure concerns. The Department not only invited the industry to form such entities, but also expected a flurry of activity in this regard since the passage of TRIA. It is discouraging that the industry has failed to exploit the full potential of this alternative despite explicit reference to this arrangement in a Department Circular Letter issued December 23, 2002. In order to promote availability, the Department, consistent with the Interim Guidelines issued by the Treasury, clarified in the Circular Letter that a voluntary joint underwriting association or a risk-sharing plan will be considered an "entity" included in the definition of "insurer" under TRIA. No constructive activity in this regard has been undertaken.

While the industry has not pursued some of the discussed alternatives, it is important to note that these alternatives, even if implemented, may not be sufficient to address the terrorism exposure in the absence of some federal participation, be it in the form of an appropriate reinsurance or other pooling mechanism, including syndication, allowing primary insurers to spread the assumed risk to the government as TRIA now provides. Current marketplace dynamics will be seriously and adversely impacted if TRIA, in some form or another, is not reauthorized or if reinsurers that vacated the market for terrorism insurance coverage after September 11th, do not reenter the market. This is borne out by the fact that since September 11th there has been no meaningful coverage available for non-certified acts of terrorism.

III. Coordination between the Treasury and the NAIC

TRIA had as one of its structural underpinnings, the National Association of Insurance Commissioners as an integral part of its implementation. The NAIC began working immediately to assist in the rapid implementation of TRIA. The NAIC's Catastrophe Working Group developed a Model Bulletin in short order that provided immediate and relevant guidance on acceptable methods to implement TRIA. As a member of this working group, the Department participated in the discussions pertaining to the development of the Model Bulletin. The Model Bulletin included model disclosure and notice forms that were subsequently adopted for use by the Department of the Treasury.

The NAIC also created the Terrorism Insurance Implementation Working Group. This working group collaborated with the Treasury on a consistent basis to get the implementation of TRIA right. Working with the Treasury Department, this group reviewed all interim guidance and final regulations prior to promulgation by the Treasury. As chair of the NAIC's Government Affairs Task Force, I have met with several Treasury officials responsible for the implementation of TRIA regarding its impact on the marketplace, including the effects of nonrenewal.

Key decisions were made by the Treasury after first discussing those issues with the working group. For example, the appropriate treatment of residual market mechanisms, captives, self-insured and group life insurance were made by the Treasury after conferring with the NAIC. Ultimately the decision to require captives to participate in the TRIA program was the correct one.

The Department also took decisive action in assisting the insurance industry in the implementation of TRIA in New York. Upon TRIA's enactment, the Department immediately initiated discussions and had several meetings, with insurers, producer groups and business organizations.

With respect to the Model Bulletin, although NAIC drafters made significant attempts to craft a document that could have applicability throughout the United States, and had, through "drafting notes," indicated a number of areas where individual state adjustments might be necessary, the overall guidance being provided appeared to have been crafted from the perspective of those states that had previously approved the use of terrorism exclusions. Since New York was among a handful of states that had not previously approved the use of terrorism exclusions, we found ourselves in a unique situation not fully addressed by the Model Bulletin. Ultimately, New York did not vote in favor of the adoption of the Model Bulletin. In lieu thereof, the Department, in consultation with New York's business community and the insurance industry, developed and issued Circular Letter No. 25 (2002) (copy attached) to address in a more specific manner the pertinent terrorism insurance issues in our State. The Circular Letter garnered strong consensus from insurers, producer groups, business organizations and property owners, as they were involved early in the drafting stage.

Similar to the NAIC's Model Bulletin, Circular Letter 25 provides an overview of TRIA including its "make available" requirements, description of its notice provisions pertaining to the nullification and reinstatement of exclusions, and the disclosure of the premium charged for covered acts of terrorism. The Circular Letter also describes the compensation provisions of the federal program.

In line with the NAIC Model Bulletin and the Treasury Guidelines, the NAIC model disclosure forms are expressly referenced in the Circular Letter for use in New York as safe harbors.

Because New York held the line and did not previously approve terrorism exclusions or limitations, the nullification and reinstatement provisions were not relevant to policies issued in the admitted market. However, to the extent that such exclusions and limitations were in force in the excess line market and in policies issued in the Free Trade Zone, the nullification and reinstatement provisions were applicable. In fact, with respect to the Free Trade Zone, the Department issued an opinion on May 17, 2002 (copy attached) clarifying that although rates and forms used in the Free Trade Zone are not required to be filed, the rates and forms remain subject to the rating and policy form standards set forth in the Insurance Law. Thus, even in the Free Trade Zone, rates cannot be excessive, inadequate, unfairly discriminatory, destructive of competition or detrimental to the solvency of insurers. In addition, policy forms cannot be misleading or violative of public policy.

Circular Letter 25 also covers the filing of policy forms and rates with the Department. TRIA preempted state prior approval or waiting period requirements until December 31, 2003 for terrorism risk insurance covered by TRIA. In our discussions prior to issuing the Circular Letter, some insurer representatives maintained that the federal preemption applied not only to rates and forms intended to provide coverage for terrorism risk but also preempted prior approval of exclusions and limitations pertaining to acts of terrorism. TRIA, however, treated the federal preemption as applying only to rates and forms implementing terrorism coverage, implying that prior approval was required for terrorism exclusions and limitations in accordance with state law. This position was based, in part, on the actual language of the legislation which applied the preemption to "rates and forms for terrorism risk insurance covered by this title." We read this language as clearly relating to the stated objective of TRIA to maintain availability and affordability of terrorism risk insurance through prompt implementation of the coverage and did not see it as designed to facilitate limitations or exclusions that reduced that coverage. This reading was also consistent with the Treasury Guidelines issued on December 3, 2002, which states that an insurer can offer coverage on different terms, amounts or coverage limitations after first satisfying the "make available" requirements of TRIA provided that "such offers do not violate any state laws or regulations." Finally, TRIA preserves the state's authority to engage in a subsequent review of forms implemented pursuant to the preemption.

Similarly, with respect to rates applicable to coverage provided under TRIA, the Circular Letter states that insurers may place such rates into effect without the Department's prior approval, however, it reserves the Department's authority to conduct a thorough review of the data, assumptions and methodologies used in developing such rates.

Given the Department's position on prior approval of terrorism exclusions and limitations, we also clarified in Circular Letter 25 that the Department will consider for approval, on an expedited basis, filings for exclusions and limitations covering certified or "insured losses" under TRIA. Among other things, the Department required that such exclusions and limitations track the language of TRIA and that the insurer first satisfy the "make available" requirements of TRIA prior to implementation of such exclusion or limitation.

The Department also developed a procedure set forth in the Circular Letter covering filings for approval of terrorism exclusions and limitations pertaining to other than insured losses under TRIA or "non-certified losses." These procedures include the filing of rating classifications for approval that identify the basis and rationale supporting the classification. While the Department was, and continues to be, prepared to give due consideration to narrowly defined exclusionary provisions, insurers were cautioned to avoid language defining terrorism that might be interpreted as denying coverage for acts that have traditionally been insured under a policy's vandalism provisions. Similarly, exclusions for domestic acts of terrorism, which are not covered under TRIA, have to be narrowly and precisely crafted in order to distinguish such acts from events that have traditionally been covered within the scope of the vandalism peril.

The Circular Letter also describes, by way of example, acceptable criteria for underwriters to employ in rating, applying exclusions, or establishing sub-limits applicable to acts of terrorism. Unique buildings, occupancy, and security measures are among listed characteristics of a risk's profile that may be given due consideration in developing objective guidelines for limiting coverage.

Finally, with respect to both "certified" and "non-certified losses," the Circular Letter clarifies that TRIA has no impact on coverages provided under statutory mandates. Accordingly, no terrorism exclusion or limitation is permissible for coverage with respect to the peril of fire that is subject to section 3404 of the Insurance Law, motor vehicle liability policies satisfying the financial responsibility requirement of the Vehicle and Traffic Law, including no-fault coverage, and workers' compensation insurance.

Circular Letter 25 was supplemented on February 19, 2003 (copy attached) to provide additional guidance to New York insurers on the method for making appropriate disclosures under TRIA.

There is no question that a productive and effective working relationship has been established between the Treasury, the NAIC and my office. We will continue to capitalize on this relationship in implementing whatever decisions are made at the federal level with respect to stabilizing the marketplace including extension and/or reauthorization of some or all of the provisions of TRIA.

IV. Supplemental and Alternative Solutions

There are various market options that could be considered as Congress deliberates reauthorization of TRIA. Some of these options are available solely to commercial policyholders, while others can be implemented by the industry or the public sector, including state and federal government. The options can be implemented individually or programs can be constructed that combine two or more options, including creating a renewed partnership between the public and the private sectors.

Commercial insureds can and have formed captive insurance companies to insure their own exposures, including the terrorism exposure. A captive insurance company is a subsidiary of a parent corporation that is established to underwrite and manage the risks of its owner and affiliated companies. Many businesses and public entities have seen the benefits that captive insurance companies can offer, such as:

- Reducing insurance costs: A captive saves money through lower overhead than a commercial insurer thus putting a greater percentage of premium dollars into paying claims. Further, a parent of the captive retains all underwriting profits and investment income on loss reserves. A captive also provides direct access to the reinsurance markets.
- Optimizes risk management activity: A captive increases internal focus on risk management and loss prevention, thereby lowering loss costs.
- Provides greater flexibility: A captive affords insurance coverage regardless of market conditions especially when coverage is either not available or is overpriced in the traditional commercial market, conditions we experienced in the wake of September 11th. Also, a captive allows the tailoring of coverage to fit the risks faced by the parent as opposed to a "one size fits all" policy offered by commercial insurers.

New York's Metropolitan Transportation Authority, the parent of New York's first captive insurer in 1997, has experienced all of these benefits. Each day more of New York's businesses and public entities are calling for the ability to form a captive and take advantage of the great benefits of captive insurance. New York has been successful in offering businesses a practical and sensible solution to their risk management strategies and a viable alternative to the traditional insurance markets.

Captives are an ideal vehicle for large commercial entities in securing their terrorism risks. Many captives domiciled in New York have specifically taken advantage of the protections offered by TRIA. Two captives were formed solely to provide TRIA terrorism coverage to their parents while seven other captives included TRIA terrorism coverage along with other traditional coverages. This was only made possible because of the federal backstop and the mandatory inclusion of captives in TRIA coverage by the Treasury in its December 18, 2002 directive. In the absence of a federal backstop or appropriate reinsurance coverage, these captives may not be able to continue providing terrorism coverage to their parents.

The primary industry has few options, but the rate structure, to replenish their reserves after a catastrophic event. Further limitations on this ability are imposed to the extent that past catastrophic losses cannot be included in the loss experience to develop future rates because catastrophes are, by definition, considered isolated incidents not predictive of future loss experience. In addition, many jurisdictions do not allow insurers to include an additional load in the rating formula for future catastrophes. The singularly most empowering tool for the primary industry in creating capacity for catastrophic events would be to enable it to set aside tax-deferred catastrophe reserves. Catastrophe reserves can serve as a supplement or an alternative to the reinsurance markets, which are largely unregulated, and reduce or eliminate capacity crunches after major disasters. This tool is currently unavailable to primary insurers in the United States because the federal tax code does not recognize reserves created for events which have not yet occurred.

This alternative merits serious consideration by Congress because of the significant potential in creating a permanent private market solution in accordance with the Congressional intent set forth in TRIA. While accumulation of sufficient catastrophe reserves will take time, working in conjunction with a federal backstop, we could devise a program that will diminish federal participation to the extent that capacity is being built in the catastrophe reserves. We are cognizant of the budget implications of creating tax-deferred catastrophe reserves, but these implications must be viewed in the context of the diminishing role and the potential removal of the federal government from the backstop program.

Another approach to creating capacity in the marketplace is to allow for, or encourage, syndication. Syndication involves structuring a layered program, vertically and/or horizontally, to cover insureds, locations, or lines of businesses that present a catastrophic exposure. Each layer of the syndicated program could be covered by a different entity, including insureds through retentions and coinsurance, primary insurers, reinsurers, state government, regional state pools/compacts and the federal government. Syndication is particularly well suited for addressing the concentration of risk issue in workers' compensation insurance, the catastrophic nature of a nuclear, biological or chemical event, or exposures with latent manifestation of injury such as asbestos or nuclear radiation. In fact, in New York, Governor Pataki, in his workers' compensation reform bill, has proposed permitting syndication, for workers' compensation, a mechanism historically available to all other lines of property and casualty business.

The primary industry in the U.S. cedes approximately 62% of total business to reinsurers domiciled in foreign jurisdictions, mainly in Europe and Bermuda. These reinsurers are not subject to any domestic regulatory oversight and therefore cannot be required to participate in any remedial efforts to create capacity in the marketplace. Incentives, such as the elimination or reduction of income taxes, may encourage reinsurers to write lines that are critical to a robust insurance marketplace.

V. Conclusion

The stated goal of TRIA is to provide a temporary federal backstop for terrorism-related losses. There is no question that TRIA has had a positive impact on the availability of terrorism coverage, and has provided significant stability to the overall insurance marketplace following the events of September 11th. TRIA offered businesses the opportunity to secure terrorism coverage necessary to complete and expand various projects thereby contributing to the economic recovery that is currently underway. In order to maintain the stability in the marketplace, it is essential that the Treasury Secretary extend the "make available" provision to the final year of the program. If the "make available" provision is not extended, terrorism insurance will again become difficult, if not impossible, to obtain one year before the expiration of TRIA. This could have a devastating impact on our national economy. Either way, this decision must be made as soon as possible so that the insurance industry and their commercial insureds will have sufficient time to issue new or renewal policies and to avoid any disruption in the marketplace.

In addition, Congress needs to consider this year whether to reauthorize TRIA and, if reauthorized, in what form. In making this decision, I urge Congress to consider the alternatives noted above. Catastrophe reserves, for example, may provide the private market with the ability to create sufficient capacity over time which should ultimately reduce, if not eliminate, the federal government's role in providing a federal backstop to the market. Indeed, this may very well be the permanent solution that Congress was looking for when TRIA was first enacted.

If the Secretary decides to extend the "make available" provision to the final year of the program, insurers will be required to offer terrorism coverage to their commercial insureds. This decision will maintain the status quo for another year. However, extending the "make available" provision to the final year without a decision on renewal of the program will create uncertainty in the marketplace. This situation will result in mandatory coverage being offered in policies issued in 2005 that extend into 2006 without the benefit of a federal backstop because the program expires on December 31, 2005. Beginning in 2005, insurers will be compelled to make difficult choices such as excluding terrorism coverage in 2006 through the use of conditional endorsements, not write any property coverage at all, or in states like New York which have not permitted terrorism exclusions outside the scope of TRIA, write the coverage and expose capital to catastrophic risk.

I commit to you here today that the Department stands ready to assist the federal government, the insurance industry and consumers in any way possible to maintain the market's currently stable environment. In doing so, I am hopeful that all parties involved will be mindful of the ultimate goal of this exercise - increasing availability and affordability of terrorism coverage throughout the nation.

Thank you.

TIMELINE OF DEPARTMENTAL ACTIONS FOLLOWING SEPTEMBER 11TH

September 11-16, 2001

- The Department's senior staff operated out of offices in midtown Manhattan, and other functions were transferred to its offices in Albany.
- The Department immediately began assessing how best to facilitate industry response to the affected area, assure the timely payment of claims without dispute, and determine what, if any, solvency implications for insurers might arise through a variety of stress test scenarios.
- Insurance Emergency Operation Center was activated.

September 12,2001

- The Department issues Circular Letter No. 26 pertaining to claims handling and cancellation/non-renewal of policies in the New York Metropolitan area.

September 17, 2001

- The Department re-opened its Manhattan office. On that day, more than half of the Department staff voluntarily reported to work in our downtown Manhattan offices, located just blocks from the World Trade Center.

September 24, 2001

- The Department issues Circular Letter No. 28 authorizing the use of an affidavit in lieu of a death certificate with respect to life insurance claims arising out of the 9/11 disasters in New York City, the Pentagon and Pennsylvania.

September 22, 2001

- The Department issues Circular Letter No. 29 pertaining to New York Insurance Law protections for members of the reserves called to active duty.

September 26, 2001

- Superintendent testifies before the U.S. House of Representatives Committee on Financial Services.

