PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES

AND THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

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PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK

Wednesday, September 27, 2006

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE 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 notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Richard H. Baker [chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises] presiding.

Present: Representatives Baker, Oxley, Bachus, Kelly, Ryun, Biggert, Fossella, Feeney, Hensarling, Garrett, McHenry, Campbell, Kanjorski, Maloney, Moore of Kansas, Capuano, Hinojosa, Crowley, Clay, Israel, McCarthy, Baca, Lynch, Miller of North Carolina, Scott, and Cleaver.

Chairman BAKER. I would like to call this meeting of the Capital Markets Subcommittee to order. Today, we meet in a cooperative environment with the Committee on Oversight, chaired by Mrs. Kelly, who will conduct the hearing in the course of the second panel this morning.

We also are reviewing the recently publicly released GAO report on the subject of unconventional weapons reinsurance coverage, and find the report to be of real value to the committee's consideration.

We have two very distinguished panels of witnesses from whom we look forward to hearing their perspectives on current market condition, and I will quickly summarize what I believe to be the important findings of the report: one, that the current structure of TRIA as passed by the Congress appears to offer little incentive to market participants to extend NBCR coverage; two, that while coverage for conventional weapons threats appear to have expanded within the market, unconventional coverage has not concurrently grown at all; and three, the conclusion reached by the GAO, to me, most important, given the challenges faced by insurers in providing coverage for and the pricing of NBCR risks, any purely market-driven expansion of coverage is highly unlikely in the foreseeable future.

I think it makes clear that the committee's work and responsibility to respond to this observation is, indeed, important, and I am hopeful that we will hear suggestion as to how modifications to the existing TRIA coverage may be offered and some taxpayer responsible mechanism should be deployed, and for my own purposes, just wish to reiterate one element of a structure that I think important, and that is to view this assistance more in terms of a bridge loan as opposed to a grant, that at such time as it is necessary to call on the taxpayer to ensure market stability of the insurance industry, that at such time the industry returns to profitability, that any funds advanced be repaid to the taxpayer.

In that fashion, we can ensure that there are favorable market conditions for stability in the insurance world, while at the same time not creating a moral hazard risk for taxpayers who would feel inappropriately taxed for purposes that would not necessarily be clear to them.

Given those general overview statements, I welcome all of our witnesses to our hearing this morning, and I now turn to Mr. Kanjorski for any opening statement he may choose to make.

Mr. KANJORSKI. Mr. Chairman, we return this morning to a question that we have often discussed in the last 5 years: how best to protect the American economy from terrorism risk. After the Al Qaeda attacks of 5 years ago, reinsurers curtailed the supply of terrorism insurance, and insurers began to exclude such coverage from policies. In response, Congress belatedly enacted the Terrorism Risk Insurance Act to address these pressing problems. Last year, after encountering an unnecessary delay, we decided to extend this law for 2 more years.

TRIA is critical to protecting our Nation's economic security. We also designed TRIA to be a temporary backstop to get our Nation through a period of 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 interrupt the development of new products.

That said, however, it has become increasingly clear that it will take some time for the private marketplace to develop and offer terrorism reinsurance products, particularly for nuclear, biological, chemical, and radiological threats. Yesterday's report by the General Accountability Office concludes that these risks are distinctly different from those hazards that are predictable, measurable in dollar terms, random, and unlikely to result in catastrophic losses for an insurer. Given these challenges, the GAO found that, "any purely market driven expansion of coverage," for these specialized terrorism risks is "highly unlikely in the foreseeable future."

Late last year, when the House passed the initial bill to extend TRIA, we included language to provide protection against nuclear, biological, chemical, and radioactive terrorism incidents. We also included provisions to provide protection against domestic terrorism events and incorporated group life insurance as a covered line. Unfortunately, the final agreement adopted none of these reforms.

We need to revisit each of these matters in the coming year before TRIA once again expires. We additionally need to work to develop a comprehensive, long-term solution to the problem of insuring terrorism risk, rather than continuing to address these issues on an ad hoc basis every 2 years and creating unnecessary uncertainty for the marketplace.

To the extent possible, I continue to believe that any workable solution should allow for the private sector to underwrite the terrorism risks that it can cover. However, because terrorism risk is a societal problem and because the size of certain catastrophic terrorism risks would likely exceed the resources of the private sector, the Federal Government will likely need to play some role in this new system.

Many of our witnesses today have already begun to think about what a long-term solution to these matters should look like. I look forward to hearing those ideas. I also want to assure them that I have an open mind on these matters.

In closing, Mr. Chairman, I have regularly noted that the provision of terrorism insurance is not a Democratic or Republican issue. It is an American issue, a business issue, an economic security issue. I therefore continue to stand ready to work with all interested parties on these important matters.

Chairman BAKER. I thank the gentleman for his statement.

Mrs. Kelly?

Mrs. KELLY. Thank you, Chairman Baker, for agreeing to cochair this important hearing with me. I believe it is especially fitting that the last hearing of our subcommittees this Congress is going to be on the subject that is of the most importance to each of us.

The September 11, 2001, terrorist attacks on our country devastated our economy both nationwide and in New York. Thousands of lives and billions of dollars in property were destroyed in a single morning. While our national economy has largely recovered, we in New York still face the physical reminders. Our efforts to rebuild have been hindered by the lack of terrorism insurance available in the immediate aftermath of 9/11.

Thanks to Chairman Oxley and you, Chairman Baker, and others, this committee has passed and renewed terrorism insurance legislation. Economic development in New York and elsewhere is moving forward, including the construction of the Freedom Tower in lower Manhattan.

Our second panel consists of representatives from the World Trade Center development, along with business leaders from New York, and I welcome their testimony.

The GAO report that was released yesterday confirms the continuing terrorist threat to our country, and it demands a Federal backstop to our insurers so that it includes, also, nuclear, biological, chemical, and radiologic attacks. We do not charge people more money for health insurance if they are hit by a car or a bus, and I do not think we should charge America's consumers moire for coverage depending on which weapons our enemies use against us.

Similarly, I think we must extend the protections of TRIA to group life coverage. Failure to include group life coverage is the economic equivalent of a neutron bomb. It protects employers against the loss of a building, but it leaves families exposed to the financial consequences of losing their loved ones.

I was very pleased that the bill I cosponsored with you, Mr. Baker, in the House last year contained this coverage, and I hope that we will work together to make sure the bill we pass next year does the same.

I urge all members—again, this morning, it is a busy morning, and I would urge all members to limit opening statements so that we can move on and hear from these important witnesses. I thank you, and I yield back the balance of my time.

Chairman BAKER. I want to thank the gentlelady for her leadership on this issue, and all members from the New York delegation have been very focused in trying to seek a remedy that is appropriate, and I do appreciate her work product.

Ms. Maloney?

Mrs. MALONEY. Thank you very much, Mr. Chairman and Ranking Member, for holding this hearing, and I congratulate all of the witnesses today.

In particular, I would like to welcome my constituent and good friend, Sharon Emek, from the Independent Insurance Agents and Brokers of America, who will be talking about the impact on small businesses and the challenge that they face in trying to get anti-terrorism insurance.

As a proud representative of New York City, one of our financial centers and the site of Ground Zero, I am deeply committed not only to our national security, but an important part of our national security is economic security, and we cannot have that without a strong anti-terrorism insurance program with a Federal backstop.

The Al Qaeda attacked the World Trade Center and caused a terrible loss to life and economic loss. We were very proud that our markets reopened very quickly afterwards and our economy moved forward, but I can tell you, of all the challenges that we faced in New York—and they were huge, and we rose to that occasion.

The private sector, the individuals did heroic work to rebuild the economy. The number one challenge that we had was getting insurance. After 9/11, nothing moved until this Congress finally passed anti-terrorism insurance. That was a great day for New York.

The building started going forward, but what I hear from individuals, what I hear from the real estate roundtables and the trade organizations is that our businesses cannot get insurance now unless there is a provision on their insurance plan that says that this is contingent on getting a Federal backstop and Federal anti-terrorism insurance.

I have heard stories that some have had to go to Lloyd's of London to get insurance, and that the cost has escalated and hampered, but right now, what we face is that it may expire, and with that would end the economic development efforts that are taking place in New York and I would say across the country.

I would like to congratulate this Congress and really the leadership of the two—of the ranking member and the chairman and my colleague from New York, Sue Kelly, in passing the TRIA legislation.

We need to renew that, or some form, and it must include unconventional weapons—nuclear, biological, chemical, and radiological—because that is what the insurance agencies are demanding.

The Government Accountability Office issued a report yesterday, and it states very clearly that, given the nature of these risks, we cannot expect the private sector to solve this problem alone, and I quote from the independent Government Accountability Office.

"Given the challenges faced by insurers in providing coverage for and pricing for nuclear, biological, chemical, and radiological risks, a purely market-driven expansion of coverage is highly unlikely in the foreseeable future,".

I encourage all of my colleagues to read this very excellent report, which explains this conclusion in detail.

Given this information, it is, once again, up to use to renew TRIA long before it expires at the end of 2007. As the witnesses will explain, the alternative is absolutely unacceptable.

At the same time, we must provide for a true blue ribbon commission, with representatives from the industry, from affected policyholders, from victims and government, to study the problem and to come up with recommendations for potential long-term solutions.

I was profoundly disappointed that this provision was removed from our last bill, and I will work hard to get it back in in any renewal we have. We from New York have some experience dealing with terrorism and its aftermath. So, this issue is very, very pressing for us, and many other cities, but it is a very serious error to view this as a New York or urban problem. It is a national challenge.

Terrorists can strike anywhere, and in fact, studies by the Rand Corporation and others suggest that they may be more likely to attack less "hardened targets" and other locations, including rural locations.

Chairman BAKER. Can the gentlelady begin to sum up?

Mrs. MALONEY. Well, I have a lot to say on this, but time is of the essence, so I request permission to put all of my comments into the record.

Chairman BAKER. Without objection.

Mrs. MALONEY. I appeal to my colleagues on both sides of the aisle to work together, as we have in the past, to renew TRIA.

Thank you for this hearing.

Chairman BAKER. I thank the gentlelady for her continued effort on this important subject.

Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman. I want to thank you for holding this hearing. It is truly a very serious topic that we discuss today. I was one of many who voted to extend TRIA, but at the time, I said that I had concerns about any time of permanent Federal backstop, and I come into this hearing continuing to have an open mind but somewhat of a skeptical mind, as well.

Number one, truly I believe that the best way that we can reduce the risk of catastrophic terrorism is to unite together and figure out the best way to win this war on terror, clearly a debate for a different committee and a different time.

I have a skeptical mind about a permanent reinsurance program, because I still have a firm belief in the power of the marketplace, given time, that if truly these types of policies are demanded, somebody will provide it at the relevant cost.

Yes, I did spend most of last evening reading over the GAO report, and did note their conclusion that nuclear, biological, chemical, and radiological risk is distinctly different.

I have not done my—I have not studied the history of the industry, but I am curious about other phenomena that at one time in

American history were distinctly different that somehow the industry had to learn how to deal with, be it airline crashes, oil spills, power outages, data losses.

Clearly, this type of risk is different in its catastrophic nature, but it wasn't that many years ago that this Nation faced the Soviet Union, with their massive nuclear arsenal, with thousands of nuclear warheads pointing at us, and we all knew the nightmare of mutual assured destruction.

I am somewhat curious how we as a Nation, in dealing with that risk, handled that catastrophe. Next, I am skeptical of any long-term Federal backstop, because I do not think the history of the Federal Government is particularly stellar in this area, when I look at what we have had to do recently in the Federal flood insurance program, which is having to be bailed out with billions of dollars; the Pension Benefit Guarantee Corporation, billions of dollars; and we all know about the plight of Social Security and Medicare and their trillions of dollars of un-funded liabilities.

So, I continue to be very concerned, particularly about families who have a lot of their net worth in their homes, small businesses, but I also know, when it comes to very large, sophisticated businesses, there are other ways to reduce their risk, and that is not to have too much of their money in any one given bill.

So, I know we have a number of serious challenges here. I look forward to hearing from our witnesses, and I hope that, indeed, we will explore all options, and particularly those that might limit the taxpayer exposure.

With that, I yield back.

Chairman BAKER. I thank the gentleman.

Mr. Moore?

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman, for having this hearing. I would like to thank you and Chairwoman Kelly for having this hearing today. It is very important, I think.

I would also like to welcome Greg Case, the president and CEO of Aon Corporation, and a Kansas native, who is testifying before us today on the first panel.

The GAO released a study this week that examines the insurability—and we have heard about that some here this morning—of risks from nuclear, biological, chemical, or radiological weapons attacks. The GAO study concludes that the risk of attacks from NBCR weapons generally fail to meet most or all of the principles of an insurable risk.

As we know too well, the terrorist attacks of September 11, 2001, resulted in thousands of deaths and injuries, along with the destruction of the World Trade Center, and many other buildings and businesses in New York. Unfortunately, those attacks also resulted in significant economic and insurance losses.

A recent study by the American Academy of Actuaries estimated the insured losses that could arise in four U.S. cities as a result of NBCR attacks. In New York alone, a large NBCR event could cost as much as $778 billion, with insured losses for commercial property at $158.3 billion and for workers comp at $483.7 billion.

There are limited circumstances, I think, when the Federal Government needs to step in, when a private market fails to develop in a certain area, and flood insurance is one of those areas. I believe that terrorism insurance is another.

Extending TRIA is not a partisan issue and should not be a partisan issue, and Democrats and Republicans ought to come together here to come up with a common sense workable solution to provide a needed element of stability and certainty to our economy. Terrorist attacks in our Nation don't target Republicans or Democrats; they target all Americans, and they affect all of us, wherever we live and whatever we do. I look forward to continuing the successful public/private partnership that we have forged on this issue, as Congress works to extend the TRIA program next year.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman for his statement.

Mr. Garrett?

Mr. GARRETT. Thank you, Mr. Chairman, and once again, I thank you for holding this hearing, as I join my colleagues here today, and I wish, as always, that this is a very important issue, that we would have more of our colleagues here to hear the discussion and testimony of this panel.

I come here today with an open mind, to hear the sides of the discussion presented. The committee voted in support of the extension of the TRIA. We did so at the same time that Chairman Oxley asked GAO to report back to us, as we recently received a report that would look at the commonly accepted principles of insurability, and whether NCBR are measurable and predictable, some of the things that we, from a gut reaction, should be able to answer without a report, but now we will have that report in hand.

In the near future, we are also expecting a more comprehensive report from the President's working group, and many of us are anxiously awaiting that and trying to find out what the inside story may be on that, in anticipation of it, but anticipation, considering where it has come from, I can somewhat predict, not the leaning, the direction in which that report may come to us.

This is an issue that just continues to—I do not want to use the word "haunt us" when they go back to the district, but certainly is raised when we go back to the district, in the State of New Jersey, from both big and small industry alike, the concern about the availability of insurance in general for them.

New Jersey, the home of the shopping centers and shopping malls, maybe the largest concentration in the State of New Jersey, and the insurability across the various spectrums of insurable risks and businesses—I am constantly confronted with the issue, from chamber of commerces and business and industry, when will you finally, once and for all, address this in one format or another.

So, I will just conclude, Mr. Chairman, that I think Congress must be taking some action in this area, whether it is on the private sector, as Mr. Hensarling suggested, or a more comprehensive approach, and I thank you for the hearing today.

Chairman BAKER. I thank the gentleman for his statement.

Mr. Crowley?

Mr. CROWLEY. Thank you, Mr. Chairman. I want to welcome this subcommittee hearing on this terrorism risk insurance, and welcome the panel before us and later today.

The timing is great, with the GAO's recent release of its report on the capacity of the private markets to provide NBCR coverage, and while we await, with baited breath, the President's working group report, the GAO report states, "Given the challenges faced by insurers in providing coverage for and pricing NBCR risks, any purely market-driven expansion on coverage is highly unlikely in the foreseeable future."

The reasons behind this GAO conclusion that there was no private sector market for NBCR are the same reasons why there was no private sector market for any terror insurance. The fact is there is no appetite for the global reinsurance market to fill the gap for either terror insurance or NBCR insurance.

Without some sort of Federal backstop, and I think supporters of TRIA are open to adjusting the program to include a pool for new tax incentives for the insurers and insured or other avenues, there will be no terrorism insurance at all. Insurers will walk away. We saw this between the time of the 9/11 attacks and when we first passed TRIA. Now it will be even worse.