October 5, 2001

- The Department issues Circular Letter No. 30 pertaining to extension of time for execution of certain reinsurance agreements due to September 11, 2001 World Trade Center disaster.

October 16, 2001

- The Department issues Circular Letter No. 31 pertaining to Executive Order blocking property and prohibiting transactions with persons who permit, threaten to commit, or support terrorism.

December 12, 2001

- Superintendent testifies before the New York State Assembly Speaker Sheldon Silver and the Assembly Standing Committee on Insurance.

February 27, 2002

- Superintendent testifies before the U.S. House of Representatives Committee on Financial Services Subcommittee on Oversight and Investigations

October 15, 2002

- Superintendent testifies before the New York State Assembly Speaker Sheldon Silver and the Assembly Standing Committee on Insurance

December 23, 2002

- Department issues Circular Letter No. 25 to provide guidance to the insurance industry on the implementation of TRIA in New York.

January 31, 2003

- Superintendent testifies before the New York State Assembly Speaker Sheldon Silver and the Assembly Standing Committee on Insurance.

February 11, 2003

- The Department approves the first terrorism exclusion for certified acts under TRIA for use in New York.

February 14, 2003

- The Department acknowledges terrorism loss costs for certified acts of terrorism coverage under TRIA as submitted by the Insurance Services Offices (ISO).

February 19, 2003

- Department issues a supplement to Circular Letter No. 25 to provide additional guidance on the implementation of TRIA in New York.

February 24, 2003

- Department approved the New York Compensation Insurance Rating Board's (NYCIRB) method of calculating the terrorism risk charged to workers' compensation insureds. The majority of workers' compensation insurers utilize the NYCIRB's calculations

March 7, 2003

- The Department issues Circular Letter Nos. 5, 6 and 7 pertaining to treatment of policyholders serving in active military duty.

March 24, 2003

- The Department issues Circular Letter No. 8 pertaining to exemption from completion of continuing education requirements for those licensees serving in active military duty.

September 29, 2003

- Superintendent testifies before the Temporary Joint Legislative Committee on Disaster Response and Preparedness and the New York State Senate Standing Committee on Veterans, Homeland Security and Military Affairs.

March 24, 2004

- The Department issues Circular Letter No. 2 pertaining to the Treasury Department's survey on the Terrorism Risk Insurance Program.

American Insurance Association

THE COUNCIL OF INSURANCE AGENTS & BROKERS

Independent Insurance Agent

PCI Property Casualty Insurers Association of America — Shaping the Future of American Insurance

RAA REINSURANCE ASSOCIATION OF AMERICA

UWC - Strategic Services on Unemployment & Workers Compensation

April 8, 2004

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Oxley:

The Terrorism Risk Insurance Act of 2002 (TRIA) provides a federal backstop to the property-casualty insurance system in the event of a major attack by foreign terrorists against a U.S. target. This public-private partnership is working to stabilize the commercial insurance markets that underpin our entrepreneurial, free-market economy. As a result of TRIA, terrorism insurance has been made available to all types of commercial insureds, including those located in high-risk areas.

TRIA was designed to be a three-year program, providing a bridge to the development of a private sector terrorism insurance market. However, at a time when America remains under the constant and very real threat of further catastrophic terrorist attacks, catastrophic terrorism remains an uninsurable risk.

There is strong consensus throughout the insurance industry, and the policyholder community we serve, that extension of the federal backstop (either the current TRIA or a modified program) is necessary for the stability of the insurance market and the protection of the public, because the insurance industry does not have the financial capacity to insure against terrorism without a federal backstop.

Although the current law is scheduled to expire on December 31, 2005, Congress must act much sooner than that time to provide the certainty that is necessary to insurers and policyholders alike as they contemplate multi-year business transactions and financial commitments. State insurance regulators understand this reality and are urging Congress to quickly take up the issue of continuing a federal terrorism risk insurance backstop beyond TRIA's sunset date.

Page Two

Our organizations are committed to working with you, state insurance regulators, and our policyholders in meeting this challenge. While recognizing the enormous challenges that exist with respect to insuring against terrorism, we also remain committed to improving homeland security and facilitating the future development of private market solutions.

Sincerely,

American Insurance Association
The Council of Insurance Agents and Brokers
Independent Insurance Agents and Brokers of America
Property Casualty Insurers Association of America
Reinsurance Association of America
UWC – Strategic Services on Unemployment & Workers' Compensation

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.

CIAT COALITION TO INSURE AGAINST TERRORISM

insure against terrorism.org

American Bankers Association
American Bankers Insurance Association
American Gas Association
American Hotel and Lodging Association
American Public Power Association
American Resort Development Association Resort Owners' Coalition
American Society of Association Executives
America's Community Bankers
Associated Builders and Contractors
Associated General Contractors of America
Association of American Railroads
Association of Art Museum Directors
The Bond Market Association
Building Owners and Managers Association International
Boston Properties
CCIM Institute
Chemical Producers and Distributors Association
Commercial Mortgage Securities Association
Edison Electric Institute
Electric Power Supply Association
The Food Marketing Institute
General Aviation Manufacturers Association
Helicopter Association International
Hilton Hotels Corporation
Host Marriott
Independent Electrical Contractors
Institute of Real Estate Management
International Council of Shopping Centers
The Long Island Import Export Association
Marriott International
Mortgage Bankers Association
National Apartment Association
National Association of Home Builders
National Association of Industrial and Office Properties
National Association of Manufacturers
National Association of REALTORS®
National Association of Real Estate Investment Trusts
National Association of Waterfront Employers
National Association of Wholesaler-Distributors
National Basketball Association
National Collegiate Athletic Association
National Council of Chain Restaurants
National Football League
National Hockey League
National Multi Housing Council
National Petrochemical & Refiners Association
National Restaurant Association
National Retail Federation
National Roofing Contractors Association
National Rural Electric Cooperative Association
The New England Council
New York City Partnership
Office of the Commissioner of Baseball
Public Utilities Risk Management Association
The Real Estate Board of New York
The Real Estate Roundtable
Six Continents Hotels
Society of American Florists
Starwood Hotels and Resorts
Taxicab, Limousine & Paratransit Association
Travel Business Round Table
UJA-Federation of New York
Union Pacific Corporation
U.S. Chamber of Commerce
Westfield

April 28, 2004

The Honorable Richard Baker
Chairman,
Subcommittee on Capital Markets,
Insurance and Government
Sponsored Enterprises
Financial Services Committee
U.S. House of Representatives

The Honorable Sue Kelly
Chair,
Subcommittee on Oversight and
Investigations
Financial Services Committee
U.S. House of Representatives

Re: Joint Hearing: "A Review of TRIA and its Effect on the Economy: Helping America Move Forward"

Dear Chairman Baker and Chairwoman Kelly:

The Coalition to Insure Against Terrorism (CIAT), a broad-based alliance of insurance policyholders, was formed after 9/11 to support the efforts by the Administration and Congress, including the important leadership provided by the House Financial Services Committee, to enact the Terrorism Risk Insurance Act of 2002 (TRIA). On behalf of the 66 trade associations and corporations that make up CIAT, we want to commend your two Subcommittees for holding this hearing on the experience with TRIA so far.

Thanks to your foresight, as well as that of Chairman Mike Oxley and others, in securing passage of this legislation, TRIA has indeed been a success to date. TRIA stabilized the terrorism insurance marketplace and restored capacity that was unavailable, following the tragic events of September 11th, to an enormous portion of the U.S. economy. Terrorism insurance coverage is now generally available and more affordable than before TRIA's enactment, and the law has enabled billions of dollars of previously stalled construction projects and other transactions to go forward by ensuring business continuity that is vital to the nation's overall economic and employment security.

We also commend both of you as well as the other Members of the Committee who have joined the letter last week to Treasury Secretary John Snow urging him to extend the "make available" provision of TRIA. CIAT believes swift

♦ ♦ ♦

1875 Eye Street, NW, Suite 600, Washington, DC 20006-5413
Phone 202-739-9400 Fax 202-739-9401

action is needed by the Treasury Secretary to ensure that this critical component of our nation's terrorism risk insurance law stays in place and that our economy continues to be protected against acts of terror. Unless the Treasury Secretary makes the decision to extend the "make available" provision of the law by September 1, 2004, the market stability we have enjoyed since TRIA went into effect is likely to disappear.

TRIA was designed to provide a temporary bridge to a future environment in which the marketplace for terrorism insurance could function well on its own. Unfortunately, we see little evidence that a private market for terrorism reinsurance is emerging or that the overall terrorism insurance marketplace could function well in the absence of TRIA. Notwithstanding the encouraging signs that TRIA is working for now as intended, CIAT members are increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary moves affirmatively to extend the "make available" provision. If this provision is allowed to expire this year, American businesses face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005. Further, it is likely that the financial markets will react negatively in the final quarter of 2004 to the prospect that insurance may not be available.

Although we had hoped, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would emerge in a post-9/11 TRIA environment, this does not appear to have happened. Consequently, we are seriously concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," significant, comprehensive terrorism insurance for the 2005 marketplace. This is especially troubling since the current marketplace is already handicapped by the unavailability of insurance against biological, chemical, radiological and nuclear events – even though TRIA backstops such events – and the very limited availability of insurance against terrorism not covered by TRIA (so-called "domestic" events).

Recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and comprehensive insurance against terrorism in the years ahead. We urge the Subcommittees to continue their effort to secure an extension of the vital "make available" provision. This will ensure that the insurance industry will be prepared in 2005 to provide American business with one of the critical tools necessary to help protect the American economy and American jobs from the ugly and harmful specter of terrorism.

Thank you very much for your consideration of our views and we look forward to working with the Subcommittees as you continue to examine the performance of TRIA and consider the possibility of renewal or replacement of the Program.

Respectfully yours,

THE COALITION TO INSURE AGAINST TERRORISM

Boston Properties

EDWARD H. LINDE
President & Chief Executive Officer

April 27, 2004

BOSTON, MA
NEW YORK, NY
PRINCETON, NJ
SAN FRANCISCO, CA
WASHINGTON, D.C.

The Honorable Sue W. Kelly
Chairwoman
Subcommittee on Oversight & Investigations
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairwoman Kelly:

I am Ed Linde, President & CEO of Boston Properties. Boston Properties is a Real Estate Investment Trust (REIT) based in Boston, Massachusetts. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance

PRUDENTIAL CENTER • 111 HUNTINGTON AVENUE • BOSTON, MASSACHUSETTS 02199-7610 • TEL 617.236.3326 • FAX 617.536.4233
E-MAIL: ELINDE@BOSTONPROPERTIES.COM • WWW.BOSTONPROPERTIES.COM • BOSTON PROPERTIES, INC. (NYSE: BXP)

Boston Properties

available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Very truly yours,

Edward H. Linde

Equity Office

April 23, 2004

The Honorable Sue W. Kelly
Chairwoman
Subcommittee on Oversight & Investigations
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairwoman Kelly:

I am David Turner, Senior Vice President, Equity Office. **Equity Office Properties Trust is the nation's largest real estate investment trust (REIT) and owner of office properties, with a portfolio of 684 buildings comprising 122 million square feet in 27 metropolitan markets. Equity Office Properties serves more than 9,000 of the most recognized companies in America.** We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with limited private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Equity Office Properties Trust
[illegible] • Fax 312 454 0332 • http://www.equityoffice.com

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

David Turner
Senior Vice President
Equity Office

SIMON
PROPERTY GROUP

April 27, 2004

The Honorable Sue W. Kelly
Chairwoman
Subcommittee on Oversight & Investigations
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairwoman Kelly:

I am Michael D. Horvath, Vice President of Risk Management at Simon Property Group. Simon Property Group is a Real Estate Investment Trust (REIT) based in Indianapolis, Indiana. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

Michael D. Horvath, CHCM, CSE
Vice President, Risk Management

115 West Washington Street • Indianapolis, Indiana 46204 • Phone: 317.636.1600
shopsimon.com.

April 23, 2004

The Honorable Sue W. Kelly
Chairwoman
Subcommittee on Oversight & Investigations
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairwoman Kelly:

I am Chris Yeakey, Risk Manager for Duke Realty Corporation. Duke Realty Corporation is a Real Estate Investment Trust (REIT) based in Indianapolis, IN. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,
Duke Realty Corporation

Chris Yeakey, Risk Manager

LA SALLE HOTEL PROPERTIES

April 27, 2004

The Honorable Sue W. Kelly, Chairwoman
Subcommittee on Oversight & Investigations
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairwoman Kelly:

I am Michael Barnello, Chief Operating Officer of LaSalle Hotel Properties, a Real Estate Investment Trust (REIT) based in Bethesda, Maryland. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

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LA SALLE HOTEL
PROPERTIES

The Honorable Sue W. Kelly
April 27, 2004
Page 2

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

Michael D. Barnello
Chief Operating Officer
LASALLE HOTEL PROPERTIES

** TOTAL PAGE.04 **

ARCHSTONE SMITH

April 26, 2004

Via Fax

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Insurance & Government-Sponsored Enterprises
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairman Baker:

I am Chaz Mueller, CFO of Archstone-Smith. Archstone-Smith is a Real Estate Investment Trust (REIT) based in Englewood, Colorado. We are a publicly traded apartment company (NYSE: ASN) that owns and operates over 87,000 apartment units in major metropolitan areas across the country. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

9200 East Panorama Circle, Suite 400 Englewood, Colorado 80112
Telephone (303) 708 5959 ▪ Fax (303) 708 5999 ▪ archstonesmith.com

Page 2
April 26, 2004

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

ARCHSTONE-SMITH

Charles E. Mueller, Jr.
Chief Financial Officer

CEM:ms

THE ROUSE COMPANY

Thomas J. DeRosa
Vice Chairman
Chief Financial Officer

April 23, 2004

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Insurance & Government. Sponsored Enterprises
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairman Baker:

I am Thomas J. DeRosa, Vice Chairman and Chief Financial Officer of The Rouse Company. The Rouse Company is a Real Estate Investment Trust (REIT) based in Columbia, MD. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

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10275 Little Patuxent Parkway Columbia, Maryland 21044-3412
410-992-6548 Fax: 410-964-3412 E-mail: tderosa@therousecompany.com

The Honorable Richard Baker
April 27, 2004
Page Two

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

Thomas J. Dehm

Taubman

The Taubman Company
200 East Long Lake Rd. Suite 300
P.O. Box 200
Bloomfield Hills, MI 48303-0200
(248) 258-6800

April 26, 2004

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Insurance & Government. Sponsored Enterprises
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairman Baker:

I am Nick Jannone, Director of Risk Management for Taubman Centers. Taubman Centers, Inc. is a Real Estate Investment Trust (REIT) based in Bloomfield Hills, Michigan. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

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Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

400 Centre Street, Newton, MA 02458-2076 tel: (617) 332-3990 fax: (617) 332-2261

HRPT
PROPERTIES TRUST

April 26, 2004

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Insurance & Government. Sponsored Enterprises
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairman Baker:

I am David Hammersley, Director of Risk Management for HRPT Properties Trust. HRPT is a Real Estate Investment Trust (REIT) based in Newton, Massachusetts. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, *a full year earlier* than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance available, primary insurers will not offer, or "make available," terrorism insurance on a going forward basis.

Given your strong support for TRIA, we hope that you and other Members of Congress share our view that recent developments throughout the world only underscore the importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

HOST MARRIOTT
CORPORATION

April 27, 2004

The Honorable Richard Baker
Chairman
Subcommittee on Capital Markets, Insurance & Government Sponsored Enterprises
Committee on Financial Services
US House of Representatives
2129 RHOB
Washington, DC 20515

Dear Chairman Baker,

I am Gus Napoli, Vice President, Risk Management of Host Marriott Corporation. Host is a Real Estate Investment Trust (REIT) based in Bethesda, Maryland. We greatly appreciate your efforts to enact the Terrorism Risk Insurance Act (TRIA). Thanks to your indispensable leadership in securing passage of this legislation, TRIA has been a success. TRIA has stabilized the terrorism insurance marketplace and restored capacity that previously was unavailable to many REITs and other public companies, thereby ensuring business continuity that is critical to the nation's overall economic and employment security. Host has found that the cost of terrorism insurance has decreased significantly, and availability is much greater than what it was prior to TRIA.

Notwithstanding the encouraging signs that TRIA is working, our company is increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of the Treasury moves affirmatively, by September 1, 2004, to extend the so-called "make available" provision of TRIA. If this provision is allowed to expire this year, REITs face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether, ***a full year earlier*** than the statute's termination date at the end of 2005.

This is because, absent such an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance, and because the private market for terrorism reinsurance below the federal trigger has failed to develop in a sufficient manner.

Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would re-emerge, this does not appear to have happened. Consequently, we are concerned that with the absence of a "mandate" in 2005 under TRIA and with a paucity of private market reinsurance

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importance of TRIA today and the economic imperative of affordable and available insurance against terrorism tomorrow.

Accordingly, we respectfully urge you to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year.

Respectfully yours,

Gus Napoli
Vice President, Risk Management
Host Marriott Corporation

Group Life COALITION
Providing Security When It Matters Most

A·C·L·I AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

THE FINANCIAL SERVICES ROUNDTABLE

Date April, 27, 2004

The Honorable Michael G. Oxley
Chairman, House Committee on Financial Services
2128 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Oxley:

The American Council of Life Insurers, the Financial Services Roundtable and the Group Life Coalition write to you as Congress begins to hold hearings on the Terrorism Risk Insurance Act of 2002 (TRIA). The Group Life Coalition is a group of insurers who provide the protection of group life insurance as an employee benefit for over 156 million Americans.

We join with other insurance and financial services groups, building industries and labor unions and all state insurance commissioners in strongly urging the extension of TRIA. This legislation produced a public-private partnership that has created stability in certain high-risk insurance markets that could not otherwise cover properties for catastrophic terrorist events. As the current law is set to expire on December 31, 2005, we urge Congress to act expeditiously so that pending multi-year business contracts and financial agreements can move forward in the stable insurance market environment afforded by a federal reinsurance backstop.

We also call on Congress to expressly include group life in the TRIA program. As Congress moves to extend TRIA, we need to insure the people inside the buildings, too. Group Life is like workers compensation in that it is a basic benefit to vulnerable highly concentrated workers and it is coverage for which there are no exclusions allowed.

Congress approved the inclusion of group life into the TRIA program in 2002. As drafted, TRIA provided the Treasury Department with broad authority to study and decide on "an expedited basis" whether "adequate and affordable" catastrophe reinsurance was available to group life insurers and to what extent the threat of terrorism

The Honorable Michael G. Oxley
April 27, 2004
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was reducing the availability of group life coverage to consumers in the United States. Congress' concern regarding the adequacy and affordability of catastrophe reinsurance was not limited to only present market conditions but extended to a determination whether group life insurance *will not be in the future* reasonably available to both insurers and consumers. Unfortunately, the Department has only pledged to continue to monitor conditions and developments.

After more than two years, the catastrophe reinsurance market for group life is either not available or remains prohibitively expensive and often contains terrorism exclusions or specific nuclear, biological and chemical exclusions with no other private sector alternatives having yet emerged. It was our firm judgment then and now that there remains a need for the inclusion of group life into a federal reinsurance program for acts of terrorism. Federal policymakers need to make sure that the buildings AND the lives in those buildings are properly covered in the case of another terrorist attack. Moreover, we remain concerned that group life insurance for specific workers, most notably first responders, or those in landmark buildings and certain metropolitan areas remains available and affordable.

Historically, it has often been the case that the prospect of uncontrolled risk exposure has affected insurance markets adversely, at times leading to dramatically higher prices, more restrictive underwriting and/or reduced availability as some companies have been influenced to limit their exposure by exiting affected markets.

The results of a decision to exclude group life from the program would be more severe in the event of another terrorist attack. Primary group life insurers that stay in the market without reinsurance coverage could face significant losses and solvency concerns and claims payment problems. The impact on consumers could be immediate. The Congress and the Administration certainly do not want to be put into a situation where they has to explain why a solution was not put into place in advance despite Congressional approval in 2002 to do so.

We believe the most prudent course of action to protect consumers and providers of group life insurance is to provide a mirror federal reinsurance program modeled on the property and casualty program but reflecting the relative scale of the group life market and industry surplus. Baring a catastrophic event an affirmative decision does not increase the total financial exposure of the Treasury to new cost yet allows private reinsurers to handle a sizable market and primary insurers can stay the course. If there is a terrorist attack, the federal government's cost would be defined and limited, solvency and claims concerns would disappear and the Administration would have acted decisively during the highest threat level in our nation's history.

The Honorable Michael G. Oxley
April 27, 2004
Page Three

The Group Life Coalition stands ready to work with you, your staff, Congress and the Administration to address this imbalance in the group life reinsurance market. Moreover, we remain committed to seeking private market solutions that address the risk of catastrophic terrorist events.

Sincerely,

Group Life Coalition
American Council of Life Insurers
Financial Services Roundtable

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

April 22, 2004

The Honorable John Snow
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Secretary:

We commend you for your stewardship of the Terrorism Risk Insurance Program, which was established by Congress under the Terrorism Risk Insurance Act of 2002 (TRIA). The Department of the Treasury has done a great service to the Nation by ensuring the continued availability of coverage for terrorism risks.

We are encouraged that TRIA helped promote the availability of insurance for economic development in the aftermath of the attacks of September 11, 2001. With TRIA, building projects and real estate transactions that would not otherwise have been possible have proceeded because of the availability of terrorism insurance coverage. Jobs were created when our economy needed them most.

As you know, the "make available" provision of TRIA is scheduled to expire at the end of 2004. We urge you to extend this provision. An extension will ensure that terrorism coverage is widely available while Treasury continues its good work and while private market solutions are still being developed.

In closing, we look forward to working with you to ensure that our nation has every benefit of a stable system of insurance against terrorism.

Yours truly,

[illegible]	Tim Murphy
Bob Ney	Judy Biggert
[illegible]	TOM FEENEY
[illegible]	Patrick J. Tiberi
Scott Garrett	Ginny Brown Waite
[illegible]	Paul Gillmor
[illegible]	Mark Kennedy

MORTGAGE BANKERS ASSOCIATION
Investing in communities

Statement Of The Mortgage Bankers Association

Joint Hearing
Of The
House Financial Services Committee's
Subcommittee On Capital Markets, Insurance,
And Government Sponsored Enterprises
and
Subcommittee On Oversight and Investigations

"A Review of TRIA and its Effect on the Economy:
Helping America Move Forward"

April 28, 2004

The Mortgage Bankers Association (MBA)[1] applauds the leadership of Chairman Baker, Chairman Kelly, Representatives Gutierrez and Kanjorski and the Subcommittees on Capital Markets and Oversight for examining the economic impact of the Terrorism Risk Insurance Act of 2002 (TRIA). The security of our nation is on everyone's mind, and TRIA is a critical component of America's economic defense against terrorism.

MBA is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Our membership of approximately 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies, pension funds and the issuers and servicers of mortgage-backed securities. The members of MBA provide over 70% of the nation's residential mortgages and the vast majority of its commercial mortgages. TRIA's effect on American economic growth is therefore a crucial issue for MBA's members.

Additionally, MBA is part of the 66-member Coalition to Insure Against Terrorism (CIAT). CIAT represents a wide range of businesses and organizations throughout the transportation, real estate, manufacturing, construction, entertainment and retail sectors.

MBA strongly supports the extension of TRIA's "make available" requirement, so that a federal reinsurance program is provided through December 2005, as originally intended by Congress. If the Treasury Department does not extend the "make available" language by September 1, insurers will not be required to offer terrorism coverage after December 31, 2004. Several insurers are already reacting to the prospect that the provision will not be extended and are only renewing policies that expire in June 2004 for six months, in lieu of the traditional one year period. MBA has urged the Administration to extend the "make available" language under TRIA so that coverage will be offered through the end of 2005. Thereafter, MBA strongly supports the extension of the TRIA program beyond its 2005 sunset or the development of another comprehensive federal approach to address the problem of terrorism insurance for commercial and multifamily real estate.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

MBA stood with the Congress, President Bush and the Administration to pass TRIA in November 2002. The need for TRIA was compelling. After the terrorist attacks of September 11, 2001, insurance coverage for potential losses from terrorism was largely unavailable and, when available, extremely expensive and often inadequate. A 2002 MBA survey of commercial mortgage originators demonstrated that approximately $8.5 billion worth of transactions during the first half of 2002 had not been consummated; were delayed; or suffered adverse pricing changes due to the lack of terrorism insurance. Also during 2002, Moody's and Fitch downgraded or placed on their watch lists approximately $7.5 billion in commercial real estate securities due to concerns about inadequate terrorism insurance.

Before the enactment of TRIA, major lenders reconsidered their willingness to invest in locations and properties considered high risk. In 2004, MBA surveyed its 40 largest commercial and multifamily mortgage banking members on terrorism insurance and TRIA. In the past year, these firms financed over $115 billion in real estate debt. Of the 29 firms responding to the poll, 79% said that the absence of terrorism insurance before TRIA's passage had delayed or prevented commercial real estate transactions. In short, pre-TRIA uncertainty about the availability and adequacy of terrorism insurance threatened significant economic activity and compromised the strength of the real estate sector, which represents 10% of U.S. gross domestic product and employs 8.7 million Americans.

The evidence indicates that TRIA has brought greatly needed stability to the insurance market. Of the leading commercial and multifamily lenders who responded to MBA's 2004 survey on TRIA, 96% stated that the program has made terrorism insurance more widely available. Of the lenders who responded to a question about TRIA's effect on insurance pricing, approximately 75% said that TRIA has made terrorism coverage less expensive.

At the same time, there is compelling evidence that the private sector cannot supply adequate terrorism coverage without a federal backstop. A private reinsurance market for terrorism coverage has not emerged, according to a recent survey conducted by the Council of Insurance Agents and Brokers (CIAB). It is anticipated that without a federal terrorism reinsurance program many carriers will stop writing coverage against foreign terrorist attacks. The limited availability of coverage against domestic terrorism attacks, which are not covered by TRIA, is instructive. CIAB reports that coverage against domestic terrorist attacks is usually available only for smaller- to medium-sized risks, leaving high-risk properties and locations unprotected.

If the TRIA program expires, a significant coverage gap can be expected for insurance against foreign terrorist attacks. The properties that will be most affected by the absence of a federal reinsurance program are all facilities considered high risk by the insurance industry. This includes key infrastructure such as power plants, bridges and water treatment facilities; as well as government buildings, airports, public transportation networks, properties in the central business districts of major cities, stadiums, major sports facilities, schools, malls and hotels.

The stability of the capital markets also will be adversely affected if TRIA's "make available" language is not extended or if TRIA is allowed to sunset. MBA's recent conversations with industry experts indicate that the lack of federal terrorism reinsurance would more than likely result in downgrades of commercial mortgage-backed securities (CMBS) and that the rating agencies would respond in a fashion very similar to pre-TRIA passage, when billions of dollars in CMBS debt were downgraded or placed on watch list. A substantial number of AAA-rated CMBS are almost certain to be downgraded if TRIA's "make available" language expires or if TRIA sunsets. Moody's Investors Service has noted that a "current Aaa rating, in our opinion, should reflect confidence through the term of the loan that necessary insurance will be available. If it is likely that terrorism insurance were to casually evaporate 30 days after an attack (most standard policies had 30-day cancellation clauses), Moody's would lack confidence in the longevity of its current ratings."[2]

The absence of terrorism insurance is also likely to cause institutional investors such as life insurance companies and pension funds to withdraw capital from projects and locations considered high risk. Prior to TRIA's passage, industry participants reported to MBA that many institutional lenders were prepared to reduce or discontinue commercial real estate lending activity in high risk areas if terrorism insurance were not available.

Thus, the failure to extend TRIA's "make available" language or to maintain a federal program if TRIA should sunset, is likely to make commercial real estate capital less available and more expensive, a situation that would threaten the economic recovery now underway and jeopardize the employment of millions of Americans.

As President Bush stated in mid-April, world events require that America be prepared for foreign-origin terrorist attacks within its borders. The nation's defenses must include the capacity to rebuild in the wake of an attack.

The failure to insure commercial and multifamily real estate against foreign terrorist attack would have stark economic consequences:

- Terrorism insurance ensures that funds are available to rebuild apartment and commercial space damaged or destroyed in a foreign terrorist attack. Without TRIA, it would be far more difficult to get

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[2] Moody's Investors Service, Structured Finance Special Report, *CMBS: Moody's Approach to Terrorism Insurance After the Federal Backstop*, January 6, 2003.

Americans re-housed or back to work after a terrorist attack. TRIA and terrorism insurance are essential to defending America against the physical and economic consequences of terrorism.

- If widespread terrorism insurance is not in place, areas adjoining or surrounding an attack site are also at risk. In the event of an uninsured attack, the ensuing damage will blight the surrounding area, making nearby commercial properties difficult or impossible to lease and further disrupting economic activity. Widely available terrorism insurance is needed to rebuild damaged areas as rapidly as possible so that economic activity resumes as fast as possible.

TRIA represents a public/private partnership to share the cost and administrative requirements of insuring American commercial and multifamily real estate against foreign terrorist attack. A federal role is appropriate at this time because the private market has not evolved sufficiently to assume this burden in its entirety. If TRIA's "make available" language is not extended, or if the federal program sunsets before the private market gap is breached, this burden will fall *completely* on the public sector.

As President Bush and National Security Advisor Condoleezza Rice have stated so eloquently, we all would have moved heaven and earth to have prevented September 11. We can't undo the events of that tragic day, but we can prepare for the future.

The extension of TRIA's "make available" language is needed urgently before September 1, 2004. Thereafter, the reauthorization of TRIA or the development of an alternative federal approach will be required until the private market develops. To do less would be to compromise our vigilance against terrorism, to cast a shadow across America's economic recovery, and to fail to secure our nation against the physical and economic consequences of another attack.

MBA stands ready to assist these Subcommittees and the entire Congress as you examine TRIA and consider its extension or reauthorization.

NAIC

making progress . . . together

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

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WORLD WIDE WEB

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April 6, 2004

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Oxley:

We are writing to urge action by the Congress this year on a federal solution to ensure continued marketplace stability when the Terrorism Risk Insurance Act of 2002 (TRIA) expires at the end of 2005.

Access to insurance is essential to business confidence and continued economic growth. Some terrorism risks may be largely uninsurable without a backstop. The members of the National Association of Insurance Commissioners (NAIC) are extremely concerned that significant market disruptions will develop before TRIA's expiration.

The commercial insurance business cycle operates in such a way that insurers and their policyholders will be required to make decisions as early as this September that will affect coverage well into 2006. Annual policy renewals with effective dates of January 2, 2005 or later will have to contemplate no federal backstop for any losses in 2006. For this reason, we fully anticipate conditional exclusions for terrorism coverage will be introduced into these renewal policies on a widespread basis. This is the same situation we encountered in the aftermath of September 11 and which in large part prompted TRIA's enactment.

Not knowing if a federal backstop will be available will dictate business decisions well before the Treasury Department's June 2005 report to Congress on these issues.

We strongly urge Congressional action this year to avoid the market disruptions that will occur in the absence of a federal backstop program. Such action will ensure the insurance market's continued role supporting economic development. In addition, it will allow the Congress the time it needs to fully evaluate the Treasury Department's June 2005 report and recommendations.

Page 2

We stand ready to work with you to address this issue of great importance to our nation's economic security.

Sincerely,

Ernst Csiszar
Director, South Carolina Insurance Department
NAIC President

Gregory V. Serio
Superintendent, New York Dept. of Insurance
Government Affairs Task Force Chair

Donna Lee H Williams

Donna Lee Williams
Commissioner, Delaware Dept. of Insurance
TRIA Working Group Chair

José Montemayor
Commissioner, Texas Dept. of Insurance
Property and Casualty Committee Chair

cc: The Honorable John Snow

STATEMENT OF

THE AMERICAN COUNCIL OF LIFE INSURANCE

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

AND THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE
COMMITTEE ON FINANCIAL SERVICES
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

ON

"A Review of TRIA and its Effect on the Economy: Helping America Move Forward."

April 28, 2004

The American Council of Life Insurers represents three hundred sixty-eight (368) legal reserve life insurance companies operating in the United States. Of these companies, three (3) are domiciled in Canada. These 368 companies account for 69 percent of the life insurance premiums, 76 percent of annuity considerations, 53 percent of disability income insurance premiums, and 72 percent of long-term care insurance premiums in the United States among legal reserve life insurance companies. ACLI member company assets account for 71 percent of legal reserve life insurance company total assets. The Council appreciates this opportunity to communicate its perspective on this important matter to the Congress.