Currently, the Federal role plus the make available language ensures we have an affordable market for terror insurance. We do not have a make available provision for the NBCR now, and what do we see? We see little NBCR coverage, because like any terror coverage, it is too difficult to price it for risk.

GAO says this, but more importantly, the fact on the streets show this. I hear some of my friends on the other side of the aisle debate this argument that the Federal backstop stops any innovation in the private sector from creating pools or other non-government-backed terror insurance. This is simply wrong. There is no other alternative to terror insurance outside of the system we have that provides a Federal backstop, because there is no interest in the capital markets to create such a private run system with no government backing, and this will not change if TRIA disappeared tomorrow somehow.

Some sort of Federal role will always be needed in the terrorism insurance marketplace, or there will be no insurance for terror. The result: If we suffer another attack, the government will be on the hook for the entire cost, as our government will not walk away and not help, as Katrina, for example. With some sort of backstop, our government is actually cushioned with financial support from the private insurance and reinsurance market.

The commonsense approach to both protect our Nation's economic well-being and the taxpayers' money is to have a permanent Federal backstop in the terror insurance marketplace, and I will just add this one final point. This is terror month here in the House of Representatives. This is as good a time, I guess, as ever to examine the only economic security measure against terror that we have enacted on the economic level that has worked over the last 5 years.

It has worked. This is a program that has worked, a program that, despite the GAO report to the contrary, many of my colleagues on the other side of the aisle want to see ended. I hope that is not the case at the end of 2007, and I hope that this hearing today will shed some additional light as to why we need to see TRIA "permanent-ized", and I yield back the balance of my time.

Chairman BAKER. I thank the gentleman for his statement.

Mr. Campbell, I know you are just arriving. Do you have a statement?

Mr. Israel?

Mr. ISRAEL. Thank you, Mr. Chairman.

Mr. Chairman, I think I have said everything that could be said on this issue in the past 2 years, and so, I am going to yield back my time and listen to our witnesses.

Chairman BAKER. I thank the brilliant observations of the leading member of your side.

Mr. Baca, do you choose to proceed?

Mr. BACA. I will make a statement.

Chairman BAKER. Please.

Mr. BACA. Thank you very much, Mr. Chairman, for holding this important issue, and this is not a partisan issue but an important issue of protecting America against a terrorism attack. The fifth anniversary of 9/11 serves as a reminder that we live in different times and must guard against economic cost of future terrorism attack.

The Terrorism Insurance Act, TRIA, has been an important safety net and has played a critical role in helping protect our Nation against this risk. Post-9/11, it is clear that a Federal backstop for terrorism insurance is essential.

The GAO report which informed us that the private sector has not fully developed the capacity to provide coverage for terrorism risk also confirms the need for Federal involvement. Without a Federal reinsurance backstop, insurance will include the type of coverage from the policy. Tens of thousands of jobs will be lost, and thousands of additional bankruptcies could occur compared to what we saw in 9/11.

Our constituents, small businesses, property owners, and communities everywhere need protection. It is critical that they have access to coverage that are at affordable rates, at affordable rates. We must reach an agreement on the best solution, and I hope today's hearing and the outcome of the report by the President's working group, PWG, on financial markets, will help us assess some of the details that need to be decided upon.

Terrorism is directed at our entire Nation. It is directed at our entire Nation, and not just certain cities and towns. It is a national security issue that needs permanent Federal solutions to help guard our citizens.

I thank the witnesses for coming to share their ideas with us, and I look forward to their testimony, and once again, I thank our chairman for hosting this important hearing today.

Thank you.

I yield back the balance of my time.

Chairman BAKER. I thank the gentleman.

Mr. Hinojosa, did you have a statement?

I thank the gentleman.

Mr. Lynch?

Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. I will follow Mr. Israel's lead.

Chairman BAKER. Thank you very much. You are contributing mightily to our progress. I appreciate that.

Mr. Scott?

Mr. SCOTT. I will follow Mr. Israel's lead a little bit.

[Laughter]

Mr. SCOTT. I just want to say that I think it is very significant for a couple of points.

One, that we not only just have representatives of industry here, but we have the CEO's, the chief executive officers of the insurance companies, because I think it points out that we definitely need a national strategy. That has to include plans to provide a back-up against possible massive insurance claims, and because terrorism is less predictable and possibly more severe than other catastrophes, it is necessary that the Federal Government ensure that insurance remains available even if the private market is not doing so, and while we passed TRIA through 2007, I think it is important that we provide a meaningful extension of TRIA, while creating a long-term market-based solution to the problem.

A final point is that, as a sponsor of the Capuano bill, I also believe it is important that the people inside the buildings be insured, and therefore, I support the inclusion of group life insurance in TRIA as we move forward.

That is it, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Cleaver?

Mr. CLEAVER. Very, very briefly.

I have listened—I have counted—there have been four different members who have said that this is not a partisan issue, and perhaps it is not, but it is the classic debate over the role of the Federal Government in this country, and it is a debate that did not start with—begin with TRIA, and I am looking forward to having that debate. It may be political, it may be ideological, it may be financial, but it is a debate, and it is not an accident that large numbers of minorities moved to Washington, D.C., because they wanted to get—they thought they were safer, the closer they got to the seat of government, and I have seen this argument even in the area of civil rights, and when you have $90 billion in New York alone in insurance losses, 200 billion in all, we are going to have a problem, and it is my hope that we will have a pure debate on this issue, because a lot depends on what we are able to do.

Mr. Chairman, I spoke to a Rotary Club in my home district in Kansas City, Missouri, and during the question-and-answer period, one of the gentlemen stood up and just went ballistic, because he did not believe the Federal Government should be involved in the clean-up on the Gulf Coast, and I think there are people with that philosophy, not just in Kansas City but in this Congress, and something should be resolved, and we do not have a long time to do it, and so, it is my hope—thank you, first of all, for the hearing, and it is my hope that, before the gavel sounds at the conclusion, that we will have come closer to moving to a political, ideological, or philosophical position that will help the people in this country with regard to their insurance in the case of NBCR or another Katrina.

Thank you.

Chairman BAKER. I thank the gentleman.

Mr. Hinojosa, did you choose to make—

Mr. HINOJOSA. Yes. Thank you, Mr. Chairman. I am ready now.

Mr. Chairman, while it is true that nuclear, biological, chemical, and radiological threats present unique risks in both size and scope, conventional terrorism, like that at the WTC, still remains a threat. I want to stress that it is absolutely necessary that we maintain a public/private partnership for these risks in order to keep this insurance coverage available.

Additionally, I also hope that, in the future, we will revisit the flood insurance legislation and the impact the 100-year flood plain mapping will have on some of the poorest counties in the country, including Hidalgo County, which is in my Congressional district, the 15th district of Texas.

With that, Mr. Chairman, I yield back the remainder of my time.

Chairman BAKER. I thank the gentleman.

Ms. Biggert, do you have an opening statement this morning?

There being no further members for recognition, at this time I would turn to our distinguished panel and state our normal operating procedures.

We ask that your full statement be limited to 5 minutes to enable members to engage in questions as much as possible. Your official statement will, of course, be made a part of the hearing record, and you will have to pull those microphones close in order to be heard well, and the little button on the bottom gets you in the game.

So, with that, our first witness is Mr. Edmund F. Kelly, chief executive officer, Liberty Mutual Insurance Company.

Welcome, sir.

STATEMENT OF MR. EDMUND F. (TED) KELLY, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, LIBERTY MUTUAL INSURANCE COMPANY

Mr. KELLY. Thank you, Chairman Baker, Chairwoman Kelly, and Ranking Member Kanjorski, for holding this meeting, and distinguished members for attending. It is a privilege to be here to testify on what I view as one of the greatest challenges facing our Nation, our economy, our industry, and its policyholders.

Before I begin, I do want to pay tribute to—although he is absent—to Chairman Mike Oxley, who is retiring this year, for his leadership on the extension act of last year. We owe him a great debt of gratitude. Now on to the subject at hand, protecting Americans from catastrophic financial loss from terrorist attack.

In an ideal world, protection from financial loss could be left to the private insurance industry operating in a free market, but as I stated in my written testimony, the insurance market is not free. Regulation prohibits us from making normal economic and fiduciary decisions mandated in the face of unpredictable and potentially hundreds of billions of dollars of losses terrorism presents.

Congressman Hensarling raised an interesting issue. In fact, during the nuclear stand-off with Russia, most insurance policies allowed for war exclusion. They do not allow for terrorism exclusion. So, the country recognized the need for a special exclusion in the face of the Soviet threat. Without exclusions, the Federal backstop is necessary, but the industry does not have the capital—it is not just a matter of pricing. The industry does not have the $7- or $800 billion of capital necessary to absorb the threat presented, particularly by NBCR. There is little capital available in the world reinsurance market.

We estimate that the total reinsurance capital available for normal terrorism, if there is such a thing, is in the area of $7- or $8 billion. There is essentially none for NBCR.

While the Terrorism Risk Insurance Act of 2002 and its extension of last year were very welcome, but they were just a stop-gap. As Chairman Oxley aptly characterized last year's activity, it was merely kicking the can. The short-term acts have created instability.

First, they are calendar-year-based, whereas we provide insurance on a policy year basis. Second, the lack of a long-term plan creates periodic economic and business uncertainty. Absent a Federal backstop, there would be little or no insurance available for terrorism.

I know the subcommittee chairs, Chairman Baker and Chairwoman Kelly, understand this, and I would be remiss if I did not take this opportunity to acknowledge the sustained and effective support for the proposition by Ranking Members Frank and Capuano from Massachusetts.

The GAO appears to have reached a similar conclusion, that given the challenges faced by the private market in providing coverage for terrorism risk, particularly NBCR, any purely private market for terrorism risk insurance is highly unlikely.

So, how should a public/private partnership that is the essence of TRIA be reworked to reflect GAO's conclusions and to meet the needs of insurers, buyers, and sellers, and to meet the legitimate concerns of you in Congress? In other words, what might the next generation of TRIA look like?

About a dozen large company CEO's, organized as the Property Casualty CEO Roundtable, which I currently chair, asked themselves the very same question. We at Liberty Mutual and The Hartford have led the industry effort to come up with an appropriate framework. The effort included the major insurance and reinsurance trades, effectively the entire U.S. property and casualty insurance industry.

What we developed is not a detailed proposal but a framework that focuses government involvement on what private markets cannot do alone, while creating significant incentive for the private sector to do much more over time. In that way, it is responsive to the quite appropriate concern that TRIA or its successor legislation not displace or interfere with private markets.

The framework envisaged a two-part structure financing both NBCR and non-NBCR risk. For NBCR, the Federal Government would assume a significant role—all or most of the risk on a reinsurance basis for losses which insurers cannot exclude, such as those on workers compensation insurance.

For losses that would be covered but for exclusions, such as property insurance, NBCR risk would be assumed by the Federal Government on a following form basis that is subject to the policy terms and limits.

For non-NBCR, a TRIA-like structure would be maintained. There would be insurer deductibles which would gradually increase—for example, one point per year for 10 years, or be adjusted subject to Treasury determination of available capacity.

There is no one right way to do this, but the notion is that insurers should bear a greater share of the non-NBCR risk as they have capacity to do so safely.

Consistent with this, there should be creation of a voluntary, federally-charted entity to facilitate development of new private reinsurance capacity from the issuance of pre-event catastrophe bonds and the sale of industry loss warranty contracts to help fund insurer deductibles. We believe that such a two-part program will effectively address both the NBCR risk, which is totally uninsurable in the private sector, and the non-NCBR event. We are committed to working with this committee and others in our industry and in the policyholder community to establish an appropriate public/private partnership that makes terrorism risk insurance available for the long term.

I do want to address Chairman Baker's repayment option. We have considered that, and it is far too early to decide whether or not to support such a thing. We have two significant concerns.

One, if it is established as a liability for the industry, it will go on our balance sheets and will make us just as bankrupt as if we had to pay the cash. So, you have to take care of the details and be careful about the accounting issues.

Second, even if they are taken care of, there is a significant problem with recovery through surcharge. Policyholder surcharges always end up being picked up by small business.

Large business can reduce their insurance buy through deductibles and self-insured retentions to avoid surcharges. So, inevitably, anytime there is a surcharge, it is borne primarily by small businesses.

So, we have to be very careful, if there is a repayment mechanism, not to do more damage to the business and economy of the country than would be done already by the act of terrorism.

We are willing to work to come up with an acceptable solution. But we have concerns with that approach, Chairman Baker.

Thank you for the opportunity to address you.

[The prepared statement of Mr. Kelly can be found on page 135 of the appendix.]

Chairman BAKER. Thank you very much, sir.

Our next witness is Mr. Ramani Ayer, chairman, president, and chief executive officer of the Hartford Financial Services Group.

Welcome, sir.

STATEMENT OF RAMANI AYER, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, THE HARTFORD FINANCIAL SERVICES GROUP

Mr. AYER. Good morning, Chairman Baker, Chairwoman Kelly, Ranking Member Kanjorski, and members of the subcommittees. Thank you for the opportunity to appear before you today.

My name is Ramani Ayer. I have been at The Hartford for 33 years, and have been its chairman and CEO for the past 9 years. I have filed my written statement for the record. Thank you for convening today's hearing on this very important topic of the economic response to the threat of terrorism.

The Hartford is a property casualty and life insurer. We provide retirement security and protection against loss for Americans and their businesses. The Hartford is the Nation's second oldest insurer. Founded in 1810, we look back with pride at our record of serving our policyholders throughout the course of American history.

Policyholders from President Abraham Lincoln to Babe Ruth have relied on us to fulfill our promise to meet our obligations to them. We were there to cover the losses of our policyholders during the Great Chicago Fire and the 1906 San Francisco earthquake. We were also there on 9/11.

As I consider The Hartford's 196-year history and my own experience in this industry, I see one peril that stands out as unique: the threat of a terrorist attack. Let me take a moment to explain why. First, terrorist acts are unpredictable. Our industry has no means of knowing when terrorists will attack, where terrorists will attack, and what kinds of weapons they will use. We do know from the terrorists' own pronouncements that their principal objective is to disrupt our way of life, inflict massive casualties on our population, and bring our economy to a standstill.

Second, as we saw with 9/11, the damage to property, loss of life, and injury, and the impact on our economy, is potentially unprecedented and incalculable. As our leaders in government constantly remind us, the terrorists' ultimate goal is to gain access to even more deadly tools such as nuclear, biological, chemical, and radiological weapons. Their goal, of course, is to have the most severe impact. Frankly, some attack scenarios considered by our intelligence sources and private modeling firms are so devastating that they would not only overwhelm the entire insurance industry, they would put the economy into a tailspin.

Third, terrorism is both a public and private risk. Most obviously, terrorist attacks are designed to hit people and property. Less obvious, they are also explicitly designed to threaten America's national security, its economy, and its sense of confidence. They ar an attack on the entire country and its vast and complex infrastructure, no matter where they occur and whoever is hurt or killed.

The incredible resilience of the people of this great country and its economy were shown in the hours, weeks, months, and years following the attacks of September 11, 2001. The terrorists thought they could change our way of life and shut down our economy. They were wrong. Our country responded as America always has in times of crisis, with resolve, purpose, and strength.

This committee passed important new laws to reflect the new reality. One law that has played an important part in that response has been the Terrorism Risk Insurance Act. The purpose of the law is to provide a public/private partnership to prevent the terrorism threat from disrupting our economy. TRIA has worked. Since its inception, it has been the economic backstop that helped America's economy to thrive in the face of a potential catastrophic threat.

So, let me commend the members of this committee for helping advance the recovery from the attacks of 9/11 and defending our economy and its foundations. As I stated earlier, our leaders in government tell us the threat of terrorism is still very real. I look forward to working with the committee in your efforts to counter the effect of terrorism and secure the economic future of every American with important laws such as the Terrorism Risk Insurance Act.

Thank you.

[The prepared statement of Mr. Ayer can be found on page 83 of the appendix.]

Chairman BAKER. Thank you, sir.

Our next witness is Mr. Gregory C. Case, president and chief executive officer of Aon Corporation.

Welcome, sir.