The American Council of Life Insurers supports reauthorization of the Terrorism Risk Insurance Act (TRIA). There is no doubt that the United States is at war with international terrorists and that substantial risk persists of future attacks upon the United States that could result in substantial mortality. This is especially true if such attacks are nuclear, biological, chemical or radiological (NBCR) in nature. Every department of the federal government is aware of the implications of heightened risks to American security. Thus it is advisable to extend the benefits of the existing federal program, which has provided stable property and commercial markets supporting continued economic growth. The experience of the TRIA has been useful both in delivering immediate benefits as well as in revealing program deficiencies that might be addressed in congressional reauthorization. Inasmuch as the TRIA provides differentiated guidance to the Treasury Department between Group Life and Individual Life insurance, the ACLI comments upon both of these lines of insurance.

Individual Life and Other Lines

It is prudent for the federal government to consider the benefits of a federal backstop for individual life and individual disability, and a potential design for a market stabilization mechanism should be prepared for a future terrorist event of such catastrophic proportions that its utilization becomes necessary. TRIA provided for a study of such a scenario. In particular, TRIA § 103(i) provides that the Secretary of the Treasury study the potential effects of acts of terrorism on the availability of life insurance and other lines of insurance coverage, and report to Congress by September 2002. ACLI is unaware whether the Treasury accomplished its task in this regard. If not, the nation is no better prepared in this important area than it was at the time TRIA was enacted. Appended to this statement is the principal information ACLI contributed to the Treasury study in August of 2002.

Group Life Insurance

TRIA § 103(h) separately required the Treasury to study, on an expedited basis, whether adequate and affordable catastrophe reinsurance for acts of terrorism is available to life insurers that issue group life insurance, and the extent to which the threat of terrorism is reducing the availability of group life insurance coverage for consumers in the United States. Unlike the study of individual life insurance mandated by the statute, the Treasury was specifically granted additional authority to extend the Terrorism Risk Insurance Program (TRIP) to group life insurers to the extent that it determined that such coverage is not *or will not be* reasonably available to *both* insurers and consumers (emphasis added).

The ACLI provided the Treasury in January 2003 with what we believe to be convincing evidence that catastrophe reinsurance for acts of terrorism – and especially NBCR events – had become substantially unavailable or unaffordable. Numerous communications between the ACLI and Treasury officials convinced the industry that inclusion of group life insurance in the TRIP was imminent. Instead, ACLI was surprised to learn in August of 2003 that Treasury would not include group life but instead merely continue its studies of the market and the implications of terrorism. This decision not to make a decision did not help to bring reinsurance back to the group life insurance market.

The result is a market that is nervously stable only because there has not been another attack by terrorists within the United States. But the Congress wisely requested the Treasury to extend the federal program if it determined that such coverage is not *or will not be* reasonably available to both such insurers and consumers. Whereas the Treasury looks at the current market and sees stability even in the absence of catastrophe reinsurance, it failed *to look forward and prepare* for the market dislocation that can be expected if another significant attack within the United States occurs. This failure is contrary to the guidance of TRIA and contrary to the planning and preparation that is underway in every other department of the federal government.

The Treasury acknowledges that no catastrophe reinsurance exists today but finds that group life insurance remains available today, thus concluding it to be unreasonable to believe there will be no availability tomorrow despite the lack of catastrophe reinsurance. ACLI argues that there is no catastrophe reinsurance today and there will be none tomorrow because the terrorism risk is fundamentally uninsurable. Consequently, carriers are "betting the company" that there will be either no more catastrophes or that there eventually will be a federal backstop established. The Homeland Security and Defense Departments indicate a high probability of future attacks while the Treasury feels either that there will none or that, even if there are other attacks, industry will somehow manage. The ACLI has notified Treasury about the dissonance in Administration agency policy perspectives but without apparent effect.

Hence, the ACLI supports reauthorization of TRIA and recommends Congress expressly include group life insurance in the reauthorized program in order to address the unavailability of catastrophe reinsurance and to prepare a mechanism that will calm life insurance markets should another attack occur. If no attack occurs, there will be no expense to government or industry. If an attack does occur, group life will be covered by TRIP and insurers will be able to maintain protections for American workers and their families, most of whom are covered by group life insurance plans.

We appreciate the opportunity to bring these issues to the attention of the subcommittees.

Accompanying Documents:

- ACLI Comments on Group Life Insurance Study pursuant to 67 Federal Register 76208 (12/11/02), Terrorism Risk Insurance Act, P.L. 107-297, Section 103(h), 10 January 2003
- ACLI Comments on Treasury Study of Individual Life Insurance and Other Lines, Letter to Ms. Lucy Huffman, Office of Microeconomic Analysis, Treasury, 13 August 2003

For further information contact:

Allen Caskie, VP Financial Services
American Council of Life Insurers
202-624-2111, or

Michael Lovendusky, Senior Counsel
American Council of Life Insurers
202-624-2390.

A·C·L·I AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

10 January 2003

Department of the Treasury
Departmental Offices
grouplifestudy@do.treas.gov
Washington DC

RE: Comments on Group Life Insurance Study
67 Federal Register 76208 (12/11/02)
Terrorism Risk Insurance Act, P.L. 107-297, Section 103(h)

Ladies, Gentlemen:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment upon the expedited study of whether adequate and affordable catastrophe reinsurance for acts of terrorism is available to life insurers that issue group life insurance, and the extent to which the threat of terrorism is impacting insurance and financial markets absent adequate private and public based safety nets. The ACLI represents 399 legal reserve life insurance companies operating in the United States. The companies account for 76 percent of the life insurance premiums and 75 percent of the total assets of such life insurers. This commentary begins with an overview of ACLI perspective, provides general observations regarding the challenges confronting life insurers, and then responds to the questions enumerated in the Notice and Request for Comments.

Overview

The stability of the insurance industry and its role in the national economy is premised on the faith of employers, employees and investors in the ability of insurers to deliver promptly on their promises – no matter the severity of the loss of life. The life insurance industry did deliver as promised in the days following September 11, 2001. The fundamental purpose of this submission is to assure that the life insurance industry can continue to deliver on its promises in the environment now confronting us.

Before 9/11, the insurance industry did not price for risks of terrorism. Since 9/11, we know this risk is very real. Pricing for it is not possible because neither the likelihood nor the severity of terrorist attacks can be actuarially predicted. At the same time, in the interest of public policy, insurance regulators disallow insurance policies from excluding terrorism risk, including nuclear, biological, chemical or radiological risk ("NBCR"), notwithstanding the industry's inability to price for it. Since risk cannot be eliminated or capped in this context, a government terrorism risk insurance backstop is the only option to protect the long-term viability of the life insurance industry.

Terrorism risk must be addressed in advance of a catastrophic loss that would otherwise

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become a solvency issue for the entire industry. Group life insurance is the right starting point because of its disproportionate concentration of risk and because of the fundamental importance of the product. In many cases, group life insurance is the only insurance on the lives of middle and lower income American employees.

Both the aggregate amount of life insurance losses due to terrorism and their potentially uneven distribution among companies must be addressed. First is the potential for a loss -- or series of losses -- so large that it destroys the ability of the industry to replace capital and remain a viable provider of life insurance coverage. Second, an individual company can face financial impairment or bankruptcy from one or more events that impacts it disproportionately. Up to a point, industry risk sharing and pooling arrangements may be able to address threats to individual company solvency. For group life insurers today, there are no risk sharing mechanisms to deal with large-scale terrorism risk. The new law gives Treasury authority to include group life insurance in the three-year federal program. Group life insurance should be included now. Treasury should then use its authority to study life insurance to determine an appropriate federal risk insurance program for all insurance.

General Observations

In the event a government insurance backstop is not available when terrorist losses of a certain magnitude threaten the ruin of either the entire industry or a significant number of companies, the potential consequences are: (1) the life insurance industry ceases to function – either entirely or in its ability to provide future group life insurance coverage; and (2) the insurance market is dislocated – to the extent the risk of industry ruin impedes development of traditional risk pooling mechanisms.

Critical to the payment of hundreds of million of dollars in life insurance to those loved by the victims of 9/11 was a seamless, efficient and well capitalized worldwide reinsurance market. The challenge was the greater because the loss of life was concentrated in a small geographic area that housed employers, each of which had hundreds of employees on the premises.

This concentration of risk is characteristic of group life insurance. In many instances, employers have thousands of employees concentrated in a discrete space. Until 9/11, the life insurance industry in the United States had never experienced nor anticipated such a concentrated loss of life and the need to respond instantly to keep its promises to the employees and their families, so as to maintain the faith of the American public. The presence or absence of appropriate safeguards in the future has a profound effect on the confidence of all Americans in the nation's life insurance industry. They are unlikely to appreciate the distinction between promises made to them in their insurance policy, be it a group policy or an individual policy.

The terrorist attack of 9/11 profoundly changed traditional risk assessment, increasing the perceived value of catastrophe reinsurance at the same time that insurers have become unable to obtain at any price the levels of protection they enjoyed prior to 9/11. The risk that a future terrorist attack will result in even greater loss cannot be ignored. Loss-of-life scenarios unimaginable two years ago are now entirely plausible. For example, in a scenario discussed in more detail below, roughly $200 Billion of group life insurance is in force in Los Angeles County, a number that exceeds the entire surplus of the life insurance industry. A concentrated attack on Los Angeles could prove ruinous. No one can predict if, when, or where another terrorist attack will take place, but the risk of a given insurer being unable to pay benefits quickly without disrupting the capital markets, in which life insurers own $3.2 Trillion in assets, is very real today. Reinsurance they can obtain now, if available at all, is far more limited and expensive.

Because no one can know if, when, or where the next attack may occur, each insurer must limit its risk concentration, reduce limits, or have assurance that there is a safety net available if and when needed. The arbitrary nature of the risk that each group writer faces was demonstrated on 9/11, when one member company was called upon to process quickly more than 900 death benefit claims totaling $143 million, with its worldwide network of reinsurers then reimbursing it $137 million. Reinsurance comparable to that protecting the company on 9/11 is no longer available.

The United States government warns that future significant terrorist attacks remain likely. Indeed, the President recently made smallpox vaccine available to the citizenry and mandated the inoculation of our armed forces. The re-appearance of traditionally priced catastrophe reinsurance at necessary levels of coverage is remote. In sum, increased retained risk, increased charges for the limited available reinsurance, and reduced competition will result in greater group life insurance costs to employers. If the anticipated cost increases occur, they may have a more significant societal cost than merely increased premiums to employers, as it seems inevitable that cost conscious employers will respond by reducing or eliminating the only life insurance protection available to a majority of American families.

Impact on Insurance Availability and Affordability Versus Potential for Industry Insolvency

Property and casualty insurers sustained losses estimated at $35-55 Billion from 9/11. While such loss did not ruin the industry, it dislocated primary commercial property insurance markets and had an adverse impact on employment and business viability. Champions of the legislation that became the Terrorism Risk Insurance Act, including the President, frequently cited the deleterious effect on economic growth attributable to the losses sustained by the property and casualty insurance industry on 9/11 and the absence of insurance for new projects. That is, the impact of 9/11 so affected the availability and affordability of certain lines of property and casualty insurance that the dislocation was perceived to affect that national economy.

Treasury's questions regarding group life insurance are representative of the considerations regarding the provision of a government backstop to the property and casualty insurance industry. Group life insurance shares a number of characteristics that are similar to those of property and casualty insurers. For example, group life insurers often cover geographically concentrated risks, many in iconic buildings, plants, factories and installations. Group life insurers, like property and casualty insurers, also purchase reinsurance annually.

Another important similarity of group life with property and casualty insurance arises out of the provisions of the new federal program itself. That is, a characteristic of the federal program is the ability to surcharge policyholders for participation in the funding of loss. The federal program provides for property and casualty insurers to surcharge policyholders to recoup some of the loss sustained by industry and government. Group life insurers similarly would be able to surcharge their policyholders based on the typical annual group life contract.

The loss of 3,030 lives on 9/11 resulted in insured losses estimated to range from $2-3 Billion. There is no accounting of how much of this amount is attributable to individual life insurance compared to group life insurance. The magnitude of the human loss did not dislocate financial markets or have impact upon employment and businesses beyond those actually located within the World Trade Towers. Due to the strength of the life insurance industry, the sad toll of 9/11 measured in mortality and disability was not of a magnitude to raise immediate solvency or availability concerns for the life insurance industry as a whole. What 9/11 did reveal, however, was the very real possibility of magnitudes of terrorism catastrophe to human lives never before appreciated. For instance, if the World Trade Towers had not held as long as they did, allowing many people to escape, the loss of lives and impact to group carriers would have been far greater. However, with the potential for terrorist events that would cause frequent widespread mortality losses – especially NBCR events – the threat of insolvency of the entire industry is quite real.

Interrelationship of Group Life and Individual Life Insurance

This commentary focuses on the subject matter set forth in the Terrorism Risk Insurance Act, P.L. 107-297, Section 103(h) and the specific request for comments regarding inclusion of group life insurance in the new federal program. Yet the interrelationships of the provision of group life and individual life insurance to consumers complicate an observer's ability to opine on the effect of terrorism attacks on one without appreciation of effect on the other. Life insurers may issue either individual or group life insurance policies. Some companies issue both forms but many focus primarily on individual life insurance and others focus primarily on group life insurance. Indeed, the complexity of situation is even greater when one considers that a terrorist loss of substantial magnitude could so affect insurer liquidity that its effects ripple through all lines of insurance including disability, accident and health, and long-term care.

The complexity of such interrelationships is especially seen when the market analysis is based upon the availability and affordability of any element of insurance or reinsurance common to both group and individual life insurance. Thus NBCR reinsurance has not only disappeared for primary group life insurers but for individual life insurers as well. The refusal of the states to permit exclusions in new or renewal policies for losses attributable to terrorist attack applies equally to both group life insurance contracts as well as individual life insurance policies. Over $9 Trillion of existing individual life insurance policies in force typically do not contain such exclusions. Thus insurers are compelled to provide coverage for a quite real risk but with no ability to price for it.

These larger issues and the implications of terrorist attacks upon the life insurance industry will be addressed by ACLI for the government study provided for in Section 103(i) of the Terrorism Risk Insurance Act. But they have also oriented ACLI evaluation of the implications of terrorism losses for group life insurers toward entire industry solvency considerations rather than only affordability and availability constraints. Hence the principal approach of this commentary is toward appreciating what size of loss might significantly impair the entire industry, the better perhaps for government policy makers to identify attachment points for group life insurer participation in the federal program.

Ruinous Terrorist Attacks

Life insurers issuing group life insurance must now be concerned about the potential occurrence of future terrorism events that could take a toll of human life potentially greater than that of 9/11. ACLI believes that, the larger the event, the more likely individual life insurers will suffer detrimental impact equal to or greater than group life insurers. That is, a catastrophe affecting all of Los Angeles County might be expected to impair the individual life insurance industry as much as the group life insurance industry, whereas a catastrophe centered on, e.g., the Sears Tower in Chicago might impair the group life insurance industry to a much greater degree.

Regarding such losses in the context of the current Treasury study, we are quite concerned by the potentially uneven distribution of group life costs among different insurers. This distribution is partly random but is also a function of the concentration of risk that is an essential feature of group life insurance. In a situation in which the entire industry participates in an insurance backstop arrangement, cost might be spread efficiently. Absent such a situation, insurers are exposed to a level of risk that cannot be priced in a reasonable way. Hence, the ACLI perspective arises from scenarios of loss that could ruin the life insurance industry. They are of two types: (1) one or more calamities so widespread as to directly impact a significant number of insurers simultaneously, and (2) single or multiple calamities so intense as to ruin one or more major insurers, driving them into insolvencies that cannot be borne by state guaranty funds.

ACLI actuaries studying the implications of terrorist disasters have considered the experience of an existing private industry catastrophe risk pool, Special Pooled Risk Administrators, Inc. (SPRA). The experience of this pool on 9/11 was that certain group life insurers had twenty times the death claims that would have been expected based on their exposure, which was variability four times that of individual life insurers. In other words, catastrophes do not hit proportionally across lines of insurance or among insurance companies.

There is $9.3 Trillion of individual life insurance in force and $6.8 Trillion of group life insurance in force nationally. Total industry surplus is estimated to be $187 Billion. In California, there is $1.2 Trillion of individual life insurance and $0.7 Trillion of group life insurance in force. About one-third of the population of California resides in Los Angeles County (9.6 million lives). The data above indicates that a catastrophe in Los Angeles County that results in the death of 30% of its population would also destroy the entire life insurance industry surplus.

A terrorist catastrophe in Los Angeles County will certainly result in substantial loss to both individual and group life insurance. Using existing pool data, which assumes a disproportional effect of 0-11.6 times the average (i.e., the weighted average of individual and group life insurance disproportions), ACLI perceives that a 2.5% Los Angeles mortality rate would likely cause an insolvency of a company. The question becomes at what level of catastrophe is industry solvency jeopardized? If a catastrophe with mortality of 30% of the population of Los Angeles County destroys 100% of industry surplus, while a catastrophe with 2.5% Los Angeles County mortality of the County could render at least one insurer insolvent, where is the threshold at which industry solvency is jeopardized? Loss of even half of industry surplus, or $94 Billion, likely is tantamount to industry ruin. Given required risk based capital ratios and effect on consumer confidence of the repercussions of such losses, industry ruin probably occurs far before loss of half of surplus. Further, the shock of a catastrophe of magnitude could be expected to create negative economic dynamics on a national and even global scale, as insurer financial investments deteriorate, lessening insurer reserves and capacity, which lessen external investors confidence in insurers, affecting the ability the industry to raise capital, and so on.

ACLI is considering scenarios other than those relating to Los Angeles County. One, for example, looks at the Sears Tower in Chicago, the largest building in the United States, an icon of American achievement. It houses about 10,000 employees and 25,000 daily visitors. One could assume the employees to be similar in insurance levels to those employed in the World Trade Towers, and visitors to be similar to the general population. If the World Trade Tower death toll was about 2,800 lives with about $2-3 Billion life insurance lost, one could estimate a total destruction of the Sears Tower (i.e., if it did not stand for the time the World Trade Towers stood) to result in life insurance losses of roughly four times the World Trade Center loss, or about $8-12 Billion.

Final results of these studies are not available at this time. ACLI proposes to supplement this communication with additional data when it is available.

ACLI Response to Treasury Questions

1.1 Who are the suppliers of group life insurance in the U.S.; who are the users; and how are sellers and buyer brought together?

Appendix A provides a ranking of 311

group life insurers in descending order from the largest, based upon Group Life Insurance Net Premiums as reported to the National Association of Insurance Commissioners (NAIC). In addition, the carriers' premiums for other potentially relevant lines of insurance are indicated.

In general, the "users" of group life insurance coverage are government; unionized industries; and high-income service industries such as medical and financial services. The greater the concentration of these industries within a geographic area, the more likely there exists group life insurance coverage.

Most employer-sponsored group insurance is distributed through independent insurance brokers, who provide several price and coverage quotes to the purchaser. Large cases may have the same services provided by an independent consultant.

1.2 What is the corporate status of group life insurers? Are they generally stand-alone companies, or affiliates of other corporations? If the latter, what are the major business interests of the other corporations?

Group life insurers are generally *not* stand-alone companies offering only group life coverage. In many cases, they also provide group accident and health coverage, and many also provide individual life insurance, either directly, or through an affiliate. See Appendix A.

1.3 What characterizes group life insurance offerings? Please describe typical terms of coverage, offer and renewal procedures, and other relevant information.

Most group life insurance is employer-sponsored term insurance, in an amount that is a function of employee salary or other scheduled amounts. Such plans often include an accidental death feature which doubles the benefit in the event of an accidental death, and a waiver of premium feature which waives future premiums in the event of employee disability. Such plans are typically renewed (between employer and insurer) annually, although two-year rate guarantees are common. Employees generally are able to purchase coverage at the inception of employment without evidence of insurability (large amounts will require some evidence), but may not subsequently elect coverage without providing evidence. Coverage usually ceases at termination of employment, but may be converted to individual plans although, in some cases, group term life insurance coverage may be maintained after employment ends. Employers may pay the entire premium, or they may require contributions from employees.

1.4 How is group life insurance regulated in the U.S.? Are there significant differences in group life regulation among the states and, if so, what are these differences?

Group life insurance is regulated by the individual states. Regulation tends to be similar from state to state.

1.5 What are the risk exposures of customers and how are they concentrated-by locality, by type of employer, other? What is the annual premium structure for these different exposures?

There are a number of examples of concentrated risk such as where employers occupy a high-rise building. Many areas of high employment, e.g., cities or research centers, may present concentrations of risk that are not easily measured because the exposures may result from employees who work for a number of different employers.

1.6 What amounts of loss exposure are typically reinsured? Please describe the structure of typical reinsurance contracts, including the period of coverage and typical renewal process.

Reinsurance for group life insurance comes in several forms. In general, group life insurers will purchase coverage on two bases, excess of loss on individual lives, and catastrophic coverage on the entire block of business.

Excess of Loss on Individual Lives: Ceding companies will normally reinsure excess amounts of group life insurance using a risk retention level that is commensurate with the size of their block of group life insurance business, the insurers capital and surplus position, and with the company risk management philosophy. Smaller group life insurers will typically cede 100% of all amounts in excess of $50,000 or $75,000 per employee and the larger group life insurers will cede 100% of all amounts in excess of $500,000 or $750,000 per employee. Risk retention levels tend to be smaller (approximately 50%) than those for individual life insurance due to the concentration risk. Excess group life reinsurance contracts are normally written on a yearly renewable term (YRT) basis for a 12-month contract period. Excess group life reinsurance contracts normally provide reinsurance coverage for both deaths and waiver of premium benefits. Disability caused by terrorist attack may trigger this benefit. Excess group life reinsurance is often provided using a monthly composite premium rate per $1,000 of volume, in order to simplify administration. Excess group life reinsurance treaties (a "treaty" implies an arrangement for automatic acceptance) are typically annually renewable and can be cancelled by either party with 90 days notice. The typical renewal process will begin with a request from the reinsurer to the insured company for updated annual census for all of their business reinsured. This census must include, at a minimum, each persons age, amount reinsured, gender and work location. Work location request is new since 9/11. This data is then evaluated and validated against administration data and contract provisions. In addition, since 9/11, location information is evaluated for concentration, buildings and terrorist targets. From the updated exposure data and financial experience analysis, a renewal action is determined. This could range from a decision to terminate to a decision to offer a rate decrease. In the event of a covered loss, reinsurers would be required to pay their portion of the claim, regardless of cause.

The typical per person excess group life reinsurance contract has at least four major sections: Definition of Risk, Administration, Financial and Special Provisions. Within those sections, the contract will cover the scope, automatic acceptances and facultative submissions, liability, premium accounting, conversions (from group to individual coverage), risk retention, maximums, claims, arbitration, insolvency, tax, duration and exhibits that fully describe the agreement between the two parties. These exhibits typically include the rate basis or rate table, exclusions from automatic acceptance and experience refunding arrangements (if any).

Catastrophic Coverage: This coverage is also called Per Occurrence Excess of Loss. Ceding companies will normally insure the entire block of business against catastrophic claims by purchasing a certain amount of coverage per occurrence on the entire block over and above a deductible amount. Once again, the amount of coverage purchased is commensurate with the size of their block of group life insurance business, the insurers capital and surplus position, and with the company's risk management philosophy. Smaller group life insurers will typically purchase reinsurance that reimburses $5-30 million of claims after a deductible of $2-5 million, whereas larger group life insurers may purchase up to $1 Billion of coverage after a $100 million deductible. This coverage generally will contain restrictions on the events covered and the minimum number of deaths in an event for coverage to be effective. After 9/11, terrorism and NBCR exclusions were added to this type of coverage. While NBCR coverage is not obtainable at this point, some reinsurers will cover terrorism (excluding NBCR) for an extra premium of 50% or more. Reinstatement of catastrophic coverage (a clause that replaces capacity after an event has depleted coverage), which was generally free and unlimited, has been reduced to one reinstatement for 100% of the original premium. Catastrophic coverage generally is renewable annually.

1.7 What was the amount of group life insurance losses in the terrorist attack of September 11, 2001; and how was it distributed-losses to insurers versus losses to reinsurers? How was it distributed within each group?

Because companies have reported both group and individual losses as one number, it is difficult to answer this question. Suffice it to say that, while the events of 9/11 resulted in significant losses for the group life insurance industry, it did not raise solvency concerns. The industry is concerned with the potential magnitude of future events.

1.8 What was the availability and price of reinsurance in the period before and following September 11, 2001, for group life insurance? What is it today? Please be specific by type and amount of coverage available, deductible, sublimit, renewability, and other relevant characteristics.

The events of 9/11 had minimal impact on the cost and availability of reinsurance for Excess of Loss On Individual Lives. Rather, Catastrophic Coverage was impacted, both in terms of coverage and price. The cost of Catastrophic Coverage, even without terrorist coverage, has increased greatly. Rates on Line (reinsurance premium divided by reinsurance limit) have increased from 600% to 1200%, with required deductibles increasing by up to 2000%. Coverage for terrorism involves an additional premium of 50% or more and NBCR coverage is generally unavailable. Maximum coverage for any one insurer has declined significantly as well, from roughly $1 Billion to $300-$400 million.

1.9 What is the current capacity of group life insurers in the U.S. to bear terrorism risk, individually and as affiliates of other companies, taking into consideration their reinsurance situation? Please provide empirical support for responses as available and appropriate.

The entire capital and surplus of the life insurance industry is estimated to be approximately $187 Billion. This capital and surplus backs all of the liabilities of United States life insurers, including individual life, disability, long-term care, and accident and health insurance, as well as group life insurance.

In the case of smaller companies that write only group life insurance, it would be possible to view all of their capital and surplus as solely standing behind their group exposure. In the case of multi-line companies, capital and surplus is not legally segregated for a particular line of business. Life insurers do, however, manage their companies by determining an appropriate level of capital and surplus for each line of business. These levels are typically based on a multiple of NAIC required risk based capital for the line of business. We estimate that the level of capital and surplus for the group life business is approximately 5% to 10% of the $187 Billion, or roughly $10 to $20 Billion. In considering the industry's capital position, we are mindful that an event causing large group life insurance losses would also cause large individual life and disability insurance losses. This, in turn, would significantly impact the entire industry's capital and surplus. We believe that another terrorist event in the range of $2 – $5 Billion group life insured loss could cause a significant number of insurers with large concentrations of group life business to fall below minimum required capital levels.

1.10 Are there other sources of protection for terrorism risks in group life insurance, e.g., through capital markets? To what extent are these sources used currently? What are the issues associated with expanded use of these sources?

The capital markets generally are not available to provide catastrophe coverage to group life insurers. Due to the historically low frequency and high severity of multiple life catastrophic occurrences, there is no generally accepted life insurance catastrophe modeling tool available.

There is one existing private industry catastrophe risk pool, Special Pooled Risk Administrators, Inc. (SPRA). Established in 1972, SPRA is a New Jersey subsidiary of Swiss Re, administering a unique program to enable life insurers to address problems of concentrated risk of catastrophic accidental death claims for both individual and group life risks. SPRA paid $104 million of group life insurance from 9/11. Since 9/11 its capacity has grown to possibly pay as high as $750 million in claims. As helpful as this might be, the SPRA does not remove the catastrophe risk of ACLI concern. In industry ruin scenarios, the value of participation in such a voluntary pool decreases because it cannot distribute risk beyond the industry or even to all members of the industry. ACLI members agree that this pool, in its current configuration, cannot address the dilemma of group life insurers confronting large terrorist loss exposures today.

Considerable questions exist as to whether private market pooling mechanisms could develop to address the concentration of risk problem besetting the group life insurance industry today. With the time that would be provided by the temporary federal program, private, voluntary pools might develop for levels of exposure below federal participation levels. Such potential voluntary pools may help determine to what extent, if any, federal assistance is needed for overall life insurance terrorism loss exposures. Because no voluntary pool can accommodate the magnitude of terrorism risk contemplated here without a federal backstop similar in nature to the federal program for property and casualty insurers, ACLI members see value in federal backstop for group life insurance losses attributable to terrorism. A federal program that is available only for catastrophes threatening ruin of our entire financial system is seen as too remote to encourage voluntary pooling remedies to form. From these considerations emerge the notion that federal program attachment points either too low or too high might frustrate the re-emergence of private risk-sharing mechanisms to address the problems challenging the group life insurance industry.

1.11 Please address and provide empirical support for whether group life insurers have reasonable access to adequate and affordable catastrophe reinsurance, and, if not, why inclusion in the Act would correct this situation. In so doing, please compare the magnitude and scope of the situation of group life insurers to the situation previous to the passage of the Act of those property and casualty insurers that are included in the Act.

Group life insurers have access to limited catastrophe reinsurance, but general terrorism and specific NBCR exclusions leave the industry exposed to potentially ruinous risks. Such risks, because of their unpredictable frequency and potentially high magnitude cannot be adequately priced by anybody, whether insurer, reinsurer, or capital markets. The development of a government-sponsored backstop program is the only viable method of insuring such a risk.

In December 2001, ACLI actuaries evaluated characteristics of different threshold amounts of loss to better evaluate the nature of industry afflictions from terrorist loss and the benefits of different approaches to remediation. This work effort did not distinguish between individual and group life exposures. The actuaries developed scenarios at four levels: $5 Billion, $10 Billion, $15 Billion, and $20 Billion. A $10 Billion event would increase industry death claims by 22.5%, reducing overall industry surplus by 5.3%. In comparison, a $10 Billion loss for property and casualty insurers would have the effect of increasing industry claims by 4.2%, and reducing overall property and casualty insurance industry surplus by 3.2% (and 8.0% of the surplus backing commercial lines). Even acknowledging that, e.g., a $10 Billion event does not necessarily translate into a $10 Billion insured loss (as premium and reserve release must be netted), and that lost capital can often be replaced through public or private equity markets, some conclusions might be derived from the above analysis. Thus, for a given size event, the resulting financial impact is much greater for the life insurance industry compared to the property and casualty insurance sector.

2.1 Please describe in detail, current group life insurance market conditions, including availability and pricing, by type and location of employers and other purchasers.

This information is difficult to collect. ACLI has been informed by several insurers that prices have gone up, due to the recognized risk of terrorism, in certain locations, such as Washington DC and New York City. The states have not permitted group life insurers to exclude terrorism risk from policy coverage. While ACLI does not have detailed information on pricing and availability, we believe that some insurers have been unwilling to quote on certain risks due to terrorism exposure.

2.2 What is the impact of terrorism risk on group life insurance availability for employees and other consumers? Please describe in as much detail as possible which employees and other consumers have been significantly affected, including availability and pricing, by type and location of employer or other purchaser of group life coverage.

To the best of our knowledge, employers have not stopped offering group life insurance to employees. In many cases, group life insurance is the only insurance on the lives of middle and lower income American employees. The primary group life insurers did not, in most cases, retain the risk of large or concentrated ("catastrophe") losses. Because catastrophe losses were so infrequent, the primary group life carriers reinsured them at relatively insignificant costs. Today the situation is entirely different. Since the terrorist attack of 9/11, group life insurers cannot find either adequate or affordable catastrophe reinsurance. Further, reinsurance for loss from NBCR terrorist attacks has ceased to exist.

This means that group life insurers in today's marketplace are, at least temporarily, accepting markedly greater risk than they did when the risk was not perceived as significant and reinsurance was widely and inexpensively available to protect against catastrophic losses. Those carriers able to reinsure any part of their enhanced risk do so at great expense. This situation has not yet begun to reduce the availability of group life insurance for consumers because most group life insurers are remaining in the market by retaining the risk of catastrophic loss without the traditional benefits of risk spreading via reinsurance.

Following 9/11, group life insurers continued traditional market coverage and pricing during a period of negotiation with reinsurers in hope they would find a way to provide affordable reinsurance. This did not occur. Now traditional coverage and pricing is being maintained in the hope that there will be government support, which will make reasonable the continued acceptance of the concentrated risk inherent in group insurance. Without the assurance of a government terrorism risk insurance backstop, the present situation is likely problematic in two ways. The first is the potentially increased cost of group life insurance. The second is the reduction of availability, which may occur both from actions of group writers and from employer responses. In the absence of meaningful government support, and particularly if the potential remains for substantial terrorism losses, it seems likely that the number of group life insurers and coverage offered will shrink.