STATEMENT OF GREGORY C. CASE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AON CORPORATION

Mr. CASE. Thank you. Good morning, and thank you, Chairman Baker, Chairwoman Kelly, and Ranking Member Kanjorski and members of the committee. I am very pleased to be here today to testify on behalf of Aon and on behalf of the Council of Insurance Agents and Brokers.

What I wanted to do first is just take a bit of a step back and explain a little bit about Aon and why I am here. In many respects, I would suggest to you that Aon is in a somewhat unique position to comment on the very important topics of today.

Aon provides risk management, risk advice. Aon is not an underwriter. So, we sit between companies and insurance companies and the capital markets. That is how we work. We do this across the world. We have got 47,000 colleagues around the world, in 500 offices and 120 countries around the world. So, arguably, we may be working with more companies on the topic of risk advice and, in accordance, terrorism than anybody else on the planet. That is the vantage point.

I would also be remiss if I did not let the committee know that Aon takes this issue quite personally. While all of us commemorated the 5-year anniversary of the tragedy of 9/11, I will tell you that Aon also remembered 176 colleagues and friends who lost their lives in the twin towers. So, I want you to understand where Aon is coming from. We are not an underwriter. We are not an insurer. We do not do what my colleagues to the right do, Mr. Ayer and Mr. Kelly.

We support them in what they do, but we really focus on our clients. That is the focal point. It is important for me to convey that to you, because I want you to use that as the basis to understand the comments I am about to make with regard to this critically important topic, and I am going to hit three issues and three issues only to start.

First, I would suggest to you, as someone who is focused on companies, businesses that we serve every day, flat out, I will tell you that TRIA has worked, in our mind. Post-9/11, you, your predecessors, and the President enacted TRIA. You also took steps to enact the next iteration of that in 2002, and the next iteration in 2005, and I will suggest to you, as we look at this through the eyes of the firms and the companies we work with around the globe, that this has been crucial in sustaining our economic performance, and I would suggest to you the economic performance and health of the economy.

TRIA, flat out, made coverage available and accessible. The comments made about the absence of coverage post-9/11 were absolutely right. In our role, we are in search of underwriters, in search of markets to serve our clients. Post-9/11, the capacity did not exist. What little capacity did exist was priced to an extreme.

I would suggest to you, as you look over the last few years, the uptake of terrorism insurance, companies out there in the United States who buy terrorism insurance, the uptake of that is 60 percent. That is an astounding number.

In that time, over the last 3 years, as well, the cost of that insurance has roughly come down by around 25 percent, and I would remind the committee that is in the context of an industry in which the cost is going up over time.

So, the pragmatic set of answers—I was not in the chamber, did not have to go through what all of you went through, but I would suggest the pragmatic set of answers and the actions you took to enact TRIA in the form that it was before 2005 and then after, and in the view of Aon, in the view of our clients, in the view of the companies we serve and work with, worked extremely well, and I commend the committee on that act. Without that, the outcome in terms of the impact to the economy would be quite devastating from our point of view. So, point one, TRIA has worked. It is a solution, a pragmatic solution that has worked.

Second observation: From our point of view, the private market, currently, as things stand today, absolutely cannot cover terrorist risk without some kind of government involvement. I look forward to discussing that with the committee. We have heard three or four arguments over the course of the last year that suggest otherwise. One is the capital markets. The capital markets are going to come in, they are going to take this risk away, do not worry about it, the capital is going to come to pass.

I am here to tell you, we work with the capital markets. We work with the primary companies, we work with the underwriters, and we work with the capital markets. We were a pioneer in issuing catastrophe bonds. We have issued as many catastrophe bonds as anybody on the marketplace today. The capital markets cannot come in and solve this issue. They will not come in and solve this issue. We know these capital markets. We know who would buy these bonds. They will not do this.

Second, we have heard that the insurance companies will step up and actually take up the slack. Colleagues to my right, Mr. Ayer and Mr. Kelly, will be able to do this with their firms.

I am to tell you, they price their products, they price what they do based on what is the risk, the frequency of the risk, the impact of the risk. It is un-achievable in this situation. They simply cannot come in and fill the entire void. As someone who represents clients, that is just the fact. That is just the case.

The final point is that reinsurers will be able to come in and solve this issue. We work with these reinsurers every day. That is what we do on behalf of our clients. The reinsurers, even more so than the primary insurers, have to price their efforts and products around frequency, how often it will occur; severity, how big of a deal will it be?

That is where it differs from airlines and from other catastrophes that have occurred over time. It is very, very different. The other factor I would suggest the committee look at is the impact of the rating agencies over the course of the last year.

Rating agencies post-Katrina have even restricted the reinsurers even more, perhaps justifiably so, but in terms of the aggregate ability for them to step in, it is very, very difficult.

The final point I would just make is that I would absolutely agree that the long-term answer has to be a combination of private sector solution, primarily—it should carry the day. The private sector solution would be the one that we would suggest, in the eyes of our clients, would be most important.

In fact, I would tell you that Aon, a year ago, put forth a solution which laid out an $80 billion pool, aggregate. It would cover four World Trade Center events, four, and be covered by the industry, and there will be many other proposals that come forward, and we would suggest to you, again, on behalf of the clients we serve and the companies we serve, the firms we serve, one of those sets of options, which will be different than TRIA—it will be an evolution of TRIA.

It will put the private sector more involved than every before, but will still need to involve some form of government support, government backing. I prefer to call it a bridge, a bridge to more of a private sector solution, as opposed to a backstop. So, my third observation is we absolutely need to move in that direction.

So, I thank the committee. Thank you very much.

[The prepared statement of Mr. Case can be found on page 88 of the appendix.]

Chairman BAKER. Thank you for your statement, sir.

Our next witness is Mr. Jacques Dubois, chairman and chief executive officer, Swiss Re America Holding Company.

Welcome.

STATEMENT OF JACQUES E. DUBOIS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, SWISS RE AMERICA HOLDING COMPANY

Mr. DUBOIS. Good morning. My name is Jacques Dubois, and I am president and chief executive officer of Swiss Re America Holding. I am also here on behalf of the Reinsurance Association of America, the RAA.

Before I begin my testimony, I want to thank Chairman Oxley, Chairman Baker, Chairwoman Kelly, Ranking Member Kanjorski, and the members of this committee for the leadership you have all shown on the terrorism insurance issue. Your leadership has been critical to the adoption and continuation of the successful TRIA program. The reinsurance industry appreciates the hard work and support you have provided on this important issue.

Now, Swiss Re and the RAA strongly supported the adoption of the Terrorism Reinsurance Act in 2002 and its extension in 2005. The Act has assisted in filling a vacuum in reinsurance capacity, and has helped bring stability to the marketplace and to the economy.

TRIA has enabled insurers to provide insurance coverage to protect assets and to support economic activity. From our perspective, TRIA has performed as designed and has cost little to administer.

Swiss Re and the RAA believe that the U.S. insurance and reinsurance industry cannot adequately underwrite and model the scale and frequency of potential future terrorist attacks. Consequently, we believe that the insurance and reinsurance industry cannot provide significant terrorism coverage for this country without TRIA's support.

Now, this may change in the future if terrorism risk lessens, but absent such world conditions or improvements, Swiss Re does not see a time when the frequency and severity of terrorism risk can be significantly and successfully modeled and underwritten for the insurance industry to supply market needs by itself. Some have expressed concern that TRIA preempted the private reinsurance market. This is absolutely not the case.

By establishing definitive loss parameters, TRIA has provided a defined layer for reinsurers to participate in sharing the retained risk that primary companies face, and reinsurers have been willing to put limited capital at risk to manage terror-related losses.

Swiss Re is active in this limited market, but the amounts are small. The RAA surveyed both reinsurance brokers and reinsurance underwriters to estimate how much terrorism reinsurance capacity the market is providing, and overall, the RAA estimates the global reinsurance capacity available in the United States for 2006 at about $6- to $8 billion for TRIA certified stand-alone and treaty reinsurance, and it is also important to emphasize, as others have today, that there is very little reinsurance appetite for nuclear, radiological, biological, and chemical risks. According to the RAA survey, NRBC capacity is estimated to be 15 to 20 percent of the terrorism risk capacity I cited a moment ago, and when it is available, pricing for coverage including NRBC is at a significant premium, and coverage amounts are also strictly limited.

With specific regard to workers compensation, insurers have been able to add terrorism peril to their reinsurance programs, but this coverage excludes NRBC losses. Some have suggested that the capital markets could assume terrorism risk. Setting aside the pricing problems that would also be faced by the capital markets, capital market participation today in insurance risk-taking is small. In 2006, issuance of cap bonds and other capital market vehicles will likely exceed $6 billion. Swiss Re experts estimate that cap bond issuance to grow to approximately $10 billion by the year 2010.

Now, this amount is dwarfed by the total value of privately owned commercial structures in the United States. According to the Bureau of Economic Analysis, these structures had an estimated value of $8.8 trillion at year-end 2005, or an amount more than 1,000 times greater than the current cap bond market.

Certain group life insurers have petitioned for inclusion of group life in TRIA. Swiss Re is the largest reinsurance of group life writers in the world and in the United States, and we support their petition. Most State regulators will not allow group life insurers to manage their risk through terrorism exclusions. As a public policy matter, most State regulators have decided that this basic insurance, covering 167 million Americans, is vital. We urge you to add group life insurance to a permanent backstop.

In conclusion, due to the nature of the terrorism peril, we believe that the private market mechanisms are insufficient to spread the risk of catastrophic terrorism loss. Without some form of Federal backstop, we would expect less coverage available at the policyholder level, increased prices for what limited amount of terrorism cover is available, and limited reinsurance capacity.

I thank you for this opportunity to address you on this important issue.

[The prepared statement of Mr. Dubois can be found on page 97 of the appendix.]

Chairman BAKER. Thank you, sir, for your statement.

Our next witness is Mr. Christopher J. Nassetta, president and chief executive officer, Host Hotels and Resorts, Inc.

Welcome.

STATEMENT OF CHRISTOPHER J. NASSETTA, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HOST HOTELS AND RESORTS, INC.

Mr. NASSETTA. Good morning, Chairman Baker, Chairwoman Kelly, Ranking Member Kanjorski, and members of both subcommittees.

My name is Chris Nassetta, and I am president and CEO of Host Hotels and Resorts, the largest public owner of hotels. I also serve as chairman of the Real Estate Roundtable, and I am appearing today on behalf of the Coalition to Insure Against Terrorism, or CIAT. CIAT is a coalition representing a broad range of businesses and organizations from across key sectors of the U.S. economy, businesses that are the Nation's principal consumers of commercial property and casualty insurance.

I would like to make three main points today: first, that the key market conditions that necessitated TRIA's enactment have not changed; second, that as proven in 14 other industrial nations, there is a need for a long-term public/private partnership, with a role for the Federal Government; and third, we stand ready to assist your subcommittees and Congress in general in developing the appropriate long-term partnership. There are a number of facts surrounding today's insurance market that have not changed since TRIA's enactment in 2002.

First, the reinsurance market currently only provides a fraction of the capacity needed to protect the U.S. economy from catastrophic terrorism losses. Current capacity is nowhere near the level needed to provide protection to our economy without the TRIA backstop. Furthermore, even with the TRIA backstop, reinsurers are not meeting the capacity demand of primary insurers for their deductible and co-insurance layers. This suggests that private reinsurers simply want very little exposure to terrorism risk, and refutes the notion that the Federal backstop is crowding out the private market.

Second, primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses without adequate reinsurance availability or a Federal backstop. We saw this last year when insurers began including—springing exclusions that would have voided terrorism coverage had TRIA lapsed. Terrorist attacks, particularly those including NBCR weapons, could result in catastrophic losses. As a new GAO report concludes, such risks are largely uninsurable because of their potential severity.

Third, even though TRIA covers NBCR perils, we have not seen any evidence that suggests coverage is being written, except where mandated in workers compensation. NBCR coverage was not included in TRIA's make-available requirement, and unfortunately, the private markets have thus far failed in this area. I am aware of no evidence to suggest this trend will change, particularly if Federal involvement were to cease. The GAO report confirms this and plainly states any purely market-driven expansion of coverage is highly unlikely in the foreseeable future.

It is a simple, indisputable fact that markets like certainty. Unfortunately, there is almost nothing that can be considered certain about terrorism risk. It is clear to us that simply allowing the Federal backstop to expire will have significant negative economic consequences. It is imperative that lawmakers, insurers, policyholders, and all other stakeholders come together to work on a long-term solution to the availability problem.

CIAT is aware of several proposals circulating for a long-term solution, and we are studying them with great interest. The Real Estate Roundtable has developed a proposal that would create a new mutual reinsurer that would cover conventional and NBCR risk through a pool that would stand between primary insurers and the Federal Government.

Over time, the Federal backstop would be reduced as the mutual reinsurer accumulates reserves, and would only be activated if terrorism losses exceeded a certain level. Meanwhile, the American Insurance Association has come up with a set of principles that differentiates between NBCR attacks and conventional terrorism, putting a TRIA-like backstop in place for conventional terrorism, while the Federal Government would assume responsibility for all NBCR attacks, with the ability to recoup up to 10 billion through policyholder assessments.

CIAT has not endorsed any specific proposal at this time, but we are pleased that many include a public/private partnership that recognizes the Federal Government's responsibility to assist markets to function appropriately and to retain a Federal backstop for only the most catastrophic losses that the insurance industry and the economy simply cannot absorb. This is a national problem that requires a Federal solution.

In the end analysis, terrorism is not aimed at a specific business or property owner; it is aimed at our governmental polices and our way of life. Government assistance to help the market function appropriately must continue to be part of our economic response to the threat of terrorism. Contrary to what some would like us to think, TRIA is not crowding out the development of private terrorism insurance markets.

Another key element of these proposals is that they are all long-term solutions. Certain market conditions are simply not going to change as long as the threat of terrorism persists, and it does the market no good to have the threat of a backstop expiration hanging over our heads every few years. A long-term solution will give the market participants what they need most, which is certainty.

Once again, we applaud the chairs and ranking members of these subcommittees for holding these very important hearings today, and I appreciate your time.

Thank you.

[The prepared statement of Mr. Nassetta can be found on page 152 of the appendix.]

Chairman BAKER. Thank you very much, sir.

I will start questions with Mr. Case, just because of your position of observation as an interface.

My concerns about our role in this are likened to the CEO's responsibility to their shareholders. They have to assure shareholders of safe and sound operation and, at some level, profitability. On my side of the desk, my shareholders are the taxpayers.

I have to prove to them that when I write a check out of their pocket, it is for a public policy reason of necessity, that it is constrained in the scope of what it offers, and that, where possible, we recover at any opportunity that assistance. The industry has been prohibited from having a long-term build-up of reserves, even dedicated for this type of risk. If we were to assume that could be made possible, which is a very long-term solution, it would also mean that we would hope for no intervening adverse event in the near term.

Should there be, however, we had proposed in earlier iterations a sliding scale where the smaller the event, the more the industry responsibility; the more catastrophic, the more the Federal Government role would be enhanced. Even with that, over time, we would have deductibles moving up, we would have benefits moving down, and transferring as best we can, in a very steady, gradual methodology, less risk from taxpayer and more to industry, because over that same time period, the dedicated reserves would be building up.

Give me your view. I am of the opinion that something must be done. The debate will be what is the nature of the remedy that is ultimately posed. What is your view of the acceptability of that general structure to the clients you represent and the ability of the industry to work in that type of environment?

Mr. CASE. Chairman Baker, if you take a step back—and again, we are in discussions with businesses all the time about this—and just think about the track from 2002 to where we are today, and then consider the multiple proposals that are on the table—colleagues to my right and left—we have suggested there are four on the table that are coming up today that we could talk about.

If you think about the track, we were at a place in 2002, when TRIA was enacted, in which we had an industry which had a limit of $15 billion that was the first initial term. We have raised that limit to $25 billion.

I think, from the standpoint of what you all should and can and, I hope, do say, and I hope the constituents understand, you all put in place something, in our mind, again, with our company hat on, our firm hat on, that in no uncertain terms created a market that would otherwise have gone away.

In our view, had TRIA not been enacted in the last bit of time, in its two iterations, capital investment in the United States would have slowed down, full stop. So, we represent and work with the largest construction companies in the world.

We are privileged to work with many of the largest hotels in the world. It would have slowed down. So, first thing, to your question on speaking to constituents as a CEO, if you will, in terms of the track, I think the track to date, as I said in my opening statement, has been about as good as one could get. It required a pragmatic solution that is never going to be perfect, but in the end, it provided affordable coverage for a very uncertain risk.

Going forward, specifically to your question, is there a solution that is longer-term, that creates more private sector ownership of a private/public combination? I suggest, absolutely.

In fact, again, the Aon solution we proposed a year ago was one in which we felt so—we were so concerned about the situation on behalf of our—the companies we serve, we put a proposal on the table to get reaction, to force the conversation. We are not wedded to the Aon solution only. We are wedded to a solution, but let me describe that solution.

Chairman BAKER. If you can be brief, I want to give Mr. Kelly a chance to jump in here before my time expires.

Mr. CASE. I apologize. The solution is an $80 billion private solution, with a $40 billion initial floor-way that builds up over the years, and if something should happen in the interim, has a funding bond which the industry pays for, which we do not believe would actually measurably increase premiums in a substantial way, and so, to your question, is there a solution that we can collectively come up with that starts to change the balance, make it more private ownership, less public, but keep the combination, absolutely. What we need is we have to have the government bridge in order to make that happen.

Chairman BAKER. Thank you.

Mr. Kelly, I know of your concerns about the repayment provision. I think at least my outside observation is the worst thing for the industry is uncertainty and surprise. If we are to do this in a very gradual, long-term program, while allowing internal reserves to build for this purpose, isn't that—I guess my role here is to tell you, I do not want to make you happy.

I want to make you reasonably uncomfortable with the solution, because that sounds like a pretty good deal from my side. In the real estate business, I never wanted to see somebody get overjoyed; I would know I had made a big mistake. So, I am trying, I guess, to be cautiously generous to make sure solvency and economic function is maintained, but we do not want to fund the industry's profitability. That is not our job. Given those concerns, can you see how a gradual implementation of the structure that I have talked about could be made acceptable?

Mr. KELLY. Actually, not only can I see it, Chairman Baker, I would applaud it. I think it is desirable that we feel uncomfortable. It is only if we are uncomfortable we will work aggressively with the capital markets to come up with solutions, but in the interim, we cannot expose—it would be Russian roulette for us to go forward without a Federal backstop. Although the chance of losing

Russian roulette is only one in six, I do not expect to play it with the capital of the company.

Chairman BAKER. But that sliding scale where, if it is a smaller event, we do less; if it is a bigger event, we do more—that is the near-term deal on our side.

Mr. KELLY. In the current situation, we—I can speak for Liberty Mutual. If there were a significant event—we would lose $1½ billion. $1½ billion is not insignificant. So, we are already under pressure, and we are willing, as I stated in my testimony, to work on any method that increases the deductible over time. It has worked very well.

Remember, what has happened in the last 5 years—buildings are more secure today because of the deductibles and insurance that we worked actively through the distribution mechanism and with our policyholders to make sure they are better protected today than they were 5 or 6 years ago.

So, TRIA has worked not just to provide reinsurance or insurance, but has also made the country safer. As we get better at that, working with the policyholders, as we build up the capital, absolutely, we stand ready, over time, to assume more of the risk, and I think it is very desirable. We are firmly committed to the private market. However, we cannot play Russian roulette with the existence of our company.

Chairman BAKER. Thank you, sir. My time has long expired.

Mr. Kanjorski?

Mr. KANJORSKI. The risk, obviously, is to the equity holder or to the funder. Yet, we do not cover certain of the contingencies that could happen in a terrorist attack on the United States. Apparently, even with that, the mortgage holders and lenders of these investments go forward and offer these mortgages. How do you explain that?

Mr. KELLY. Well, I mean, right now, I think—we have a mandatory offer. Under TRIA, we are mandated to offer terrorism coverage, and I think the real estate industry has made it clear that they see the absolute need for their mortgage holders. In fact, if you look at how quickly New York has recovered, I think both Congresswoman Maloney and Chairwoman Kelly alluded to how well New York has recovered, we met those needs because of mortgage holders where legitimate claims were paid.

Mr. KANJORSKI. Mr. Kelly, I am curious. Why were the mortgage holders happy when a great deal of their risks were not covered?

Mr. KELLY. Well, I think, in any environment, there is only so much money that we can make available.

Mr. KANJORSKI. That is what I am trying to get to. Just how much of the risk should we think about covering?

There has to be certainly the possibility of a hydrogen attack on New York City. It would be trillions of dollars in losses. So, regardless of what we write into law here, it would pretty much bankrupt the country.

Mr. KELLY. I think there is a two-phase process. I think we all share the belief that the private sector should take on as much as it can right now. So, we work on that. We can envision $7-, $8-, $900 billion events very easily.

So, what we would propose is, right now, set a deductible that the private sector can handle, not comfortably—and I understand what Chairman Baker says. We are uncomfortable with it, because it is un-priceable, but we can get some money for it.

Start with a deductible, and then say, beyond that deductible, it is so unpredictable and potentially so large that no single industry or no sets of industry can absorb that risk. It does become a shared risk, albeit the taxpayer shares it, but it is so large that the private sector cannot absorb it.

Mr. KANJORSKI. Because we do not cover that risk at all right now, what portion would we have to cover—

Mr. KELLY. We absolutely do cover it. Under workers compensation, we have no exclusions. I mean if an event were to happen—

Mr. KANJORSKI. I am talking more about other property and casualty lines.

Mr. KELLY. Well, on property, in many States there are—in 16 or so States, which represents a small number of States but more than half the insurance industry premium, we cannot exclude—we are mandated to provide the coverage. In New York, for example, we have to provide the coverage. I mean we cannot exclude it. So, the exclusions are not there, not available to us.

Under a normal free market, we would exclude risks that would potentially bankrupt us. We cannot exclude those risks in most of the major States.

Mr. KANJORSKI. When do the mortgagers become happy and satisfied to continue the normal course of business? In other words, what is that risk that they are willing to accept that you cannot insure and you do not want to cover that risk?

Mr. KELLY. I do not think it as much the mortgage holders as it is the lenders.

Mr. KANJORSKI. Lenders.

Mr. KELLY. I think they have made it very clear.

The mortgage issuers made it very clear that, absent a Federal backstop, there will be no commercial—very limited commercial—mortgage available, and I think this would better be addressed by the representative of the Real Estate Roundtable.

Mr. NASSETTA. I think that is right.

I think the question you are trying to pinpoint, as I am hearing it, is on NBCR, for example, where we are saying there are exclusions, how are mortgage holders getting comfortable that—having something on basic conventional terrorism but nothing beyond that, and I think the answer is, from our perspective, they had minimally been comfortable with that, but I think that the risk in it is there only has to be one event, and it does not have to be a large event, that falls into those other categories, and I will tell you uncategorically, you will see the mortgage industry shut down in terms of its ability to lend to the real estate industry, because it will not be willing to take those risks. How they have concluded to date to take those risks—I could not tell you how the underwriting has been done, but I can assure you, in our opinion, that to the extent you have any event, that will shut down the CMBS market, which is obviously a large part of that market.

Mr. KANJORSKI. If it shuts down, how will you reopen it?

Mr. NASSETTA. I think you will reopen it by having that risk covered in some way.

Mr. KANJORSKI. So, we would have to come back here to Congress?

Mr. NASSETTA. You would have to come back, and so, I think part of our objective in being here, and having worked on this personally for the last 5 or 6 years, is to have an orderly process set up in advance to deal with these problems, rather than having a catastrophic shutdown in one or more parts of our capital markets.

Mr. KANJORSKI. Okay. Maybe I misunderstand you, but are you suggesting that if we do not cover nuclear, chemical, and biological events, and once that occurs, and since it is not covered, that it will shut down the market?

Mr. NASSETTA. I think that would cause a very significant shutdown in the lending market.

Mr. KANJORSKI. So, as TRIA exists today, it would take one terrorist attack, using one of those mechanisms, to cripple the economy?

Mr. NASSETTA. In my estimation.

TRIA exists today. I think it is fabulous. I applaud the leadership in getting it done, and it does allow for capacity in the market that has been needed to keep the capital markets generally flowing, but there are some important things missing from TRIA.

I think the distinction between domestic terrorism and the risk associated with domestic terrorism is a gap in the system, and NBCR is a meaningful gap, not in TRIA, but given the fact that it—unlike conventional terrorism, there is not a make-available provision. It is not offered, and I think, absolutely, to the extent you had a meaningful event that fell under those categories, it would be very disruptive to the financial markets.

One other comment on the question Mr. Baker asked and got a response to: When we think about reduction or increases, rather, in retention or deductibles and additional capacity coming into the market—and I respect, obviously, everybody to my right that is in the industry, that is providing this product, but I will tell you, from my experience, personal experience on the matter, with the deductibles going up after the extension, actually capacity has been diminishing in the market, and the cost has been going up.

Now, we are not here from a consumer point of view to complain about costs. We will pay what it takes. We are just talking about capacity. But I think we have to be very careful to make sure whatever we are doing in weaning the Federal Government out of the system, which we absolutely agree with over time, that there is somehow created a pool of capital that is there to pick up the slack, because to the extent—as we are doing today, we just modify TRIA, and we do not create any mechanism for capital to accumulate.

My own opinion is that there is risk to the capacity in the market. Certainly, as I say, our personal experience has been, in the last 2 years, capacity for what we could achieve has gone down, costs have gone way up.

Mr. AYER. Chairman Kanjorski, if I could jump in here and just clarify a couple of things?

Mr. KANJORSKI. Yes.

Mr. AYER. First of all, on the question of nuclear, biological, chemical, radiological, the GAO report has one or two errors in it. The market still does cover, first of all, all conventional attack modes. There is also coverage available today, and specific to the nuclear peril, since most property destruction occurs from fire following the nuclear peril. So, there is enormous coverage.

Mr. KANJORSKI. You therefore think that there is potential coverage there?

Mr. AYER. Fire following coverage, as Mr. Kelly was pointing out, is still in the contracts, and our big concern is the fact that absent NBCR type of backstop, we not only take property-oriented risk, but workers compensation, which is a big, big amount of coverage that the insurance industry provides for American workers will be one where the industry could get devastated.

Mr. KANJORSKI. I am going to use a term now that will absolutely exacerbate the other side of the aisle, but I am throwing it out to you, because I am listening to an industry that wants help.

Mr. AYER. Please do not get me in the middle of that.

Mr. KANJORSKI. I have always been considered extremely conservative about inserting government into the private sector. But now, as testified here rather unanimously of the need for government involvement and as my opening remarks indicated, I tend to agree with you in this time of peril, perhaps the next 2 or 3 decades, we are probably going to have that involvement.

As a potential solution, how much thought has been given—I think, Mr. Kelly, you may have even referred to it in your testimony—to creating a government-sponsored enterprise, somewhat similar to Fannie Mae or Freddie Mac?

Chairman BAKER. You are right about some people's response to that.

Mr. KANJORSKI. I just wanted to give you prior warning.

Mr. KELLY. I did not mean a government-sponsored entity.

I mean legislation that would enable the private sector—for example, the cat bond market, right now, is, in fact, based in the Cayman Islands, for tax reasons. It is not a U.S. market.

Mr. KANJORSKI. You get all the up-side, and we get all the downside.

If we form a government-sponsored enterprise, we fill a vacuum that the private sector has not yet filled.

It can be structured in such a way as to create a reinsurance market and eventually go back to the private market. But if, in the meantime, no disaster occurs and there are some premiums that are acquired, there is a sharing of the benefit. I think it is only fair, if we are going to play cards together that the taxpayers that Mr. Baker wants to protect should be the recipients of some of the premiums or benefits from the game.

Mr. KELLY. I do not want to get into the discussion of Fannie Mae and the issues involved in government-sponsored entities.

I do believe that, to the extent there is no event, the taxpayer does participate; it gets 35 percent. We pay significant taxes on our profits. We are a significant taxpayer. So, to the extent there is no event, indeed, the government participates. What we want to do is create an environment where the economy can grow. The government is going to benefit from increased tax revenue.

Mr. KANJORSKI. So, your answer is you would not look at a government-sponsored enterprise.

Mr. KELLY. No, we think—legislation enabling the private sector to form better structures. Right now, the cat bond market, for example, is, in fact, an offshore market for tax reasons.

Mr. KANJORSKI. Should it be mandatory that every company—

Chairman BAKER. That has to be the gentleman's last question.

Mr. KELLY. Mandatory that every company offer terrorism—

Mr. KANJORSKI. Yes.

Mr. KELLY. We work under a mandatory offer right now. It has worked. Whether or not I get into the philosophical debate is immaterial. It has worked, and I think we can live with the current mandate.

Chairman BAKER. The gentleman's time has expired.

Chairman Oxley?

The CHAIRMAN. Thank you, Mr. Chairman.

Mr. Kelly, your answer on the GSE's was absolutely correct, and I am sorry I missed your opening statement. I hope you did not do any unwarranted bragging about the results of the Ryder Cup.

Mr. KELLY. I restrained myself.

The CHAIRMAN. Thank you.

Mr. KELLY. But if you want me to start, I shall.

The CHAIRMAN. No, I do not want to give you that chance.

We have had quite a history of TRIA, and I was thinking the other day that our goal, ultimately, when we passed the original TRIA bill, with the strong support of the President—we probably would not have been able to do it without his aggressiveness on dealing with this issue, and I remember, at the bill-signing ceremony, how proud I was that we had really come together, bipartisan, and the Administration, to pass the original TRIA bill, and then the second go-round was not as satisfying, because we had issues with the other body, to some extent, with the executive branch, about the extension and how we would—ultimately, what kind of conclusion we would come to.

Ultimately, the goal, as Chairman Baker knows, and Chairwoman Kelly, and others who worked on this bill, was to provide a backstop but, indeed, to encourage the private sector to step up and deal with this issue, to get the reinsurers back in the game, to really gradually come back to a free market solution.

It is obvious from your testimony and experience that that has not happened, and we still face that same problem, except that we now face it with a looming deadline that could be catastrophic, to coin a term, for our economy in going forward with our insurance coverage.

As you know, both the original TRIA bill and the Baker-Oxley-Kelly extension bill allowed insurers to set aside dedicated terrorism reserves, and because we were unable to secure the cooperation and support of the Ways and Means Committee, we were left with something less than a whole package to try to deal with that.

So, let me just ask anybody, or all of you on the panel, is there any question that allowing long-term reserving for terrorism risk without a tax penalty would help stabilize the market over time? Is there any doubt about that statement?

Mr. AYER. Congressman Oxley, first of all, thank you for your leadership on the first TRIA bill and your continuing support. I just wanted to be sure we all recognize your contribution here.

Going back to the chairman's earlier question on this whole issue of tax reserves, tax reserves, over time, will help the insurance industry deal with catastrophic losses if we are permitted to do so, but it is very important that we all recognize—and you as CEO's have to be commended, CEOs in the taxpayers' behalf, because you moved our retention from 7½ percent to 20 percent.

Our retention went from somewhere around $400 million or so to $1.3 billion going into next year. So, you are shifting accountability to a greater and greater degree, and even in the layers above the industry's retention, the participation of the industry will increase going into 2007. So, you are doing a fair amount of shifting accountability to the private sector. My big concern is, even given all these best efforts, on NBCR-type perils, the devastation that could result from it, absent a Federal backstop, will wipe out big chunks of the insurance industry. That is the reason why we need a public/private partnership. We cannot forget that.

The CHAIRMAN. I think that is well spoken, and indeed, the hidden secret is that this thing has worked, and it is proof positive it has worked, and I think it would have worked better, frankly, if we had the reserving option, and hopefully, in the next Congress, we are kind of setting the table here, I think, Mr. Chairman, for what will inevitably be an effort to reestablish TRIA, to continue to provide for more participation of the private sector, for you folks to have more skin in the game, to be able to protect the taxpayers, which Chairman Baker has insisted on, correctly, but I would hope that we could take a step back and look at the whole picture, and clearly, the reserving aspect is critically important.

I wondered if all of you could just simply give me a sense of how long and how we would best structure a reserving program, how long it would take, for example, and how you would see it unfold as we try to move more responsibility towards the private sector and less towards the government. If you were to write a bill or if you were to look at your own particular situation, how would you structure that that would make sense and protect our economy and really make certain that we do not have a real meltdown should some catastrophic event occur?

Mr. KELLY. This is an issue—there is significant discussion within the industry, because it is not just with respect to terrorism risk, it is also the overall natural catastrophe risk.