2.3 What is the cost and availability of alternative sources of life insurance coverage for those employees and other consumers affected by the reduced availability and affordability of group life insurance?

Availability of employee coverage has not yet been affected. Should group life insurance not be included in the federal program, it is likely that some writers will reassess the desirability of offering this coverage. If coverage is reduced or eliminated in the future, employees' alternative source of coverage will be individual life insurance. This form of insurance may be cost prohibitive or unavailable for some individuals.

2.4 Please explain and provide empirical support concerning the extent to which the threat of terrorism is reducing reasonable availability of group life coverage for employees and other consumers in the U.S., and whether it would continue to be reduced if group life insurers continue to be excluded from the Program. Please compare the magnitude and scope of the impact on consumers of not including group life insurance to the impact on consumers previous to the passage of the Act of those property and casualty insurance lines covered under the Act. Please explain how inclusion would correct this situation.

Failure to include group life insurance in the federal terrorism risk insurance program could result in higher costs and more restricted coverage for group life consumers. It is expected that the cost of capital will increase once investors begin to understand the risks being borne.

Inclusion of group life insurance in the program will likely assure that the product remains available to the broad range of employee groups.

3.1 Treasury presumes that, if it would be appropriate to include group life insurance under the Act, Treasury would apply the current provisions of the Act to group life insurers. If this is not the case, please discuss and provide a detailed explanation of the changes that would need to be made to implement the Program for group life insurers. Please include discussion of any operational difficulties with applying the current provision in the Act to group life insurance that should be considered with respect to any financial assistance if group life insurers were included under the Act, and the benefits and costs, including administrative cost, of any proposed changes to the provisions for group life insurers.

It is essential that, should group life insurance be covered under the Program, a separate and distinct pool be established for the life insurance risk. To establish appropriate parameters for inclusion of group life in the federal program, comparison of group and individual life premium to that of the property and casualty insurance industry might be appropriate. Given the similar concentration of risk issues, industry limits proportional to those established for the property and casualty insurance program might be appropriate. However, the coincidence of the Treasury comment period with the seasonal holidays has complicated the ability of the ACLI to formulate proposed program changes to address group life insurance characteristics and administration. ACLI proposes to supplement this communication with a detailed response to this question as soon as possible.

ACLI Communications

Thank you for your consideration of these comments. To expedite ACLI responsiveness to Treasury inquiries and requests for information, please use the following individuals as your contacts for ongoing communications:

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Paul Graham, Chief Actuary
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Sincerely,

John F Barrett

The American Council of Life Insurers

John F. Barrett
Chairman of the Board, President, and Chief Executive Officer of
The Western & Southern Financial Group
Chairman of the Board, American Council of Life Insurers

Attachment: Appendix A (In Excel)

AMERICAN COUNCIL OF LIFE INSURERS
FINANCIAL SECURITY FOR LIFE

13 August 2003

Lucy Huffman
Office of Microeconomic Analysis
United State Treasury Department
1500 Pennsylvania Avenue
Washington DC 20220
Via otherlinesstudy@do.treas.gov

RE: Comments on Study of Other Lines

Ladies & Gentlemen:

The American Council of Life Insurers appreciates the opportunity to comment upon the potential effects of terrorism on the availability of life insurance and other lines of insurance. Following the Table of Contents, this document comments first generally on the situation confronting insurers with regard to terrorist threats; next reports on the findings of a survey of its members; responds then to each of the questions enumerated by Treasury; and finally suggests the concept of a possible government terrorism backstop mechanism, should future events prove it to be necessary.

Table of Contents

Summary Conclusions

The strength of the life insurance industry permitted it to withstand 9/11 losses without dislocation or the need for government assistance. The industry is strong enough to withstand catastrophes several times the magnitude of 9/11. A majority of ACLI members do not perceive an immediate need for a federal backstop for individual life insurance. However, the industry believes that it is hamstrung in reacting to the increased mortality and morbidity risk from terrorism because, while it believes that the increased risk is minimal, it cannot be quantified or specifically identified. Hence, a significant number of industry experts are troubled about the implications of catastrophic terrorist attacks for the vitality of their industry. The ACLI believes that it is prudent for the federal government to consider the benefits of a federal backstop for Individual Life and Individual Disability and that a potential design be prepared should a future terrorist event of such catastrophic proportions make such a mechanism necessary.

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General Observations

There is ample reason for concern about the implications of future terrorist attacks for the availability of life insurance. The Administration advises that the terrorism threat is real and continuing, and that the US is likely to suffer other attacks within the next decade. Scientists and officials advise us that the nature of these attacks could result in extremely high mortality, especially if they involve nuclear, biological, chemical or radiological (NBCR) weapons. While the likelihood of additional terrorism loss is high and predicted in general, color-coded alerts, actual frequency, severity and locality cannot be predicted for insurance underwriting purposes. Indeed, the human agency behind terrorism denies its evaluation as a natural phenomenon reducible to an actuarial probability. Based on government and scientific information, it is reasonable to believe that there will be either individual incidents of extreme loss or multiple incidents of loss that, in aggregate, will be extreme and could test the strength of the life insurance industry.

There is not much life insurers can do to prepare for the terrorism risk. If the solvency of insurers were the only public policy concern, it would be reasonable to permit an insurer to manage such a risk with policy exclusions. But the States disallow any exclusion for terrorism loss to direct insurers. Reinsurers, on the other hand, are not constrained by regulation from excluding terrorism and especially NBCR loss in their treaties; rather, the constraints for reinsurers arise from competitive concerns in their relatively free market. Even Congress likely cannot permit exclusions for terrorism loss because they could be prospective only, i.e., constitutional obstacles likely prohibit application of terrorism exclusions to individual life policies in force.

Neither is there new private capital available to permit insurers to accommodate the risk to terrorism loss. Traditional sources of capital eschew risk that cannot be traditionally underwritten. Market competition inhibits increased pricing for the risk, at least until future attacks impress the reality of the situation upon everyone, and then too late. So it is that primary life insurers are caught between the rock of exclusion prohibitions and the hard place of no fresh capital for the new risk. Only federal government resources exist as a source of additional capital that might be made available to address catastrophic terrorism loss.

Survey of Terrorism Impact

Treasury noticed its interest in receiving comments on the implications of terrorist attack for individual life insurance and other lines on June 16.[i] The ACLI shortly thereafter surveyed its 383 legal reserve life insurers operating in the United States and Canada for data responsive to Treasury's request. These companies account for 70% of life insurance premiums, 77% of annuity considerations, 43% of disability premiums, and 63% of long-term care premiums in the United States among legal reserve life insurance companies. ACLI member company assets account for 73% of legal reserve life insurance company total assets. The surveys were sent to the attention of the chief actuaries and chief financial officers of each member company.

The survey was designed to gather information and feedback from the industry regarding their practices and experiences in the wake of 9/11, as well as their opinion regarding the need today for a federal backstop. Such questions could be answered with certainty. The survey did not ask respondents to speculate regarding the likely impact on the market of future terrorist attacks of unknown scope and magnitude. Such issues were deemed too subjective to be tabulated in a meaningful way through a survey, but are addressed in our response based on extensive consultations with the industry and internal analysis by ACLI staff.

Survey responses were received from 149 companies participating in 80 corporate holding systems, or fleets. These companies represent 40% of the ACLI membership and 36% of total life insurance industry assets. The tabulated responses to the ACLI survey are found at Appendix A.

A significant number of surveys were accompanied by editorial remarks that are reflected in this commentary. The ACLI commentary goes beyond the basic numerical tabulations of its survey data to include relevant editorial and analytical information from the survey data as well as that gleaned from discussions with its members.

ACLI Responses to Treasury Questions

I. Exposure of Insurance Lines Not Covered Under Section 102(6) of the Act to Acts of Terrorism Defined in Section 102(1) of the Act

1.1 *What lines of insurance would not be likely to experience potentially significant reductions in availability as a result of the occurrence of future acts of terrorism or the risk of acts of terrorism?*

Based on our analysis, the following lines of insurance might not experience significant reductions in availability:

- Credit Life Insurance
- Individual Annuities
- Group Annuities
- Long Term Care

With respect to Individual Life and Individual Disability, a majority of the companies responding to our survey concluded that there is no immediate need for a federal backstop because the increased risk is currently minimal or cannot be quantified. While approximately 10% of life insurers have instituted risk mitigation techniques in the wake of 9/11 such as increasing diversification through reinsurance, limiting sales within certain geographic areas, or imposing underwriting criteria limiting concentrated groups, the majority of companies have carried on business as usual.

The targets of 9/11 were not quantified by insurers for terrorism risk (even though the World Trade Center experienced in 1993 a terrorist attack with loss of lives). It is not clear even now that the targets of 9/11 should have been identified as high-risk exposures for life insurers. From a life insurance standpoint, it cannot be assumed that an attack of the magnitude of 9/11 is the worst we are ever to endure. It is conceivable that an event with dramatically higher loss of life than 9/11 could happen. As uncomfortable as it is to consider, such an event is within the realm of possibility, particularly with the use of NBCR weaponry. The current market – the market reflected in the responses to the ACLI – continues to look at actual historical precedent for its cues. Congress asked Treasury to contemplate the effect on insurance availability of future acts of terrorism. We do not have, and may never have, reliable models to predict with any accuracy the frequency and severity of future terrorism events. It is not clear whether future acts of terrorism will be limited to the magnitudes of those of the past.

1.2 What lines of insurance would be likely to experience potentially significant reductions in availability as a result of the occurrence of future acts of terrorism or the risk of acts of terrorism?

According to our analysis, the following lines might experience significant reductions in availability:

- Individual Life
- Individual Disability
- Group Life Insurance
- Group Disability Income
- Reinsurance

As indicated in the response to Question 1.1, the majority of ACLI survey respondents indicated that there is no immediate need for a federal backstop against acts of terrorism for individual life insurance products at the company level. The inclusion of Individual Life and Individual Disability in the response to this Question is a result of industry concern about the potential impact of future terrorist attacks of such magnitude or frequency as to affect the fundamental conduct of the business of life insurance. Analysis of the particular responses generating these findings revealed that nearly all respondents that agreed that there is a need for a backstop for Group Life and Group Disability also believe the need extends to Reinsurance, while many respondents who believe there is not a need for a backstop for Individual Life or Individual Disability had no opinion as to whether a backstop should be extended to Reinsurance.

A few insurers that did not believe that an immediate backstop was necessary for Individual Life thought that it was necessary for reinsurers. The apparent peculiarity of this position is lessened if it is considered that much of the Individual Life exposure in force was reinsured before 9/11 and, consequently, the primary insurers are insulated to substantial degree from excess loss attributable to terrorist attack. Such exposure, however, likely would befall the reinsurers under pre-9/11 treaties. Hence it is not unreasonable to perceive a potential need for a federal backstop for reinsurers to address the heightened terrorist risk to Individual Life Insurance in force

That is, Individual Life insurance concerns the long-term contractual commitment life insurers make to their clients. Life insurers cannot cancel policies unless premiums are not paid. They also cannot increase prices above levels agreed upon at the inception of the policy. Terrorism exposure for life insurers and life reinsurers is locked in for all contracts in force. This is in contrast with, e.g., property and casualty insurers, who have an opportunity to cancel or reprice the coverage annually, allowing them to avoid the risk in the future or recoup the costs of a previous event. For life insurance in force, life insurers and life reinsurers have neither a market mechanism to price for terrorism risk nor a market mechanism to recoup terrorism losses from their clients. The long-term commitment of life insurance policies results in an exposure to terrorism threats that could be ruinous to the sector.

Thus, even though the majority of the companies responding to our survey concluded that there is no current need for a federal backstop for Individual Life and Individual Disability insurance, our analysis is that their conclusions did not envision a prospective industry ruin scenario. The life insurance industry contributes vitally to American strength. Employing 2.3 million workers and holding $3.4 trillion US assets, the stability of the industry should be of high concern to the government. This is especially true inasmuch as life insurers' assets are invested in direct support of government and other US industries, including $1.7 trillion of corporate and government bonds, $791 billion of corporate equity, and $251 billion of mortgages.[ii]

There will be little cost to government to plan for a federal backstop program. If terrorist attacks fail to materialize, or if they continue sporadically with minimal loss, there would be no federal payment even if a plan was put in place. On the other hand, the opinions of company actuaries about whether the terrorist risk is minimal, quantifiable, or identifiable may about-face in the nanosecond it takes to detonate a dirty bomb in an American downtown. Advance government planning, including consideration of a federal terrorism backstop, will serve the country and the insurance industry well in the event government predictions of significant future terrorism events become true.

1.3 What are the attributes of those lines cited in 1.2 that could lead to potentially significant reductions in availability? For example, are there unavoidable concentrations of risk? Is there a particular exposure to certain types of acts of terrorism?

Individual Life Insurance: The 9/11 attacks were not of a nature to raise concerns about the overall strength of the life insurance industry because the loss was not sufficiently large as to threaten the industry's overall strength. The impact of such kinds of attacks for individual life insurers would be expected to be dissimilar to that experienced by insurers with potentially large numbers of group policy certificate-holders concentrated in, e.g., iconic buildings or facilities. There is no assurance that future attacks will be of the nature of those of 9/11. The major concern today is that terrorists or hostile nations will acquire and detonate a weapon of mass destruction against an US target. Thus the nature of terrorist attack of concern to ACLI members include:

1. A NBCR attack affecting a large geographic or heavily populated area or both; and
2. Numerous attacks in one or more specific geographic areas (e.g., one or more state or metropolitan area) with relatively few insurers representing a high percentage of the market.

Other attributes relevant to individual life insurance and related to NBCR risk include:

- Availability constrictions attributable to higher reinsurance costs (affecting the pricing and profitability of new policies); and
- Availability constriction attributable to reinsurance treaty terrorism exclusions (affecting new policies only).

Group Life Insurance: Treasury is aware that there are unavoidable concentrations of risk for Group Life and Group Disability Insurance. ACLI submitted comments justifying inclusion of group life in the federal terrorism risk insurance program on 10 January 2003. It has provided supplementary information upon request, including new data regarding state-specific market concentration data, as recently as 27 June 2003. ACLI President Frank Keating and company officials have met several times with Treasury officials, including Secretary Snow, as recently as 18 June 2003. The ACLI refers Treasury to its existing collection of information, including the comment by the ACLI, regarding the implications of terrorism upon the availability and affordability of group life insurance.

Individual Disability Insurance: Individual Disability Insurance may be purchased as a stand-alone policy or as a supplemental benefit to an Individual Life Insurance policy, providing benefits to cover financial losses resulting from a sickness or injury. Stand-alone policies are designed as partial income replacement in the event of disability. Benefit payments commence after an elimination period and are generally paid monthly thereafter as long as the insured remains disabled or until he or she attains retirement age. The most common supplementary benefit is the waiver of premium benefit, which pays the life insurance premium while an insured is disabled. Of individual life policies in force in 2001, 27%, or 44 million, contained a waiver of premium provision, totaling $2.9 trillion, or 31%, of the individual life insurance face amount in force.[iii] Thus, concerns identified above for Individual Life Insurance extend to Individual Disability Insurance as well. An additional concern attributable to Individual Disability Insurance is the possibility that substantial experience of waiver of premium attributable to extremely high disability numbers would lessen insurer premium revenue in a manner exponentially increasing stress on insurer claims payment capability.

Group Disability Insurance: Similar to the inclusion of Individual Disability Insurance coverage in Individual Life Insurance, most group insurers bundle Group Life with Group Disability protection. Extraordinary claims on one product line can be expected to stress capital and surplus funds earmarked for another. For both Group Life and Group Disability, there is an effort to improve group underwriting with concentration of risk analyses, though such analyses are difficult when group certificate-holders are relatively anonymous and their daily location is unknown to the insurer. Because the viability of the Group Disability Insurance market is linked to that of the viability of Group Life Insurance, ACLI refers Treasury to its information relevant to whether to include Group Life Insurance in the existing federal program.