There is no debate that, for every contingency that confronts the country, we are much better off if there is savings accumulated in the private sector, and reserves are a form of savings, if you will, and tax-free reserving encourages saving.

In most countries, in Europe, there have been traditionally—and up until about 20 years ago in the U.S. casualty industry—contingency reserves allowed on an accounting basis, not on a tax basis in the United States, and you can set up mechanisms that say how much a company could put into it in a given year, based on their total exposure, on the deductibles, and whatnot, as the deductible moves up.

The CHAIRMAN. So, it would be a ceiling, essentially?

Mr. KELLY. Yes, a ceiling. The problem is—as a mutual—we are under less pressure from shareholders to release profit quickly. So, as the industry is sorting it out, we have to balance the industry with shareholders and whatnot, the public, but there is a significant portion of the industry that believes that tax-free reserves, properly structured, are a very good way, over time—I have not seen a model to see when we would accumulate a lot, but this is still an open discussion in the industry.

Mr. AYER. If I could just clarify, Congressman Oxley, the eligible lines, property casualty insurance lines, premiums is about $150 billion or so, and so, if you are thinking in terms of a $100 billion event, you know, you can do the math on how long it is going to take from a reserving perspective to provision for something like that, and that is exactly why a public/private partnership is very helpful, because under the current TRIA bill, post-an event, the government does have a recoupment mechanism excess of the company retention.

There is an enormous amount of genius in the way you all have constructed the current proposal. I would not reject it that easily, because there is a good balance between private involvement, between your capacity to recoup from policyholders and companies over an extended period of time once you have a terrorism event.

The CHAIRWOMAN. I know Mr. Case wants to respond, but back to my frustrations, had we enacted that reserving as part of our original bill, we would be well on our way to having those reserves, and so, we really—we have lost 4 or 5 years here, dithering around, worried about jurisdiction and everything else that is totally irrelevant to the issue at hand.

Mr. Case?

Mr. CASE. Congressman Oxley, I think the facts bear out exactly what you said, and I think your specific question was what you do going forward. At the risk of putting an option out that Aon put forward to the industry a year ago for colleagues to react to, I will get very specific around how one might think about it. First of all, do you need the build-up capability you have described? Absolutely.

I think the committee has to make some decisions, and our broader—the broader group has to make some decisions. Is the government going to be involves? Yes or no? You have heard all of us say quite strongly it will not work otherwise.

Then the second question is to what level? How high does it go? And you need some specifics. The analytics we did basically said, at what point will the reduction in capital—again, we are doing this on behalf of clients, of which some are insurance companies—at which point does the industry start to lose rating, and when the industry loses its rating, it will lose its ability to write, capacity goes away, and none of us like that picture.

So, there is a threshold. The threshold around the analytics—and we are not saying it is exactly right—was roughly $40 billion. So, in a $40 billion first traunch, if the industry—we stepped up to that, and they had made a $2 billion contribution every year for the next 20 years, we start to build what you have described. Now, $40 billion—that is two World Trade Center events. That would be first layer.

The second layer would be a post-event issuance of a bond. If something happens, a bond is issued, and the industry pays it back. This actually has—you captured a lot of this insight in the first round of TRIA, and that's another $40 billion, and the industry would pay that back. That basically says that the industry steps up to $80 billion over time, and I have thrown out a 20-year time-frame, again not because, Congressman, it is the right answer, but it gives you a perspective.

If you said—and you are going to have make that—we are going to have to make that call. You are going to have to make that decision, at what level are you describing, I would put forth two $40 billion traunches, one more direct, one more indirect, at $80 billion.

The item I would urge you not to get confused is we continue talk about NBCR and the efforts—you know, $80 billion, while a tremendous amount of money, is wiped out in some of these other issues, which is why they have to be included, from a government standpoint, but make no mistake about it, you know, getting the industry, guys to my right and left, to step up to an $80 billion commitment, traunched over time, with the build-up you have described, puts us in a fundamentally different position, and again, back to you as a CEO, thinking about your constituents, there is $80 billion at risk before the government steps in. That is a pretty fundamental commitment, and again, we are not suggesting the 80 billion is correct, or the traunch of 40, Congressman, is right, or the next traunch.

What we looked at was inflection points and when the industry got downgraded, at which time the industry would lose its ability to actually be effective.

Chairman BAKER. Thank you.

Mr. DUBOIS. I would like to comment that I think there are examples elsewhere in the world, in other countries, where reserves have been allowed to build up in pools or other vehicles, that then get used to pay for terrorism risk, should terrorism events happen.

Now, none of these other pools or reserves have suffered losses like we did on 9/11, but nonetheless, there certainly are possibilities and models that can be looked at.

You know, the industry, with, let us say, a $30 billion retention today, or whatever, is already in a position of having a lot of skin in the game, and the types of losses that NBCR could create are so severe that these losses—and I do not think there really are pools that could be created on a short-term basis, that could come close to dealing with this. I think the government has to be involved, and has to be involved in a very substantial way.

I think that there are also potential issues with regard to how you go about establishing reserves for this. There needs to be an actuarial determination. How do you determine how much reserve you should put aside for something for which the frequency and severity are unknowable? I think those are big issues that would have to be wrestled with to avoid problems that could be created and create issues that taxpayers would object to.

The CHAIRMAN. Thank you.

Mr. NASSETTA. I guess, following on what the two gentlemen to my right just said, the thing we cannot lose sight of in any program, ultimately, that we jointly come up with is that, whether it is $70- or $80 billion of skin in the game, from a consumer point of view, one of the things—and from an economic point of view, looking at the country's economy, we cannot disregard the NBCR and the super-cat.

A lot of the solutions that have been batted around, I think—and while TRIA, as I said already today, is a very successful program and allows for NBCR, we have to find a mechanism in whatever we do to allow for capacity in those areas.

If we do not, obviously the markets are functioning reasonably well today, effectively, without it, because it is not being offered, but as I mentioned in response to Mr. Kanjorski's earlier question, all it takes is one event, and we are back in a mad scramble, a la Katrina, to figure out what we are going to do, and what I would off out is I think it will cost the Federal Government a lot more money trying to clean up the mess afterwards than it would have to have a reasoned program put in place up front.

So, while we have not had to deal with it yet, certainly the risks that we all hear about from our President and everybody down the line is those are the real risks that are in front of us today.

I think any program we come up with that leaves those super-cat kind of concept to, you know, figuring it out later are misguided. I think it will be very costly to the economy and very costly, ultimately, to the taxpayers.

The CHAIRMAN. Mr. Chairman, I think Mr. Nassetta said it best. That is, does anybody here really think, if we had a catastrophic event, that the Federal Government would not respond, the way we did with Katrina or any other natural disaster, whether they are floods or draught or anything else?

That is just the nature of the beast, and anything that we can do to alleviate that or to mitigate it seems to me exactly the right approach to take, and to say, you know, next year, the program expires and everybody goes back to their corners, to me, is not even close to a solution. As a matter of fact, it abdicates our responsibility to the taxpayers big time, and I thank you for your leadership, Chairwoman Kelly, others on the committee, who get it and who want to make this thing right, despite all of the political difficulties that we run into. You are on the right track, and I wish you the best.

I yield back.

Chairman BAKER. Thank you, Mr. Chairman. I simply want to say that the general testimony here this morning has been that the TRIA in place has had a substantial positive effect on market function. It has worked, it was properly crafted, and to a great extent, it is the product of your work effort and intense focus to get this across the finish line.

So, I wish to sincerely commend you for your hard work on this, and please know, going forward, whatever fortunes hold next year, you hanging over our shoulder up here will be a constant reminder we need to get this thing right.

Ms. Maloney?

Mrs. MALONEY. Thank you, Mr. Chairman. I would add to your statement about TRIA working. From our experience in New York, we could not even build a hot dog stand until we got TRIA in place. All building had stopped, and the rebuilding had stopped, until we got the insurance program in place. I join my colleagues in thanking you for your thoughtful testimony.

All of you have spent a great deal of time trying to come up with some long-term solutions, and that is the type of thinking that members of this committee tried to write into the TRIA extension bill.

We tried to include a blue ribbon commission of leaders in the industry that would come forward with concrete ideas and solutions to move forward with. Unfortunately, that was not included in the extension of TRIA. It only provided for a working group, which is led by the Administration. The Administration has not issued their report yet from this working group, but from some of the signals that I have gotten from the Administration, I am not optimistic that they will come out with creative ideas that include a government component.

So, my question to you is what have you done to advance your ideas with the Administration or, specifically, with the working group that is charged with coming up with a long-term solution, and then, secondly, what can we as a government do to help your industry, to support your industry while you work to come up with a long-term solution?

As I said, we tried to have it in the Administration—in the bill that we put forward, but the working group is out there, they are going to be coming out with a report soon. I hope that you have made contact with your ideas, and I would like to really call first on Mr. Case and Mr. Kelly, because they have spoken at great length on some of their ideas and some of their solutions, and really open it up to all of the members of the panel.

Mr. KELLY. Thank you, Congressman Maloney.

We have met—Liberty and the industry have met several times with the working group. I do not think they heard anything that you have not heard today. We have spelled out clearly two things, and I will reiterate them.

First, there is not enough capacity—I think there is unanimity—there is not enough capacity in the private sector to absorb a significant event.

Second, the private sector stands willing to absorb more risk over time and is willing to work with creative mechanisms to allow us to do that. We have made that clear.

Most importantly, we cannot live continually under a period where we are going to lose coverage every 2 or 3 years. It is not useful for us, it is very disruptive for our policyholders, and it is bad for the economy. So, we need to recognize—and we have made this point very clear—we cannot do it without government help, we will try to do more over time, and we cannot continue to stand the uncertainty.

Mr. CASE. Congresswoman Maloney, you asked two questions.

One is what specifically are we doing and what you can do to help the industry. You know, what we have done is tried to put a concrete proposal on the table, again not as an answer but as a stocking horse, if you will, to take shots, and it has gotten plenty, lots of new ideas on the table, but we are going to continue to redouble our efforts to make sure that the committee understands what is out there, what the possibilities are.

The most important thing I would address, though, is, in my mind, your second question, which is what can the industry do? One thought I would suggest to the committee is that if this is viewed as an insurance industry issue—again, Aon is not an insurer in the way that my colleagues to the right and my left are—it is a view on the issue that is—scope is way too narrow.

I am not suggesting you were there in any way, in any event, but just for the record, this is an issue for businesses. It is an issue for Marriott. It is an issue for businesses around the world.

Our concern, which is the reason we put forward a solution, is, if it ever gets construed as an insurance company set of issues and an insurance company backstop, if you will, in our view, that undermines what you all have actually put in place, and undermines the ability to actually talk about this issue in a way that can be very productive. So, I would ask your help to make sure that, when the solutions come forward, they are from a broad-base sector—financial services, which include the banks; the insurance companies, their constituents and companies out there trying to make investments and build. All these constituents are incredibly impacted by this.

I can make an argument that banks are as impacted as insurance companies. Banks will eventually be—if they are building buildings and they finance them, they eventually are going to be the construction owners, and they are eventually going to be insurance companies, if anything happens, and the banks do not want to do that. So, please help us make sure the constituent group is broad enough.

Mrs. MALONEY. Any other comments?

Mr. AYER. We belong, Congresswoman Maloney, to—we belong—the AIA, ACLI, as well as the CEO Roundtable that Mr. Kelly referred to, and in all cases, we have actually worked and reached out to the working group to advance ideas and kick around different alternatives, and I believe that the industry eagerly awaits the analysis and is hopeful that, fundamentally, we will continue to have a public/private partnership here for the risk of terrorism.

Mr. DUBOIS. We have been involved in this discussion for 5 years now, as many of us here in this room, and we are today reinsuring terrorism risk, to some extent. We are the largest reinsurer worldwide, and we collect premiums from around the world to cover exposures here and in the U.K. and in Spain, etc.

The appetite, for the industry, however, as I said earlier, for reinsuring terrorism risk, is still limited. That may change over time, but it would require the reinsurers and society at large to consider terrorism risk to be a lessening risk. We do not yet see that.

We in the RAA have been working on alternative solutions, as well, just as Mr. Kelly and Mr. Ayer and Mr. Case have been suggesting for themselves, and I think that there is an opportunity for all of us to get together to work on these solutions. Pools are one possibility. Reserving is another possibility. They all have problems attached to them, but I think that there may be ways that, collectively, we can do it.

You know, cat bonds are suggested as an alternative. Yes, but cat bonds face the same pricing problem that we face. I do not know why the capital markets would look at the pricing any differently. After all, the capital markets supply capital to us.

So, consequently, I think that it is a potential long-term solution, but it is nothing immediate, but I can assure you that we, Swiss Re, are more than happy and willing to work with any working group or any of the insurers, reinsurers, and brokers, etcetera, to come up with alternative solutions that can be meaningful on as short a term period as possible.

Mrs. MALONEY. Thank you.

Mr. NASSETTA. I think most of it has been said. On behalf of CIAT and the roundtable and personally, we have been spending a lot of time with the members of the President's working group and, I think, have had a good dialogue, as others have, about the various options. We are not, at CIAT, promoting one versus another. We think there are a lot of alternatives that would make sense.

What we are promoting is, really, making sure all the interested parties are in the same room and have an incentive to find a way to make this work that is balanced, that is balanced in terms of the policyholder versus the insurers, the reinsurers, and ultimately the taxpayer. So, from the standpoint of your question, what can you do, short of, of course, passing legislation, which would be terrific, it would be to continue to put the pressure on all of us and all the other interested parties on this issue to really sit down and force the parties to figure out a balanced public/private partnership equation that ultimately makes everybody reasonably uncomfortable, as Chairman Baker said, which I think was a very good way of putting it, and so, I think there is a good start.

I think there is a lot further to go, obviously, and we are going to be running out of time. People are renewing policies. From a consumer point of view, this is an issue that is accelerating very rapidly as people go out to renew their policies, and so, very timely that we are having the hearing today, and again, all of us very much appreciate it.

Chairman BAKER. The gentlelady's time has expired.

Our co-chair, Mrs. Kelly.

Mrs. KELLY. Thank you. The House bill we drafted last year had a specific program for the NBCR coverage, and the GAO has said that that is the greatest terror risk to our country, but there is no private market that has really developed on that. Is there any doubt that we need to have a specific NBCR protection written into this law? Do any of you have any question about that? I am just going to ask you to give me a quick yes or no.

Mr. KELLY. I think, given the significant difference in NBCR from, if you will, conventional terror—I mean it is somewhat sad that we now talk about conventional and non-conventional terrorist acts, I mean the world has changed so much.

There is such a significant difference in terms of predictability, in terms of the long-term emergence of damage from—whether it be biochemical or nuclear—that it is so significantly different, we believe it is highly desirable to treat the two separately. They can be coordinated, but they need to be treated separately.

Mr. AYER. There is no doubt in my mind that we need a Federal partnership on NBCR. I would also say, on conventional acts, we are always concerned, as you saw in the case of the London terrorism incident, of what we in our industry refer to as swarm attacks. So, you could have conventional attacks occur in several cities at the same time, which collectively could be a serious size loss that the industry would have difficulty responding to.

That is the reason why your increasing retention has been a nice device, a good device to construct the right balance between how much the industry ought to bear versus how much the government ought to step in as a backstop.

Mrs. KELLY. One of the things I think that is problematic for the general public is that they have not seen the movements within the industry that have enabled it to cover, so far, the World Trade Tower disaster and Hurricane Katrina, and with the terrorist attack on the towers, followed by Katrina, it has had an economic effect on the whole country, but people have not thought about what has gone on within the industry itself, and I would like to ask what it took, if you are willing to share, what it took within your industry to be able to cover the disaster of Katrina and the hit of the terrorist in New York.

Mr. KELLY. We assume great fiduciary responsibility for the capital of our companies, so we try our best to manage risk, and it is a truism in the insurance industry, the best accident or best claim is one that never happens. I think if you go around the cities and malls of America, you will see that they are significantly safer, whether it be devices as concrete pylons, metal pylons, to keep trucks away from the front of the building—we, separately, and a competitive marketplace, have worked with each of our policyholders to reduce the terrorism risk.

The average consumer does not see that. They see a planter in front of a building, and they think we are beautifying the building. No. We are working with the policyholder to make sure nobody can drive a truck bomb up beside that building.