Reinsurance: For purposes of this discussion, Reinsurance should be understood as two categories of coverage, catastrophic and non-catestrophic. As can be seen from the survey, many insurers and reinsurers have already experienced decreased availability of catastrophe reinsurance coverage as a result of the events of 9/11. Additionally, if the coverage is available at all, the risk of loss from NBCR events is now being excluded and the price has increased exponentially from pre-9/11 levels. The diminished availability of catastrophe reinsurance and the associated increased pricing directly correlates to the inability of catastrophe reinsurers, like all insurers, to actuarially evaluate terrorism risk. On the other hand, there has been no reported lack of availability of other, non-catastrophic, traditional forms of life reinsurance, such as quota share and yearly renewable term. The concern expressed in this document about the future availability of life and disability insurance is echoed for non-catastrophic reinsurance. Reinsurers providing such coverage follow the fortunes of their direct writing client companies but are not able to purchase catastrophe reinsurance to spread their risk.

1.4 What is the market structure of those lines of insurance cited in 1.2? In your answer, please describe, as quantitatively as you can, the degree of competition in the markets for those lines, the net premiums to surplus ratios for companies in those lines, and other measures of market structure that you believe are relevant; and compare them to the insurance industry average. What is the distribution of market share (highly concentrated among a few entities, broadly distributed, other)? What types of insurers hold the majority of the market share (local, regional, national, other)?

US life insurance companies sell the vast majority of life insurance and annuities purchased in the United States. Fraternal organizations and federal government agencies are also in the marketplace, and certain Canadian life insurers with US legal reserves are allowed to sell insurance directly from their Canadian offices to US purchasers. The number of life insurance companies in business in the United States was 1,171 at the end of 2002. Most life companies are organized as either stock or mutual companies. The majority of life insurers are stock companies—1,076, or 92%, of the industry. Many life insurance companies are affiliated with other life and non-life insurance companies in fleets with a single parent. Together, stock and mutual life insurers provide 94% of the total insurance and annuities underwritten by US organizations. Mutual life insurance companies had $1.8 trillion of life insurance in force in 2002 and stock life insurance companies, $14.5 trillion.[iv]

The proportion of foreign-owned insurance companies operating in the United States increased to 11% by 2002. From 67 companies in 1996, foreign-owned life insurers expanded their presence to 132 companies in 2002. The same countries have fielded the major foreign players in the US market since the mid-1990s: the Netherlands (32 companies), Canada (24), Belgium (17), Switzerland (15), and the United Kingdom (12). Appendix B provides the Capital Ratios for the Top 50 Individual Life Insurance Companies. Appendix C provides Individual Life Insurance Market Share Ratios By State. Appendix D provides the Capital Ratios for the Top 50 Group Life Insurance Companies. Appendix E provides Group Life Insurance Market Share Ratios By State.[v] Insurers distributing products though-out the US hold the vast majority of the market share in each state.

1.5 What is the current capacity of insurers in those lines cited in 1.2 to bear the risk of acts of terrorism, individually and as affiliates of other companies with support from them?

An insurer's ability to withstand losses from unexpected events is related to the size of its surplus. Surplus funds amounted to $198 billion for US life insurers at the end of 2002. These funds provide extra reserve safeguards for such contingencies as an unexpected rise in death rates among policyholders, unusual changes in the value of securities, and general protection for policy obligations. Several factors influence the amount of surplus retained by a life insurer, including the size of the company, kinds of insurance written, mortality experience, general business conditions, and government regulation.

One measure of the adequacy of a life insurer's surplus is its capital ratio: surplus funds plus capital stock plus the Asset Valuation Reserve (an amount set aside to dampen asset value fluctuation) as a percentage of general account assets. Theoretically, the higher the capital ratio, the better a company is able to withstand adverse investment and mortality experience. However, the type of company and the distribution of its book of business can make comparisons among companies and to an industry-wide average much less meaningful. In 2002, the aggregate capital ratio of U.S. life insurers dropped to 9.3% from 10.1% in 2001. Life insurance regulators created the risk-based capital (RBC) ratio to monitor life insurance company solvency. The RBC ratio is total adjusted capital divided by a risk-adjusted required capital amount, for a threshold ratio of 100 percent. The ratio provides a means for evaluating the adequacy of an insurer's capital relative to the *known* risks inherent in the insurer's operations. From 1993 when life insurers began reporting risk-based capital, the average RBC ratio rose steadily to a plateau of 290% in 1997, which remained unbroken until 2001. The ratio jumped to 346% in 2001, due mainly to two accounting changes. The ratio decreased to 325 percent in 2002. Most companies have an RBC ratio well above the regulatory minimum level of 100%. By year-end 2002, 1,002 companies, or 89% of life insurers, had a ratio of 200% or more. These companies carried 97% of the industry's total assets. Only 25 companies had inadequate capital triggering regulatory action at the end of 2002.[vi] It is important to note that, while an industry-wide RBC ratio in excess of 300% would indicate a strongly capitalized industry, the risk adjustment formula for required capital does not include the contingent risk of terrorist events. Because such events are difficult, or even impossible, to model, it is unclear how the inclusion of terrorism might impact RBC ratios. Most importantly, the statistical correlation between a terrorist induced high mortality/morbidity event and the financial markets' response to that event is unknown. It is likely that insurers are holding assets that would be seriously impaired in light of any major terrorist attack, undermining their surplus when it is most needed to pay increased death and disability claims.

1.6 Compared to the condition of reinsurance and alternative markets before the attack of September 11, 2001, what is the availability and affordability of reinsurance or of alternatives sources of protection, for insurers offering coverage in lines cited in 1.2? What is the degree to which those insurers can mitigate their exposure through other means? Are there additional loss control programs or mitigation measures that could be undertaken?

The capital markets generally are not available to provide catastrophe coverage to life insurers. Due to the historically low frequency and high severity of multiple life catastrophic occurrences, there is no generally accepted life insurance catastrophe modeling tool available.

There is one existing private industry catastrophe risk pool, Special Pooled Risk Administrators, Inc. (SPRA). Established in 1972, SPRA is a New Jersey subsidiary of Swiss Re, administering a unique program to enable life insurers to address problems of concentrated risk of catastrophic accidental death claims for both individual and group life risks. Individual risks are covered in the Ordinary Pool; group life risks are covered in the Group Pool.

An insurer joins the pool by contracting with SPRA, the administrator. Each participant makes a pro rata payment on each catastrophic accident claim presented to the pool by itself or any other member. Such payments, made after the occurrence and settlement by the insuring participant and its policyholders, are the actual experience of the pool and, thus, the only "premium" for the reinsurance provided.

On 9/11, the Ordinary Pool represented 111 individual life insurers, and the Group Pool represented 42 life insurers. SPRA paid $104 million of group life insurance and $180 million of individual life insurance from 9/11.

Since 9/11, SPRA capacity has grown to $750 million for the Group Pool and $450 million for the Ordinary Pool. As helpful as this might be, the SPRA does not remove the catastrophe risk of ACLI concern. SPRA does not address the issue of loss mitigation if the loss is substantial but it does address the risk associated with geographic concentration even if the loss is as large as the 9/11 loss. In industry ruin scenarios, the value of participation in such a voluntary pool decreases because it cannot distribute risk beyond the industry or even to all members of the industry. ACLI members agree that this pool cannot address the dilemma of life insurers confronting large terrorist loss exposures today.

Questions exist as to whether private market pool mechanisms could develop to fully address terrorism risk besetting the life insurance industry today. Because no voluntary pool can accommodate the magnitude of possible terrorism events, the ACLI sees value in the federal government exploring possible federal alternatives.

Other means of risk mitigation available to the life insurance industry include portfolio diversification through reinsurance, limiting sales in high-risk geographical or metropolitan areas, and limiting sales made to groups where a large number of covered lives are concentrated in a limited number of locations. However, these risk mitigation techniques address the problem only minimally, as insurers have limited means to identify high-risk areas or methodologies to properly quantify the risk.

1.7 *What is the Federal and State regulatory structure applicable to those lines of insurance cited in 1.2? In particular please describe whether exclusions are allowed and for what risks.*

There is no Federal regulatory structure applicable to Individual Life Insurance, Group Life Insurance, Individual Disability Income, Group Disability Income, or Reinsurance. Rather, the States regulate the identified lines. Reinsurance is not regulated *per se*, though States do evaluate reinsurance for purposes of determining to what extent credit for reinsurance will be granted to ceding insurers. The States, to some degree, coordinate their policies on various insurance matters through the offices and activities of the National Association of Insurance Commissioners (NAIC).

The States and the NAIC recognized the stress visited upon certain lines of property and casualty insurance following 9/11 and promptly approved terrorism exclusions for such lines. Turning then to other insurance lines, the NAIC discussed in February 2002 whether NAIC should recommend that state insurance departments approve applications for terrorism exclusions for property and casualty personal lines risks and group life and disability risks. There was no support for approving exclusions to property and casualty personal lines insurance.

With regard to group life and disability risks, there was an appreciation that there exists a concentration of risk factor similar to that present for commercial liability and property risks, the only two kinds of insurance for which NAIC recommended state approval of terrorism exclusions. Regulators were concerned that consumers relying on group and life and disability insurance for family needs might be misled by a terrorism exclusion without special disclosure.. The existence of markets for such risks, however, led regulators to believe that any problems are company-specific rather than affecting sector or line of business.

Terrorism exclusions. Special terrorism exclusions are not wholly new to life insurers. There appears to be some limited experience in requiring them for individuals working in locations where there is heightened terrorist risk, e.g., Northern Ireland. But the idea of including terrorism exclusions generally into both individual and group life insurance contracts as a result of the post-9/11 environment is new and raises several important and difficult questions.

On one hand, 9/11, the anthrax letters, and the Oklahoma City bombing indicate that the terrorist threat to American civilians has risen to a new dimension that may require insurers to respond. Experts testifying before the Congress and state regulators[vii] disagree whether it is possible to underwrite the terrorist risk, though the majority of them apparently conclude that underwriting is impossible.[viii]

On the other hand, it appears unlikely that the expected magnitude of increased risk would affect the mortality tables used in pricing and reserving life insurance. In general, actuaries use smoothing techniques to eliminate (what they believe to be) one-time mortality spikes. Even the 1917 influenza epidemic – the historical event contributing the worst US mortality experience – did not have a discernible impact upon the mortality tables. Short of an unprecedented NBCR attack using a weapon of mass destruction, or multiple attacks with several thousand deaths per event, it seems unlikely that there might be individually insured lives lost that even upon an aggregated basis would disrupt individual life underwriting. Thus it seems that terrorism exclusions on individual life insurance policies might be unwarranted without a particular demonstration of need by an insurer to its state regulator.

But group life and disability insurance presents geographical concentrations of risk that do clearly affect underwriting and risk management decisions that might touch on the exposure of the insurer to insolvency. Hence, group life and disability insurer applications for approval of terrorism exclusions should be considered on the merits by the state regulator.

The NAIC adopted a statement of guidance to the states regarding applications by life insurers for exclusions from policy coverage for acts of terrorism. The NAIC statement is as follows:

> *It is the sense of the NAIC membership that terrorism exclusions are not necessary for individual life and health products, and are generally not necessary to maintain a competitive market for group life and health products. They also may violate state law. However, we recognize that state laws vary in their authority and discretion. Further, there may be unique company circumstances in the group market that need to be considered on a case-by-case basis. We expect the need for the exceptions to be limited. We urge carriers and government entities to explore private and public pooling mechanisms in the group market to mitigate problems that arise from concentration of risk.*
>
> (Adopted 17 March 2002, NAIC Spring National Meeting, Reno, Nevada.)

Several states have adopted policy based upon NAIC guidance.[ix] Generally, states have not approved the use of terrorism exclusions for any line of life insurance.

War exclusions. The vast majority of states have historically permitted life insurance policy exclusions for war risk.[x] War clauses vary widely, ranging from absolute prohibition of payment if the insured was in the armed forces at the time of death to a clause which denies payment only if the insured's death resulted from war. In most cases, the insurer must refund the premium or an amount equal to the policy reserve.[xi] One reason there is such a variety of war clauses in existence is because courts often construe them to provide coverage when it was not intended by the insurer; hence the language of the clauses sometimes appear to contain excess verbiage or to be over-reaching.[xii] Also important is the fact that all members of the Uniformed Services are automatically insured for $250,000 under the federal Servicemembers' Group Life Insurance (SGLI) program unless the individual elects otherwise.[xiii]

The enforcement of war exclusion against a loss suffered due to terrorism likely raises two sets of questions in today's environment. The first set has to do with the precise articulation of the war clause in the policy. The second may relate to the facts of the loss. That is, the President of the United States and other national leaders speak of a "war on terrorism", and Al Qaeda, the Islamic terrorist organization against which current military action is being directed, declared "war" against the United States, expressly including US citizens. A loss attributable to an attack from Al Qaeda operatives may well be addressed by the traditional war exclusion. On the other hand, it is not clear that *any* loss attributable to terrorism would be addressed by the war exclusion.

II. Current Insurance Availability Conditions

2.1 Please describe current insurance availability conditions in as much detail as possible for customers of the lines cited in 1.2. If there is reduced availability of a particular line of insurance for some customers, please indicate the line and describe the reduced availability as quantitatively as possible, including, to the extent you can, which customers have been significantly affected, by type and location. Please indicate whether such customers have access to alternative sources of insurance, including the cost and availability of these alternative sources, or whether the customers are not covered.

The survey results show that there has been as yet no broad reduction in availability for any line of insurance due to the events of 9/11 and the ongoing threat of other terrorist attacks. However, certain group insurers have limited sales to groups where covered lives are concentrated in a limited number of locations and some insurers are limiting sales in what are perceived as high-risk geographic areas. *See* Appendix A, Question 5.

2.2 What is the impact on community and regional economies and well-being, and the national economy of such reduced availability and affordability for those customers?

The impact has been minimal thus far. The number of companies that have changed underwriting practices to limit availability is small and the remainder of the market has provided coverage for all who seek insurance. However, the current stability in the market could be expected to change if a material terrorist attack or series of attacks occurred. The capital market would likely be inhibited from continued investment in the insurance industry in an environment where the risk of large losses by insurers became evident, or would demand a much higher return on capital given the high degree of risk. Such events would cause many insurers to leave the market, while those remaining would likely be pressed to increase prices to accommodate the demanded higher return on capital by investors.

III. Impact of Potential Future Acts of Terrorism

In this section we solicit comment on the effect of potential future acts of terrorism—single events or aggregation of several events across locale or across a time period—that could cause significant and extended disruptions in availability of insurance lines cited in 1.2.

3.1 In order to facilitate our analysis, please set out the consequences of potential future acts of terrorism for each line of insurance cited in 1.2 within the following broad dimensions:

(1) The relative concentration of the insurance industry exposed to the loss (including the following categories: (a) Loss broadly distributed—share of loss is equivalent to market share; (b) concentration of loss among many small companies—share of loss is greater than market share for large number of small companies and less than market share among market leaders; (c) concentration of loss among market leaders—share of loss is greater than market share for large companies and less than market share among small companies; (d) other distributions deemed of interest); and (2) the size of the loss (including the following categories: net present value of losses of approximately the following sizes: $5 billion, $15 billion, $30 billion, $60 billion or larger). Within each ''cell'' identified by a single concentration and loss category, please describe as specifically as possible:

- *Impact on financial capacity of insurers in the line (e.g., as reduction in share of large local, regional or national market), whether and how many insolvencies might be the result, the extent to which state guarantee funds might be affected, any systemic impact on the insurance industry; and the length of time over which the industry might be able to recover.*
- *Scope of any significant reduction in availability of coverage in the line, including length of time over which coverage is reduced and numbers of customers or subsets of customers potentially affected.*
- *Scope of impact on the economies and well being of the communities in which the reductions in availability take place, the associated regions, and the national economy. Please be specific as to how the impact is transmitted from the affected community to the regional and national economy.*
- *If you do not believe this format allows you to adequately answer the question, please alter as needed. Please note that descriptions of scenarios of individual events are not likely to be as helpful as broad aggregates.*

This question, which asks for a matrix of sixty cells of information and then complicated analyses of their significance, might be accomplished by a sophisticated actuarial firm at great expense with sufficient time. It is beyond the ken of ACLI with such short notice and due within the statutory deadline.