I think what is not obvious—obviously, what is obvious in New York, Chairwoman Kelly, is that things recovered, but what is not obvious is that around the country, we, working with the policyholders, have made this country safer against terrorism. We are glad it is not noticed. We are proud of what we have done, and each of us do it in our own way, but it is a safer country for that reason.

Mrs. KELLY. I want to go back to this question again and ask about manipulations within the industry itself. Have you had to help each other because of the amount of coverage and exposure that one person in the industry has had versus another person?

Mr. KELLY. The TRIA has allowed the free market to work in the following sense—and I speak for how we approach it. We can tell you in New York, within a hundred yards, within a quarter of a mile, how much exposure we have. Once it gets more than we have an appetite for, we back out.

TRIA allows other people who are willing to step in, to pick up the exposure. We cannot do it in collusion, but when we, as a company, decide not to bid, there is always enough people in there bidding for the risks we do not want. So, TRIA, by creating a certainty as to the absolute amount of loss, no runaway losses, has allowed the free market to work very, very well. We can make normal economic decisions, and there is enough capacity left underneath the TRIA deductible to meet the needs. So, it is a remarkably effective construct.

Mr. AYER. From a consumer point of view, I agree with all that, and I think it is actually a fairly simple approach, when you think about it.

As it has been for a hundred years or more in the insurance industry, the tradeoff has been limited, as described by Mr. Kelly, meaning limiting exposure in certain areas.

It has been through exclusions, like excluding NBCR and other things, so that not taking certain risks at all—and it has been through rates, which is to say that our rates from a consumer point of view—and again, I am not saying it in a negative sense, it is because of these things that have happened—the rates are multiples.

So, it is through limiting risk, excluding risk, and getting greater payments to cover what risk remains. It is a simple equation of a profit-making business.

Mrs. KELLY. Mr. Case, I see you looking as though you would like to answer that question.

Mr. CASE. Congresswoman Kelly, it is interesting—I agree the markets have worked in a wonderful way. There is $15- to $25 billion at risk as that has evolved over time. Mr. Nassetta is right, though. Rates have gone up. Post-9/11, rates went up quite substantially, as they needed to do.

If you talk to constituents, look at the balance sheets of the insurance industry, because one question you should be asked is why would you be thinking about this when it looks like the industry is so strong right now? That will be a question you will be asked.

I think a reasonable response is that the balance sheets of the entire industry, the overall capital, were at a much weaker position, having coming through a decade of softer prices in 2001. The $20 billion event, which was the World Trade Center, was devastating in that context, plus we had a market crash afterwards, equally devastating.

Understand, last summer was a 60-plus-billion-dollar event that my colleagues' balance sheets absorbed, and they actually came out of it quite well. In fact, they are prepared and they are well equipped to kind of continue to meet the needs of consumers and of businesses, and it is because of all the preventions that happened, that Mr. Kelly talked about, and everything that went on, all those are good, but the market was forced to react. Prices did go up over time, and the mechanisms did work.

Mrs. KELLY. Thank you.

Yes, Mr. Ayer.

Mr. AYER. Just a quick additional thought here. TRIA cost us close to a billion dollars—not TRIA—the World Trade Center cost us close to a billion dollars, and the devastating hurricanes of last year cost us close to a billion dollars. When we had the WTC event, we did have reinsurance. Today, our retention inside of TRIA is entirely borne by The Hartford.

On the other hand, we have close to a billion-and-a-half of reinsurance available on natural disasters, and so, today, we scour the world markets, including capital markets, to seek reinsurance support. So, that is the distinction.

So, what changes inside The Hartford? We not only are a writer of property, casualty, and workers' compensation insurance; we also provide group life, and we are one of the largest lenders to commercial real estate through commercial mortgage-backed securities.

So, what we have to do is really take a second look at how our aggregations stack up inside of cities, including New York City, how much lending are we doing, how much group life are we writing, how much comp and property insurance are we affording, and that is the change in our lives post-TRIA.

Mrs. KELLY. I have one more question, and that is, the White House-controlled PWG report last year was not—did not contain what the House bill contained. The House bill—we had an independent commission looking at the future of terrorism insurance that would have had experts from both sides. Would you support the establishment of an independent TRIA commission that represented government, policyholders, and the industry?

Mr. KELLY. I hate to say yes, but—yes, I think that would be a very desirable way to make sure there is an open hearing and a broader constituency.

My concern is that were we to advocate such a commission, it would provide an excuse to give us another temporary extension, and one message I do want to leave—I have said it several times, and I will say it again, and I think Mr. Nassetta alluded to it several times, too. This idea that, every 2 or 3 years, we are in limbo is not a good thing.

So, if a commission delayed a permanent solution—it would be not a desirable thing at all. On the other hand, any mechanism that gets the best and widest thinking would be highly desirable.

Mrs. KELLY. Thank you, Mr. Kelly.

Chairman BAKER. I thank the gentlelady.

Mr. CASE. As long as the industry is defined broadly enough—and I apologize for repeating, but if the industry is the insurance world, it has, in my view, hindered the ability to actually push this forward. If the industry is represented by the capital providers, banks, etcetera, and is there with insurance companies, with reinsurers, and it is broad-based, you are going to get a much richer view of what the possibilities are.

Chairman BAKER. I thank the gentleman.

Mr. Hinojosa?

Mr. HINOJOSA. Thank you, Mr. Chairman.

I would like to make a statement and then ask a question of Mr. Gregory Case.

Some folks suggest that TRIA is crowding out private market solutions. Has the amount of reinsurance available for this risk increased since we renewed TRIA, and is it enough?

Mr. CASE. To the question of is it crowding out private solutions, within the construct that was set up by TRIA, in terms of the aggregates that are there for the broader market that the industry absorbs, I think, as Mr. Kelly was pointing out, there has been a tremendous amount of innovation to try to operate within that context. To take on additional risks that are both unpredictable and unquantifiable, basically, if I may offer, kind of finite capital against infinite risk, there have not been a lot of solutions that show up sort of in that genre, as Mr. Dubois described, which is why, within the context of the next iteration, should there be one, of how we think about, you know, a set of solutions, the innovation in the capital markets and the innovation in the industry, the innovation on the reinsurance side is—you know, in my view, is not going to be constrained at all with regard to whether the government—if the government is involved. In fact, quite the reverse, what the government backing would do is to provide a stable playing field upon which the participants could actually put some things forward and potentially price product to be effective.

Mr. HINOJOSA. Mr. Chairman, based on what I have read and heard, I think it remains extremely important that we, the Federal Government, continue to collaborate with the private sector and, in some form, on this issue.

I want to thank you, Chairman Baker, for holding this hearing, and I want to work with you and Ranking Member Kanjorski and with other members of our subcommittee to keep this terrorism coverage available. I yield back the balance of my time.

Chairman BAKER. I thank the gentleman.

Mr. Garrett?

Mr. GARRETT. Thank you, Mr. Chairman. Just a couple of quick questions.

Mr. Case, you had made an indication before that, after 9/11, because of the situation at that time, a deadening of the economy, and but for us taking some sort of action on TRIA, you would have probably seen a deadening of the economy and new construction and the like, what have you. You also indicated that you have constituents or clients around the world, as well. Could you or other members just very briefly tell us what is going on in the rest of the world, to the best of your knowledge, in this area, whether they have a TRIA backstop in the other countries, or do we see a flattening of their economies?

Mr. CASE. First of all, in terms of sort of what happened in the United States, it is, in fact, exactly what happened for a period of time, until things became more stabilized. We have seen other constituents around the world asking the same sets of questions. The capital is global. The capital is fungible.

They are seeking and they are trying to understand, when you think about the events that have happened in the U.K., the incident that happened in Madrid, a whole set of issues are being raised. This is not just a U.S.—

Mr. GARRETT. But did the other countries adopt this?

Mr. DUBOIS. Maybe I could address that for a moment. There are a number of countries around the world that have terrorism risk protection programs in place. One of the oldest is the one in the Republic of South Africa, and it has been there for decades. Potentially older is the program in Spain, which dates back to the early Franco days, in the civil war. The U.K. has a program that can be considered a model for us. France, Germany, and other countries, the Netherlands, set up programs after 9/11. Australia has, as well. So, there are plenty of models out there that we can look to for example.

They all have what some might consider failings, but nonetheless, you know, they are in place. Other than Spain and Israel and

South Africa, there is only one that really has responded to terrorist acts, and that would be the U.K. program. It was set up in 1993 in response to IRA attacks in London and elsewhere in England. The funding was provided through a mechanism where policyholders paid insurers, who paid into a pool, and that pool accumulated the funds.

It also purchased a reinsurance line from the U.K. government, which served as the ultimate reinsurer for that pool. It has responded on three or four occasions out of the funds that have collected in the pool and is, today, expanding its coverage. It is not shrinking it. It is expanding what it covers. So, it is actually going in the opposite direction. Instead of reducing its involvement, it is actually going the other way.

As I understand it, that company, although more limited in size, in terms of the funds involved and its coverage, it employs about nine people. So, it is not exactly an enormous bureaucracy. It has, frankly, been quite effective.

Mr. GARRETT. I guess my next question was going to be—as far as whether what we have done has sort of frozen out either innovation or any enlargements into the system because—obviously, industry knowing that we are here, you are not going to be expanding into this market.

Mr. DUBOIS. Well, from a reinsurer perspective, I can say that we have changed our view on terrorism risk over the last number of years.

As some of you know—we can talk, certainly, about large numbers—we suffered losses of $3.3 billion on 9/11, and we immediately, within a week's time—my colleague from Switzerland and I visited the White House and indicated that we would not be renewing our treaties with reinsurance—with terrorism being protected under our treaties. Since that time, we have been changing our view, and we do now provide reinsurance protection for terrorism risk, as I testified earlier.

Mr. GARRETT. So, had the original TRIA been in place prior to 9/11, the impact upon the industry, the government, in that situation, would have actually had to have stepped in to a significant degree. First of all, is that correct, and secondly, if it is correct—

Mr. DUBOIS. I think it would depend on what you mean. What were the deductibles in place, you know, in a pre-9/11 TRIA package?

Mr. GARRETT. The original TRIA that we passed.

Mr. DUBOIS. Then the government would have picked up, probably, some of the tab, yes.

Mr. GARRETT. Thank you.

Mr. KELLY. If you recall, the very low level of industry deductible early in TRIA was because we were recovering from 9/11. We did not have the capital at that time.

One can always speculate as to what might have happened, but had it been—my belief is that, had TRIA been enacted earlier, the deductibles would be more like the levels we have right now, in which case there would have been very little Federal Government involvement. The early 7½ percent was only so low because the capital has been significantly damaged by 9/11.

Mr. GARRETT. But the industry was able to absorb—

Mr. KELLY. Yes, we were able to absorb it, but we could not absorb the high deductible, 7½ percent, post-event.

So, the 7½ percent initially was recognizing that we had been damaged significantly.

Mr. NASSETTA. I think Chairman Oxley made the comment before, which is worth noting again, which is to say some of these other programs, as Mr. Dubois describes around the world, have been very successful, including the U.K. program, where they are building pools.

To the extent that approach had been taken, which is an approach that a number of parties, including the Roundtable, have put forth, 5 or 6 years ago, you would have, today, substantial pools of capital that would be available.

So, it is something that—it is not the only solution, but is a solution that we should be, as a group, considering. In the end analysis, some kind of pooling system—we can debate what mechanism, and whether it is reserves, tax-free reserves, etcetera—some mechanism to build up a capital base of some kind or another is absolutely necessary here in order to ultimately have the Federal Government be able to lessen its role over time, and again, debatable what exact form that will take, but the concepts that have been used around the world, which vary a great degree, have largely, in my opinion, been successful, because they have build up independent pools of capital to deal with this risk, and ultimately taken their Federal Government exposure down over time.

Mr. GARRETT. In each one of those cases, is there always a government backstop at the other side of those pools?

Mr. NASSETTA. There has been in each one that I am aware of, yes.

Mr. KELLY. There is not enough capital in the private sector to absorb the hundred, three, four, five hundred billion dollar loss that could easily occur. There is a level at which there is not enough—there is no mechanism that will create enough private capital. What is desirable is to create an environment with a mechanism to move that government step-in point higher and higher over time, but there will always be a need, ultimately, for a Federal Government backstop.

Mr. AYER. One misunderstood point, Congressman Garrett, is the fact that, today, there is private capital. It is the insurance industry, and you know, in stepping up our retention from 7½ percent to 20 percent, what you have done is brought the insurance in as private capital, but unlike natural disaster risks that take us—for example, we are in the market on natural catastrophes where we have reinsurance from cat bonds protecting us.

With respect to TRIA, we cannot get or secure protection from capital markets or from reinsurance markets, and that is the distinction.

Chairman BAKER. The gentleman's time has expired.

Ms. McCarthy?

Ms. MCCARTHY. Thank you, Mr. Chairman. I want to thank everybody for the testimony. It really has been fascinating.

I am one of those who do believe that the Federal Government should be involved in backing up for the terrorist insurance, and actually even for catastrophe insurance, what we have seen in the last couple of years that has happened here in the United States.

From listening to your testimony, probably most of you were talking, especially, from 9/11 and Katrina. It has opened up our eyes to what we all are exposed to, but one of the things I have not heard—one part, I heard that the insurance have actually gone down about 25 percent, I believe, Mr. Case, you had mentioned, that it was being stabilized?

Mr. CASE. What I mentioned was in the context of the effectiveness of TRIA, that the terrorism rates had come down roughly 25 percent. That is, within the context of insurance rates, dramatically increasing over that period of time.

Ms. MCCARTHY. Okay. Because my concern is really—no one has talked about small businesses. We know that, from 9/11, in the building, certainly there were large corporations, and certainly they were extremely hurt, but there was also small businesses that were in the building and in the surrounding areas.

My concern would be a lot of those businesses have not cone back, because they were not prepared for, certainly, that kind of a disaster, and I think one of the problems that we are going to see in the future, whether it is a Katrina-like issue or another terrorist attack, if it does happen here in the United States, that small businesses are still going to end up losing, and I think that is something that needs to be adjusted somehow.

You had mentioned that your costs have gone up quite a bit. Is there anything that we can do to incorporate—to make sure that small businesses are covered—with the rates?

Mr. AYER. If I could pick up on this, The Hartford is one of the largest small business insurers in the country. We have 770,000 small businesses that we insure today, and a ton of them were our insureds in the 9/11 incident, and a ton of them have come back, and absent reinsurance availability, that would be a challenge, but a lot of them do buy the terrorism insurance currently in their contracts, because it is automatic on workers compensation, and it is also available on property insurance, because it is a mandatory offer today.

Ms. MCCARTHY. I am wondering today, with what we are dealing with, possibly, for the future—I know here—actually, on one of my other committees, we had—for small businesses to be able to buy health care, to pool together. When I talk about small business, I am talking about the little guy that has got a little shop, probably does not have any insurance whatsoever, or if it is, it is minimal, because we talked about fire, but if we had a biological attack, which we are hearing about constantly, there would be no fire.

Obviously, some other attacks, yes, there would be explosions and then fires. That would be covered. How do we, as the government, work with you to try and cover those particular different areas?

Mr. KELLY. First of all, the small business market is very competitive. There is lots of property and casualty capacity available to small business. Now, whether or not they want to pay for it or not, that is a decision.

They have to pay the rent, and there is the form of doing business. It is a competitive market. We compete against my colleagues at The Hartford.

It is a very active—and I think, later, you will hear from the independent agents—it is a very active market, but to the extent they are exposed to things such as nuclear or biological, you know, it is the same for an aggregation of small businesses as for a big business. Our capital is at risk.

So, if TRIA provides the appropriate backstop, then we can provide the coverage. It is no different. The mechanism will be no different than it is for the larger risks.

Ms. MCCARTHY. Let me ask you a question, because it just popped into my mind. You know the insurance business better than I do, but with a large corporation—say they are an accounting firm. You know, they have records, they have paperwork, but downstairs there is a restaurant which would be considered a small business.

They might not be prepared for the loss of, number one, closing the restaurant down for weeks, months, certainly the loss of income, food, and everything else. So, your insurance would cover something like that?

Mr. KELLY. Business interruption insurance is probably the most significant part of their coverage. They would get significant business interruption payment that is based on their revenue and profits. Mr. Ayer alluded to how well his policyholders recovered, the same as ours. That is a huge part of the business, business interruption insurance. It is readily available, it is freely available, and if someone decides not to buy it, I mean—it is a cost of doing business, but it is there. It is there.

Mr. NASSETTA. I think, again, from a consumer point of view, whether large or small—and a lot of our businesses certainly are large, but there are small businesses involved—I think it gets back to the underlying issues that I have talked about, others have talked about here, and that is we cannot—in thinking about terrorism insurance, you cannot exclude certain aspects of it like NBCR and feel like we have accomplished the objective.

Again, while TRIA has been very, very successful and does, in fact, cover it, there needs to be a plan put in place to stimulate more capacity for those types of things, for small business, big business, medium-size businesses. Otherwise, to the extent that we have an occurrence of that sort, it is going to devastate all businesses in whatever particular zone of the country that it occurs.

So, I think the small business will ultimately benefit from whatever we are doing in the same exact way that any medium or larger business would.

Chairman BAKER. The gentlelady's time has expired.

Ms. MCCARTHY. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentlelady.

Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

Mr. Kelly, you have at least mentioned, for the first time in any of the hearings on TRIA, a concern that I have had about what is the insurance industry doing to push the private sector to be prepared for terrorism attacks, to be—what is the insurance industry doing for preparedness. I am glad to see that that—that you have addressed that, or you mentioned it, at least.

The 9/11 Commission report said that the private sector was almost wholly unprepared. All of the witnesses said that, despite the clear risk, the private sector was almost wholly unprepared, 85 percent of the likely targets were in the private sector, and that there was, in fact, no widely understood set of standards for care, for preparedness that was being embraced, that was embraced by the private sector, and actually, when the 9/11 Commission did their follow-up report card just a year ago, private sector preparedness still got a grade of minimal progress and said that the insurance and credit rating industries were just beginning to incorporate national preparedness standards into their underwriting and risk assessment criteria, and that there needed to be a great deal more of that done.

Are you requiring your insureds to submit to preparedness, terrorism preparedness audits? Are you telling them of standards? Are there clearly understood standards for preparedness?

Are you telling them about that? Are you able to require that they meet those standards?

Mr. KELLY. Yes. I think it is always easy to look at 9/11 and say we should have been prepared. As a country, we should have been prepared. We were not. We were not prepared.

I understand it is easy to say, in retrospect, we should have been. No one could have anticipated it. So, that criticism, let us put aside, but I do think the report is absolutely incorrect.

Each of us in our own way—we cannot compare underwriting rules. The Hartford has theirs; we have ours.

It is an essential part, before we will assume a risk. Have they protected the building? Have they taken care if something goes wrong? And we have worked with various groups to develop our underwriting standards.

Our competitors have similar standards, and it is a central part—people who do not meet the standards cannot get insurance.

Mr. NASSETTA. As a consumer, I would have to agree with that, from what we are seeing.

It is certainly a very active dialogue that occurs as we are placing our insurance—as an industry, we are placing insurance. It starts with a fundamental belief that there are some things that you can protect against and some you cannot. We cannot protect against a plane flying into our building, as an example, and we had that happen at our company. We owned the World Trade Center. Marriott—we lost a number of guests, a lot of employees, and ultimately, an 820-room hotel that was taken out.

There is nothing, ultimately—the Federal Government can help protect us against that; we cannot. Having said that, as an industry, not only is it being driven through the discussion we are having with lenders and insurers, but it is being driven by our own interest in protecting ourselves because of what I am describing, which is a lot of these risks and perils that we have, we do not have coverage for.

I mean the fact of the matter is, when it gets down to NBCR—I have talked about it 5 times. I will not say it again. We really think we have very little coverage. So, we have to protect ourselves right now as best we can. There are some things we can do, some we cannot. The real estate industry has gotten together with the Federal Government and created a real estate information sharing analysis center, real estate ISAC, that we have invested a lot of capital into, that is working very well.

Individual companies are doing a great deal to harden targets as best they can. I know we are spending millions and millions of dollars, our company, additionally, a year, on security and protection against NBCR and other forms of terrorism that we think we can protect against. So, I disagree with the report in the sense of what I see day to day and what we are doing in our business, what I see in the industry, overall, and I think, you know, there is a kind of self-help component to what is happening, not just the influence of lenders and insurers but a self-help in the sense that it is the only protection we may have on some of these events right now.

Mr. MILLER OF NORTH CAROLINA. One of the other findings of the 9/11 Commission was the civil liability system should be part of the market inducement to preparedness, that if the company has what should be a known risk and fails to take the actions to prepare for that risk and causes harm to others, under the civil justice system, they should have liability for that.

Mr. Kelly, do you agree with that finding of the 9/11 Commission?

Mr. KELLY. That is an area I think is beyond where I have expertise.

Mr. MILLER OF NORTH CAROLINA. Does anyone on the panel wish to claim expertise and address that?

Mr. NASSETTA. I have no expertise, but I have to say I would not be in favor of it.

I think what it will lead to is a massive amount of litigation in which you are going to turn—what will ultimately happen is the victims of terrorism will be victimized again with a debate, with a thousand lawyers trying to determine whether the locks on our doors of our HVAC system were adequate enough to keep somebody out of putting a chemical agent in there that harmed our guests. I can only imagine the anarchy that would follow.

So, I personally, speaking on my own behalf, think it is a very, very difficult thing to do.

Mr. MILLER OF NORTH CAROLINA. Actually, I think the 9/11 Commission was not talking about statutory liability but simply common law liability; the existing law of negligence would hold that once—in 9/11, nobody thinks the World Trade Center should have understood that they were going to be hit by a plane filled with jet fuel.

No business in America can now say who would have thought—who would ever have thought we could be the victim of a terror attack, particularly the chemical industry, particularly all the industries that we know are likely victims.

If there is a clear set of standards of what they should do, they did not do it, and others suffered as a result, you do not believe that they should be held—

Mr. NASSETTA. The clear standards are the rule of law and people that are not abiding by the rule of law or set-out rules, I think there is a different set of issues involved. That is not how I understood the—

Mr. KELLY. Let us hypothesize a situation. There are certain glass standards you can put in a hotel. I will posit that as a situation. Well, unless you mandated a specific manufacturer and said, unless you buy that manufacturer's glass, then there is significant liability. Well, the bar will begin saying, well, you bought that glass, but that does not quite meet the standard in the following way—or it was not installed properly because in the upper right-hand corner, on the 22nd floor, you find a millimeter—it opens and so on. The plaintiff bar is remarkably creative in using liability laws to significantly increase the cost of doing business in this country, and to create a new liability, with all the interpretation of clear standards, and use legislation to encourage litigation, which this would do—it would not just allow it, it would encourage litigation—would be a deleterious effect on the broad economy.

Mr. AYER. It would be a tragedy, Mr. Miller, if you used this legislation to spawn or support the idea—

Mr. MILLER OF NORTH CAROLINA. Actually, I was just asking if you agreed with the 9/11 Commission.

Mr. AYER. I just believe that litigation is not the best way—

Mr. MILLER OF NORTH CAROLINA. I think the answer is no.

Mr. AYER. Litigation is not the best way to enforce accountability, in my view.

Mr. CASE. The one item I would also just highlight is to what purpose?

What I thought was interesting when you asked the question, is there preparedness and is there efforts around preparedness, you actually heard as emotional a response as you have heard today, and it was from the insurance world, who talked about—you know, they actually spend real time with companies, with firms, not just asking but requiring, and the penalty for not complying is much, much higher rates or no coverage, and then you heard a client describe the fact that they believe most of their terrorism risks right now are uncovered. They are self-insured, and what is insured—again, they have tremendous economic incentive to try to get the best possible situation they can.

So, I would just ask—I would concur with the other panel members but would ask to what end? Are we trying to improve the situation, because we have got tremendous incentives to try to do that now.

Chairman BAKER. Can you make this your last one, Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. I can.

I also understand that, for the vast majority of insureds, who are not required to have a form of insurance—workers comp insurance, one obvious example; the other is the requirements of the lenders, mortgage lenders—that the vast majority of insureds, commercial insureds, decline terrorism insurance.

They do not pay the additional premium. They simply bear the risk. Given the fact that some are obviously vulnerable, their vulnerability affects others. Their failure to take precautions affects others.

Do you believe that, for some businesses that are obvious terrorism risks, that insurance should be optional or required?

Mr. KELLY. I think mandatory coverages inevitably lead to regulatory abuse, and I think to mandate coverages would be a bad thing.

Let the person's risk appetite determine what they are willing to pay in the marketplace, and it is not—you should not be surprised that the take-up—it is increasingly dramatically, I think, as Mr. Case pointed out—take-up is low.

Think of a California earthquake. A State program available to individuals on their homes, people living on the faults do not buy it. Very small take-up of earthquake insurance by individuals in California. Is that a rational act? No. But should the government mandate rationality? I think that would be unfortunate.

Chairman BAKER. I think government and rational are mutually exclusive.

That was the gentleman's last question, I believe, and I just wanted to clarify, Mr. Kelly, with regard to pricing freedom, the NAIC has taken the position with regard to this issue that there are no pricing constraints. The GAO report seems to indicate that there is considerable friction between insurers and varying State regulation. I believe it extremely important to have pricing freedom for this product in order to have availability.

From your role, and particularly given the extent to which you are engaged in workers comp, do you find, from your perspective, there is State regulatory intervention in your pricing models?

Mr. KELLY. Significant. In our own State of Massachusetts, pretty much the rate is mandated.

I think very interesting in the GAO report is the situation in California.

The industry is in a peculiar Catch-22 situation. California regulation says that before a rate can be approved, it must be actuarially based. Because of the nature of the terrorism risk, they say your rates are not actuarially based, so we will not let you charge anything. Essentially, I mean it is a Catch-22. I mean it is not an actuarial system.

So, in many, many, many States, there is significant price control of workers comp. We do not operate in anything remotely like a free market.

Mr. AYER. Congressman Baker, I would like to add—I think it's a very well-framed question.

I believe, today, that price and forms are not areas where the industry has much freedom.

As a matter of fact, I believe that the NAIC is not right in suggesting that there is enormous freedom in both rates and forms today.

Chairman BAKER. I thank you. I want to express appreciation on behalf of the committee to each of you. This has been a very informative hearing, very good information provided from various perspectives, and it will be of substantive help to us as we move forward in this resolution.

Mr. KELLY. Thank you for inviting us to testify.

Chairman BAKER. I appreciate your time, and this panel is dismissed, and Mrs. Kelly will assume the chair.

Mrs. KELLY. [presiding] Thank you very much for joining us today.

This second panel begins with Dr. Sharon Emek, a partner of CBS Coverage Group, Incorporated. She appears today on behalf of the Independent Insurance Agents and Brokers of America. She has testified numerous times before the New York State Assembly on terrorism insurance, insurance market conditions, and broker compensation. Most recently, she testified before the National Association of Insurance Commissioners on developing a permanent terrorism insurance solution.

We welcome you, Ms. Emek, and let us start with you.

STATEMENT OF SHARON EMEK, CBS COVERAGE GROUP, INC., ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA, INC.

Dr. EMEK. Thank you. Good morning, Chairman Baker, Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez, and members of the subcommittee. My name is Sharon Emek, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America to present our association's perspective on terrorism insurance. I am currently a managing director and partner at CBS Coverage Group in New York, and also chair of the board for the Independent Insurance Agents and Brokers of New York.

I would like to begin by complimenting the committee and Congress for passing TRIA in 2002 and its extension in 2005. The Federal backstop created by these laws have worked well. It has ensured that terrorism insurance is available and more affordable. It has allowed businesses to continue operating and growing and preserve jobs, at virtually no cost to the Federal Government.

However, as we all know, TRIA is scheduled to expire at the end of 2007. There is still no reason to believe that the threat of terrorism is on the decline, or that the private insurance alone can adequately provide coverage.

As such, the Big I encourages Congress to develop a long-term solution that encourages the private sector to take on additional risk. Based on our members' experience in the market, we would like to stress that this is not just a big city or a big business problem; it is truly a national issue. Policyholders across the country insist on having the coverage. We have seen terrorism coverage purchased everywhere, from small towns in Mississippi to small and large businesses in New York City.

Similarly, this issue impacts all businesses, large and small. The fabric of this country and our economy are built on small businesses. Without a long-term solution, we anticipate that coverage would be very expensive and unaffordable to smaller businesses. It would be years before there would be sufficient take-up to make it affordable for small businesses, if ever. These businesses would be at risk, with no option, and I personally have seen what can happen after a terrorist attack.

I work and live in New York City, and I lived through the horrific event at the World Trade Center. After 9/11, a number of my friends had to close their businesses because they did not have sufficient business interruption coverage, even with terrorism being covered on their policies at the time, because no one could have anticipated the length of time it would take to get back into business after a terrorist attack.

Imagine how many more businesses would go out of business without business interruption coverage at all, because they could not purchase affordable terrorism insurance. Without the ability to purchase affordable terrorism insurance, businesses will have no business interruption protection, and in the event of a terrorist act, many more businesses will go out of business.

You have heard plenty of testimony from experts on why terrorism insurance is uninsurable in the free market alone, as it does not have the appropriate characteristics and creates adverse selection. So, I would like to tell you about the businesses I insure, and what they think and worry about every day, and I insure small to mid-size businesses all across the country, not just in New York.

At most of my client renewal meetings this year, my clients ask, first thing, about a permanent terrorism insurance solution. They say will it still be available? Will it be affordable for me? What would happen to me if a terrorist attack happened in my surrounding area? How would I get back into business?

We agents have to deal with these questions and help our clients figure out how to best protect themselves in the case of a terrorist event. Without the availability of affordable terrorism insurance, we would not be able to help them.

Imagine a terrorist act happening in a few industrial complexes around the country, some of which I insure, at the time, and a ripple effect it would have across the country on the businesses in their supply chain. If they cannot get back into business because they were not able to purchase affordable terrorism insurance, it will have a dire economic effect on all the businesses they support, not just perhaps their distributors and the retailers that they might supply, but their accountants, consultants, attorneys, the coffee vendors, the office supply vendors—all of them would have economic impact because these businesses would not be able to get back into business without the ability to purchase affordable terrorism insurance.

I can tell you from firsthand experience that the ripple effect of 9/11 in the city was enormous. All of the retail shops in downtown New York were closed for months. Many never were able to get back into business, even with having terrorism coverage at the time.

Imagine how many more would have gone out of business without it, but it was not just the retail stores. One of my clients was a dentist, just blocks away from the World Trade Center, and his practice was built on servicing those professionals who worked in the World Trade Center. At 55 years of age, he was out of business, because there were no more customers available.

What I want to reiterate is that we need to look at this problem from the bottom up and not just from the top down. Millions of small businesses across the country can be affected without affordable terrorism insurance. The Big I is encouraged by the report released by the Government Accountability Office yesterday. We believe its findings highlight the need for a limited but continued Federal role in terrorism insurance.

Coverage would be very limited and less affordable without a Federal role to encourage the private market, especially as it relates to NBCR attacks.

The requirement that insurance companies make available coverage has been very important to the policyholders that our members serve, because it encouraged greater uptake, resulting in increased capacity and lower premiums.

The Big I supports the continuation of make-available requirements in any future public/private partnership, and consider extending the make-available provision to NBCR attacks, providing that this risk is separated and given special treatment.

Any program should focus on increasing uptake rates to spread the risk and build capacity while protecting taxpayers from ad hoc post-disaster funding.

In conclusion, the Big I applauds Congress for not ending TRIA abruptly last year and for having the foresight to continue the program while working on a viable long-term solution.

Most importantly, we thank this committee and Congress for its continued leadership on these issues. Your efforts are crucial for finding long-term solutions of the economic and physical risk associated with terrorism.

Thank you.

[The prepared statement of Dr. Emek can be found on page 110 of the appendix.]

Mrs. KELLY. Thank you, Ms. Emek.

Mr. Heck, I am going to call on you, but I am going to ask if you could curtail your opening remarks. We have your full testimony, it will be made part of the record, but we are just being called to the Floor for some votes, and if we could have your testimony before we go to the Floor, it would be very convenient for Chairman Baker and myself.

STATEMENT OF WARREN HECK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GREATER NEW YORK MUTUAL INSURANCE COMPANY, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Mr. HECK. I will cut out most of what I was going to say, but there are a few items that I think I should cover.