However, one part of this Question inquires about the ability of state guaranty funds to handle large terrorism losses. The ACLI has brought Treasury's Federal Register notice to the attention of the National Organization of Life and Health Insurance Guaranty Associations (NOLGHA), and we respectfully recommend that Treasury address any specific question concerning state guaranty funds to that organization. ACLI takes this opportunity, however, to point out that the state guaranty funds have much the same limitations as other forms of pools, i.e., they operate within a closed system of funding limited by the total capital and surplus of the life insurance industry. Further, they operate only to address failed insurers. The failure of several major insurance companies would have broad economic consequences, as policyholders and investors alike could be expected to flee insurance companies, contributing more stress on a crippled industry. It is not difficult to imagine a snowballing effect, as more and more policyholders withdraw their money, leading to failures within the industry.

In order to better evaluate the nature of industry afflictions from terrorist loss and the benefits of different approaches to remediation, ACLI actuaries developed characteristics of different threshold amounts of loss (Threshold Amount). The actuaries developed scenarios at four levels: $5B, 10B, 15B, and 20B. For perspective, the actuaries measured approximate losses from 2 catastrophic events. Losses from 9/11 have been estimated at $2-3 Billion. An event that increases mortality rates by 30-40%, such as the 1918 influenza epidemic, would cause additional death claims of $14.5-19.3 Billion. Table 1 compares these four thresholds with other various measures. As can be seen, a $10 Billion event would have the effect of increasing industry death claims by 20.7%, and reducing overall industry surplus by 4.9%. For comparison, a $10 Billion event for property and casualty insurers would have the effect of increasing industry claims by 4.2%, and reducing overall property and casualty insurance industry surplus by 3.2% (and 8.0% of the surplus backing commercial lines). Hence, for a given size event, the resulting financial impact is much greater for the life insurance industry versus the property and casualty insurance industry. Similar comparisons are shown for all four scenarios. ACLI proffers the following analysis for consideration:

(continued...)

Table 1, Considerations in Setting Threshold

	Annual Threshold			
Quantitative	**$5 Billion**	**$10 Billion**	**$15 Billion**	**$20 Billion**
% of Life Industry Death Claims[1]	10.4%	20.7%	31.1%	41.5%
% of Life Industry Surplus[2]				
– Total	2.5	4.9	7.4	9.9
– Portion Attributable to C-2[3]	12.5	24.5	37.0	49.5
% of P&C Industry[4]				
– % of Total Claims	2.1	4.2	6.3	8.4
– % of Industry Surplus	1.6	3.2	4.7	6.3
– % of P&C Threshold[5]	50.0	100.0	150.0	200.0
– % of Surplus for Comm Lines	4.0	8.0	12.0	16.0

Qualitative	
$5 Billion	Approximately 2 times the size of WTC disaster — approximately 3,000 lives lost, $2.0-3.0 billion of life claims.
$15 Billion	Comparable to 1917 flu epidemic, which resulted in approximately 30-40% increase in mortality rates in 1918. If this had occurred in 2002, it would translate to $14.5-19.3 billion of additional claims.

[1] Total industry death claims = $48.2 billion (as of 12/31/02)
[2] Industry surplus as of 12/31/2002 = $202.1 billion
[3] Assumes C-2 (mortality/morbidity risk) component = 20% of total
[4] P&C industry reflects 2000 figures; $239 billion of total claims, $317 billion of total surplus, commercial lines surplus = $125 billion
[5] % of 2003 insurance marketplace aggregate retention amount established by HR3210

Other considerations:

1. Impact of terrorist attacks will vary by individual company
2. Analysis does not reflect impact of economic correlation with large terrorist attack (e.g., bond defaults, market declines)

3.2 If not already identified in the matrix above, please describe the class of events with the "worst" impact for the line of insurance affected, indicating the concentration and the size of the event (or aggregate of events).

Group insurers, both life and disability, are more subject to concentration risk, meaning that an isolated terrorist attack on a large center of employment could have a substantial impact on any insurer writing those lines of business.

On the other hand, Individual Life and Disability insurers, while exposed to less concentration risk in relation to employment location, still may have significant concentration of insureds within a particular metropolitan area or state. Therefore, any terrorist event that affected a population center could have a substantial impact on Individual Life insurers.

Obviously, the "worst" impact, based on scenarios described in Question 3.1, occurs with an event of $20 billion or more of claims. However, scenarios of substantial impact occur at significantly lower claims levels. *See* Table 1, supra, responding to Question 3.1.

3.3 Please describe, to the extent possible, the likelihood of the events included in the matrix above.

Treasury, with its Administration relationship to Departments of Homeland Security, Defense, and State, is much better positioned to answer this question than is ACLI. As recently as the last week of July 2003 government officials advised of a heightened possibility of suicide commercial jetliner attacks against American targets during August 2003 based on information obtained from Al Qaeda. ACLI observes that there is a rich history of analysis from government, academic and scientific sources discussing various events and their likelihood.[xiv] Most recently, federal and state authorities have engaged in drills in various municipalities for emergency events the authorities must believe are potentially realistic.

3.4 *Please indicate whether you believe that the severity and likelihood of these events as you have described them is accurately reflected in current insurance availability conditions. Please be as specific as possible, including citing instances from your answers to questions 2.1–2.4.*

ACLI believes its survey and commentary above addresses this Question.

Federal Options

The ACLI believes that it is prudent for the federal government to consider the benefits of a federal backstop for Individual Life and Individual Disability and that a potential design be prepared should a future terrorist event of such catastrophic proportions make such a mechanism necessary. For purposes of education and discussion, the ACLI has prepared a concept draft of a possible federal backstop mechanism. The concept draft contemplates that the United States government would provide stabilization funding to direct insurers for ordinary life, group life, or disability excess losses attributable to terrorism when excess losses reach a Threshold Amount. Life insurers would report all claims for terrorism losses (Covered Acts) to the Secretary of the Treasury as well as reinsurers with a direct interest in the claim. The Secretary would aggregate such losses, determining whether any particular incident was terrorism for reporting purposes. If the aggregated losses reach a Threshold Amount of excess loss, Treasury is authorized to fund 80-100% of the excess loss, depending on level of excess.

Federal stabilization payments would be based upon the terrorism losses experienced by individually reporting insurers, comparing each insurer's experience to the total, aggregated losses of all insurers and the ratio of aggregated excess over industry retained loss. The concept draft provides for federal distribution of funds by March 1 of the year following that of excess loss determination, though advance periodic payments are provided for should they be warranted.

The ACLI concept draft contemplates industry retaining its historical proportion of risk and managing it with traditional underwriting, pooling and reinsurance tools. Federal stabilization funding is required only upon excess losses due to genuinely extraordinary catastrophic experience(s). The simple funds distribution method is admittedly insensitive to the possibility of geographic or market concentration that could result in disproportionate loss to an insurer or insurers, but it recognizes the impossibility of predicting terrorism loss by geography or market, and serves as an incentive for insurers to decentralize risk via underwriting, pooling and reinsurance.

The ACLI concept draft omits payback provisions such as those that exist in the Terrorism Risk Insurance Act (TRIA). This is because there is no way to retroactively surcharge in force Individual Life Insurance policies to recoup the additional terrorism exposure costs of the 21st Century. Inasmuch as the industry would retain its historical proportion of risk, it further seems appropriate as a matter of public policy that the loss attributable to a calamitous terrorist attack or series of attacks would be recognized as a public burden properly distributed via the federal backstop.

Another difference between the ACLI concept draft and the TRIA is the non-inclusion of company deductibles. The TRIA, which provides a backstop for property and casualty insurance risks and possibly a backstop for Group Life, includes threshold limits at a company level in addition to industry thresholds. This mechanism provides relief to a company distressed from terrorism losses even when the total catastrophe is not large enough to break through the industry threshold limit. The concept draft does not include a provision for company threshold limits. This is consistent with the ACLI Survey results suggesting that there is not a perceived need for a backstop at the company level but a perceived need at the Reinsurance level.

The concept draft is found at Appendix F. Briefly, it provides as follows:

CONCEPT DRAFT FEDERAL TERRORISM RESPONSE LEGISLATION
Section-by-Section Summary

Section 1. Short Title

The Act is entitled the "Life and Disability Insurance Terrorism Response and Financial Stabilization Act".

Section 2. Congressional Findings and Declaration of Purpose

The provision finds that the September 11 attack threatens the availability and affordability of life and disability insurance because the risk of catastrophic mortality or disability was not underwritten. Finds further that terrorism is a social issue that should be addressed through shared commitment of industry and government. The purpose of the Act is to provide assurance to insurers and reinsurers that they can continue to provide life and disability insurance—including group coverage to employers—to cover the risk of catastrophic loss due to terrorism occurring within the US.

Section 3. Definitions

Defines 12 particular terms used in the Act. A "Covered Act" is any act of terrorism in the US occurring after 11 September 2001 including such acts in US territories and possessions, on non-military US flag aircraft or vessels anywhere in the world, and on any aircraft en route to or from a destination in the US. "Covered Disability Claims" are defined as those claims paid for which reserves are established resulting from a Covered Act. "Covered Disability Losses" are defined to mean an amount equal to reserves held on disability insurance for federal income tax purposes. "Covered Life Losses" means claims arising from Covered Acts incurred by direct insurers on policies in force. "Covered Losses" means the sum of Covered Life plus Disability Losses sustained by direct insurers. "Excess Losses" means Covered Losses in excess of the Threshold Amount. "Funding Amount" means:

1. 80% of Excess Loss up to [10] billions dollars;
2. 90% of additional Excess Loss to [20] billion dollars; and
3. 100% of additional Excess Loss above [20] billion dollars.

"Life Insurer" is a direct insurer licensed by a US State to write life or disability insurance that participates in a state guaranty fund. "Reinsurer" is a company or entity that has assumed Covered Life or Disability Losses from a Life Insurer pursuant to a reinsurance agreement that has paid all or a portion of the Covered Losses. The "Secretary" is the US Secretary of the Treasury. The "Threshold Amount" is numerically undefined, but provided to exceed a billion dollars except for any calendar year immediately following a year in which Covered Losses exceed a lesser numerical amount that itself exceeds at least a billion dollars. The dollar amount shall be increased annually by the same percentage as Social Security benefits. The multi-year flexibility built into the definition of Threshold Amount addresses the possibility that Covered Acts could occur but not reach the Threshold Amount in the first year though still substantially draining upon industry reserves. Hence the Threshold Amount is reduced in the second year to address Covered Losses over time.

Section 4. Federal Stabilization Funds

Authorizes the Secretary to provide funds to Life Insurers and Reinsurers to fund Excess Losses. All Life Insurers and Reinsurers shall report by January 15 of every relevant year both gross Covered Losses and Losses net of reinsurance recovery as of the end of the preceding year. An allocation formula is provided to calculate the distribution of federal funding, which is accomplished on a net basis utilizing the same ratio of funding amount over total Covered Losses. A fund distribution plan is provided for. A retrospective company analysis is required to enable government to recoup excess funds released compared to actual claims experience.

Section 5. Rulemaking Authority

The Treasury Secretary is granted regulatory authority.

Section 6. Applicability of State Law

States laws regulating the amount of coverage or policy form approval or disapproval are preempted to the extent they apply to terrorism coverage in life or disability insurance policy forms. Funds released under the Act become admitted assets of the insurer or reinsurer for reporting purposes. The domiciliary state insurance department is charged to audit the distribution of federal funding.

Section 7. Secretary's Determination

The Secretary is authorized to determine whether any incident constitutes a Covered Act of terrorism. In the absence of the Secretary' determination, insurers and reinsurers may appeal to, first, the Secretary and, second, to US District Court for a determination.

Section 8. Authorization of Appropriations

Such sums as may be necessary are authorized for appropriation.

Section 9. Federal Definition of Insurance

Certain policy charges are recognized as Qualified Additional Benefits for tax compliance purposes.

Section 10. Termination of Federal Stabilization Funding

The concept draft applies to Covered Acts occurring prior to 1 January 2007. A commission is authorized in 2005 to evaluate the terrorist threat as well as private insurance market resources to address such threat. The study is to be delivered to Congress by 2006.

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ACLI Communications

Thank you for considering these comments. To expedite ACLI responsiveness to Treasury inquiries and requests for information, please use the following individuals as your contacts for ongoing communications:

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Sincerely,

Frank

FRANK KEATING, PRESIDENT
The American Council of Life Insurers

Appendices

A: ACLI Terrorism Impact Survey
B: Capital Ratios for the Top 50 Individual Life Insurance Companies
C: Individual Life Insurance Market Share Ratios By State
D: Capital Ratios for the Top 35 Group Life Insurance Companies
E: Group Life Insurance Market Share Ratios By State
F: "Life and Disability Insurance Terrorism Response and Financial Stabilization Act"

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[i] 68 Fed. Reg. 35775.
[ii] *Life Insurers Fact Book 2003*, ACLI, Chapter 2, "Assets".
[iii] *Ibid*, Table 7.5 "Life Insurance With Disability Provisions in the United States, 2001".
[iv] *Life Insurers Fact Book 2003*, ACLI, Chapter 1, "Overview
[v] "Ibid.
[vi] See, generally, *Life Insurers Fact Book 2002*, ACLI, Chapter 3, "Liabilities".
[vii] Experts discussed this particular aspect of the situation on 17 January 2002 during the National Association of Insurance Commissioners Public Forum on the Availability and Affordability of Terrorism Reinsurance.
[viii] The argument divides between those who believe it impossible to underwrite a risk where the causal agent, i.e., the terrorist, learns from experience, has technology to increase his or her deadly effectiveness, and may be willing to sacrifice his or her own life to achieve the deadly goal; and those who believe it just as possible to evaluate possible mortality attributable to terrorism as it is to evaluate mortality attributable to earthquake or influenza.
[ix] See, e.g., North Carolina Department of Insurance Bulletin 02-B-2 (3/15/02).
[x] Two other standard exclusions are those for suicide and aviation risk.
[xi] Mehr & Cammack, Principles of Insurance, 1976, pp. 427-428.
[xii] That is, courts have held insurance contracts to be contracts of adhesion, where any ambiguity is interpreted against the insurer that prepared the text of the policy and its exclusions. An insurer intends to exclude war from coverage, for example, and includes a phrase "enemy attack by armed forces, including action taken by military, naval, or air forces in resisting an actual or an immediately pending attack." Along comes an insured with a loss who argues that it was not caused by "enemy attack" but rather by invasion. A court agrees with the insured, or beneficiary of the policy. The policy exclusion is then amended to add the word "invasion." See Mehr & Cammack, ibid., at pp. 162-163. Thus many war clauses have been extended to "war, declared or undeclared" to address the historical fact that it became politically unfashionable to have Congress declare war even though the United States was involved over the second half of the 20th Century in numerous military or "police" actions involving troops, naval and air forces, and resulting in many American casualties. Indeed, the current situation is rife with ambiguity of consternation to insurers, since the war against terrorism is unlikely to be formally declared by Congress and not directed against any recognized state or nation.
[xiii] Members of the Individual Ready Reserve (IRR), assigned to positions in which they may be required to perform active duty, are also automatically enrolled in the SGLI program for $250,000. The SGLI also covers spouses and children of members insured under the program.
[xiv] The Cold War generated numerous studies of potential nuclear calamities. See, e.g., *The Effects of Nuclear War*, Office of Technology Assessment (National Technical Information Service) August, 1979. Chapter II discusses the effects of the detonation of a one-megaton nuclear device over Detroit. More recently, the effects of a nuclear explosion at the World Trade Center was discussed in "Avoiding Nuclear Anarchy", *BCSIA Studies in International Security*, 1996 (G.T. Allison, editor). The ramifications of terrorist attack against commercial nuclear reactors is discussed in "Nuclear Power Plants and Their Fuel as Terrorist Targets", D.M. Chaplin, *Science* 297, pp. 997-998 (2002). See, also, *Science* 299, pp. 201-203 (2003). Biological threat scenarios are summarized in *Engineering and Science*, 64[3-4](2001)(Steven Koonin article). In July 2001, ACLI President Frank Keating, then Governor of Oklahoma, participated in the Dark Winter exercise (a simulated covert smallpox attack on the US) carried out by The Johns Hopkins University Center for Civilian Biodefense Strategies, in collaboration with the Center for Strategic and International Studies (CSIS), the Analytic Services Institute for Homeland Security, and the Oklahoma National Memorial Institute for the Prevention of Terrorism. This and other exercises are engagingly discussed in *Our Final Hour: A Scientist's Warning* by Dr. Martin Rees (New York)(2003).