My experience tells me that, without a Federal program, we would find ourselves in the same position we were in at 9/11, with insurers excluding terrorism, unless they were required, as they are in New York, to provide it. Insurers forced to write such coverage in New York would either leave New York or they would increase their rates.

Now, my company is a medium-size company. It is the fourth-largest writer of commercial multi-peril in New York State, and we are one of the major writers of commercial insurance in New York City. We talked about the capital markets, so I will not say anything about that, but I would like to say that the insurance industry has been working to devise a long-term program for Congressional consideration that would maximize private sector participation without threatening the economy and the industry.

One way might be to create a federally-charted entity that will establish a reinsurers market below the deductibles. With voluntary insurer participation, this “middle layer” of potential risk-bearing capacity would provide the kind of private market test that some in the Congress believe is needed. Another critical consideration is the size of the trigger, and this is very important. We heard a lot of very large insurance companies discuss this today.

We should consider the small and medium-size companies, and for medium-size and small companies, the event trigger is critical. Too high a trigger would drive them from the market, because reinsurance costs would be too expensive, making primary coverage unaffordable.

A trigger in excess of $50 million would severely limit my company’s ability to offer as much coverage as it does now. I think a $50 million trigger would likely assure the continued involvement of these insurers in the sale of terrorism insurance.

Absent their involvement, I believe there would not be enough capacity and interest to stabilize the economy after another event.

One of the very important things to consider is that there are 2,100 property and casualty insurance companies that operate in the United States. If you look at the amount of premium that they write and the surplus that they have, there are only approximately 40 companies that have $1 billion or more of written premium and about 60 companies that have $1 billion or more of surplus.

In order to make terrorism available and affordable, it is essential that all companies participate, so that the risk can be spread. You need the smaller companies, too, and many small companies, like my company, operate in New York, and write a significant part of that market. There is much more detailed information, as you had indicated, in my written testimony, as well as a description of NAMIC’s views regarding a long-term terrorism risk insurance proposal.

Thank you once again for the opportunity to testify on this issue. NAMIC appreciates your continuing leadership. We stand ready to assist you in any way possible in developing an effective long-term terrorism insurance plan.

[The prepared statement of Mr. Heck can be found on page 125 of the appendix.]

Mrs. KELLY. Thank you.

Mr. Heck is chairman and chief executive officer of the Greater New York Mutual Insurance Company, and he testified today on behalf of the National Association of Mutual Insurance Companies. Mr. Heck, you have been with us before. You have testified before. We are always happy to have you here again.

We have been called, as I said, for a vote. There are three votes. I would imagine that we will probably have to figure, I would think, at least—to give it some time, because I do not know what is going to happen between the votes, I would say we will recess for approximately 20 to 25 minutes, and see you all back—I am sorry for the break, but this is the way it is today.

Thank you.

[Recess]

Mrs. KELLY. [presiding] Thank you very much, all of you, for your indulgence on our going off to vote.

We will hear now from Janice M. Abraham, who serves as the president and chief executive officer of United Educators Insurance, having occupied that position since 1998. She testifies today on behalf of the Property Casualty Insurers Association of America. Ms. Abraham has over 14 years of experience in serving the higher education community through her work as chief financial officer/treasurer of Whitman College, various senior positions at Cornell, and the National Association of College and University Business Officers.

We welcome you and we look forward to your testimony.

STATEMENT OF JANICE M. ABRAHAM, PRESIDENT AND CHIEF EXECUTIVE OFFICER, UNITED EDUCATORS INSURANCE, ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

Ms. ABRAHAM. Thank you very much, and I appreciate the opportunity to talk to you today, Chairwoman Kelly, and Ranking Member Kanjorski. Thank you very much.

I am Janice Abraham, and I am president and CEO of United Educators. We are an insurance company owned by over 1,200 schools, colleges, and universities throughout the United States, and we are very interested in the continuation of the partnership that exists in providing liability insurance, property insurance, and workers compensation insurance for terrorist events in this country.

On first blush, it might be unlikely to think about educational institutions as targets, but the experts have identified educational institutions, colleges, and schools as potential soft targets, and there are really four reasons that we are focused on that.

The first is colleges and universities. Our schools are symbols of what is great about this country. They are the envy of the entire world. They are icons of America. It is not at all unusual to walk down the street of a foreign capital and see a t-shirt for Sarah Lawrence, for Dickenson, for any of the institutions, University of Michigan, Cornell University, St. John's, on somebody walking down the street. They are known, they are respected, and they are envied around the world.

Our campuses, our schools are open. They are open for debate, for controversy, and they are open physically. We cannot and we do not want to lock down our campuses. There are some areas that are restricted, obviously, but for the most part, we encourage visitors. We encourage individuals to come to our campuses, to engage in the arts, to engage in the discussion and the gatherings that happen, and so, we cannot lock down nor do we want to make a hardened target for our colleges and universities.

We are also magnets for mass gatherings, whether or not it is 110,000 people at the football stadium at the University of Michigan; the presidential debates, which are often held on our college campuses; or a commencement, where you will have thousands of individuals, plus illustrious speakers, gathered for an important ceremony. Thousands and thousands of people come to our campus every day for nationally televised events, and it is an important symbol of what we do.

Finally, some of the most important research, often done under Federal grants and contracts, is done in the laboratories of schools and colleges and universities. Research on ebola, on anthrax, and on botulism is done in our labs, and we take great care to keep those laboratories safe; however, it is not unthinkable that there would be a break-in and dangerous substances would be stolen and used as part of a weapon in a terrorist event.

So, it is—we are targets, potentially soft targets for a potential terrorist event.

Our first line of defense as an insurance company which is owned by the educational institutions is to do risk management, and we do extensive work on crisis planning, on safety, on security, but if that were all it took, we would not be here today. We would not be talking about this issue.

Rather, we need—we are dependent on having a three-way partnership to provide terrorism insurance. We offer very high limits of liability insurance to our educational institutions, and if the Federal Government is not part of the three-way partnership, we will not be able to offer this coverage to our members.

We will either exclude it or we will sub-limit it significantly and leave our educational institutions with a significant uninsured position, and the three-way partnership is this:

First, our schools and colleges commit a lot of resources in crisis planning, keeping the athletic stadium safe, and they have significant financial investments in this.

Second, as an insurance company, we have a significant investment in the risk management that we offer our educational institutions, and we have a significant financial exposure to the loss. That is what we do. We are not looking to step away from that, but we are a small company, and we are dependent on our reinsurers.

I just came back late last night from meeting with five of our domestic reinsurers, and they told me that they are not able to provide unlimited terrorism insurance for us, for United Educators without the role of the Federal Government. They cannot predict what the frequency, the severity, when it would happen, how it would happen, and they are not able to provide that protection to us, and so, without—as a small company, without the reinsurance support, we will not provide it.

So, we need the Federal Government to be a backstop, not a bailout but a partner in a long-term solution, some of the solutions that were talked about earlier this morning, to make sure that educational institutions continue to meet their mission.

In conclusion, we do not know when the next event will be. We do not know where it will be. Will it be at a college? Will it be at a shopping mall? Will it be at a Federal Government building? We do not know that.

We do not know what method the terrorists will use, but what we do know is that United Educators, small insurance companies, our educational institutions, and our reinsurers want to be part of that solution, but we cannot do it without the role of the Federal Government.

Thank you very much for the opportunity to speak to you today. I would be happy to answer questions later on.

[The prepared statement of Ms. Abraham can be found on page 75 of the appendix.]

Mrs. KELLY. Thank you, Ms. Abraham.

We turn now to Mr. Edwin Harper. Dr. Harper is a senior vice president with Assurant. Prior to joining the Assurant Group in 1998, Dr. Harper held a number of senior management positions in the private sector. He also served as an assistant to President Richard Nixon for policy planning and budgeting. During the Reagan Administration, he was Deputy Director of the Office of Management and Budget, and Chief of Policy Development.

We welcome you and look forward to your testimony, Mr. Harper.

STATEMENT OF EDWIN L. HARPER, SENIOR VICE PRESIDENT, ASSURANT, INC.

Mr. HARPER. Thank you very much, Chairwoman Kelly, and Ranking Member Kanjorski. My name is Ed Harper, and I am here today representing the ACLA, Assurant Inc., and as chairman of the Group Life Coalition, and I will summarize my written testimony by making a couple of points and then telling a story.

In 2001, I walked through the smell of quenched fire and ashes to my office at One Chase Manhattan Plaza, and from my office, I looked down into the hole which was the site of the World Trade Center, where more than 2,000 people lost their lives. Most of those lives were covered by group life insurance. So, we at Assurant know about terrorism attacks and group life from close-up.

My message here today, to this committee, is do it again, and do not let go. This committee got the TRIA extension right by including group life in last year's bill, and as we heard from the earlier panel, TRIA has done a lot of excellent things and has made a huge difference, but TRIA has a big gap, as it was finally enacted.

It provided for the buildings, the brick and mortar, but not for the people who work in those buildings. The workers got left behind when the bill was finally signed.

The National Association of Insurance Commissioners has publicly stated its support for group life's inclusion in TRIA. Howard Mills, New York's superintendent of insurance, vigorously restated his support for this position in a hearing at the NAIC's quarterly meeting 2 weeks ago in St. Louis, and group life is important, because it is the only insurance that most of the working men and women of America have.

At the end of 2004, there were 165 million certificate holders of group policies. It is interesting. I am told, historically, that New York State wanted to isolate itself from potential insurance company failures in other less rigorously regulated States, since the subsidiaries who operate in the single State of New York, the amount of surplus and assets available to pay claims is limited to the amount of company operating in New York but protected by potential failures elsewhere.

The normal solvency regulation says you have surplus proportionate to the amount of risk the company has. Some group life actuaries would suggest that normal is to expect four deaths per 1,000 lives covered each year, with the average claim cost of just over $46,000.

Thus, the normal loss would expect to be about $184,000 per thousand employees covered per year. However, in terrorism risk, there is no normal.

Let me illustrate the dynamics of the situation with a story about two companies: one, the ABC Financial Services Company; the other, the XYZ Insurance Company. The story is fiction, but as they say in movie previews, it is based on a true story.

What is true is there was an ABC Company that was decimated in 9/11, and the XYZ Insurance Company's financials represent those of a not atypical mid-sized group life insurer.

In our story, ABC Financial Services, a successful company with about 700 employees operating from the heights of a prime building on Wall Street decide to get group life for its employees it pays well, about $250,000 a year, so they got group life coverage of one times their salary, then an accidental policy covers another one times their salary. So, the average employee there could expect a half-a-million dollars of death claim if they died.

ABC's risk manager checked out the XYZ Insurance Company and found that XYZ was operating profitably in New York, with a $50 million surplus. In further checking, he found that, on 9/11, XYZ had catastrophic reinsurance which covered the entire amount of claims, without a deductible, but today, the best catastrophic reinsurance they could get is $60 million of reinsurance after paying a $20 million deductible. It should still not be a problem, right?

This risk manager was a tough analyst, and he looked into New York State's regulatory regime, and he realized they were good, solid regulators. Well, the risk manager felt good. He had bought group life cheap as a part of his employee benefit package. He had bought from a company that was profitable, had a nice surplus, and from a company under a strong regulatory regime, and XYZ surplus was far in excess of the claims one would normally expect.

What could go wrong? Now, we start the movie based on a true story. ABC is devastated by a terrorist attack, with 658 of the 700 employees killed in the terrorist attack. The claims are $329 million. XYZ's reinsurance pays $60 million of that amount, leaving claims of 269 million to be paid from assets and surplus, but XYZ's surplus in New York, available to pay claims, is only $50 million.

Thus, if XYZ's New York operation were bankrupted to pay claims, there would still be 438 employees who would have to rely on public guarantee funds to be paid their justly due claims, and claimants in XYZ's other lines of insurance would find that they were not getting paid because the company was bankrupt, it was gone. Well, that is a short, gruesome movie with needless suffering.

If XYZ had been able to purchase the same level of catastrophic reinsurance it had before 9/11, there would not be a problem, no need for public sector involvement, but the catastrophic reinsurance available since that time has not been on the terms or in the amounts available for it. There is a lack of capacity.

Interesting, revitalizing the private sector market for catastrophic reinsurance for group life could be as simple as including it in TRIA this time.

The June 30, 2005, Treasury study assessing the effectiveness of TRIA demonstrated that reinsurance markets for a covered line, such as workers comp, was revitalized by its inclusion in TRIA. You might look at page 113, among other pages, for that point. The data suggests that the reinsurance market for group life would be similarly revitalized by the inclusion of group life in TRIA.

This committee understands the problem. In its prior action, refining TRIA and extending it, it included group life. This time it must include group life again and insist that the others in the legislative process not leave group life and the American workers behind.

Thank you very much.

[The prepared statement of Mr. Harper can be found on page 119 of the appendix.]

Mrs. KELLY. Thank you very much, Dr. Harper.

Next we hear from Ira Shapiro, who serves as the chief executive officer of Fisher, Harris, Shapiro Company, an outsourced risk management company. He appears today on behalf of the Real Estate Board of New York. Mr. Shapiro was principal of the JLS Group, one of the Nation's larger mid-sized boutique brokerage firms, for 30 years. He was also a senior executive of the Kay Group, Incorporated, and in 1995, he founded Ira Shapiro Consulting Services, Incorporated. In 1998, Mr. Shapiro combined with colleagues to form Fisher, Harris, Shapiro.

Mr. Shapiro, we look forward to your testimony.

STATEMENT OF IRA SHAPIRO, CHIEF EXECUTIVE OFFICER, FISHER HARRIS SHAPIRO, ON BEHALF OF THE REAL ESTATE BOARD OF NEW YORK

Mr. SHAPIRO. Thank you very much. I appreciate the opportunity to be here and testify on behalf of this subject matter. I am the CEO of Fisher, Harris, Shapiro. We are a outsource risk management consulting firm. We do not sell insurance. Most of our clients are in the real estate business. We serve over 30 real estate portfolios and large construction projects, most of which are New York City-based or located in New York City area.

My clients represent about $45 billion of total insured value, 900 million square feet of commercial space, and 71,000 residential units. As a result of that, we are well versed of what is going on in the marketplace.

While New York City and other urban centers face serious concentration of risk issues, the problem is a national scope. As an example, mortgages: Mortgages were discussed earlier today, but mortgages are securitized, and these securities are held by pension funds, mutual funds, and individuals.

Without TRIA, these commercial mortgage-backed securities are in danger of underlying the mortgages and being in default. This could impact millions of Americans, as one example.

What I would like to talk about is the present state of the insurance marketplace. New York City, in particular, and I am sure, other major cities, are having more and more problems in getting their insurance portfolios completed. It is happening almost—and I am not being dramatic—almost on a daily basis, insurance is disappearing.

Just yesterday, we got a call from one of our portfolios that the broker was trying to put it together. He had anticipated buying $175 million, which was promised to him by the insurance company, in one of their layers which was scheduled to be put in place on October 26th. They called him yesterday and they said you put the insurance in force today or we are going to take the capacity away from you, and this is without the portfolio having been completed. So, this is something we had to do. There was no option.

The reason that—2006 has been probably the most difficult year that I have seen in the insurance business, and I have been in the business for over 40 years and in my consulting firm for over 12 years—and the question is why is 2006 such a difficult terrorism issue when TRIA is still in effect, and this has come about because of TRIA. TRIA obviously has been a basically very important matter to the industry. Had it not been for TRIA, we would be having a catastrophe as far as trying to get insurance.

The government has tried, in the extension of TRIA, to remove itself as much as possible from small exposures and tried to get the insurance industry to take on higher risks. The extension of TRIA was a godsend to buyers of insurance, because TRIA now had to be mandated by the insurance companies.

On the other hand, the insurance companies were being—with the extension of TRIA—were being exposed to greater self-insured retentions. We had a $5 million criteria before TRIA would respond to an event. With the extension of TRIA, it is now $50 million. So, insurance companies, on any risk that becomes less than $50 million, has no TRIA back-up.

There have been actuarial studies made by the American Academy of Actuaries and Risk Management Solutions wherein they took a study of 10 possible terrorism attacks and came to the conclusion that 9 of those 10 attacks would not pierce the $50 million layer, and the insurance companies look at that and say we are not going to have protection. I am not here to support the insurance companies. I am here to tell you how it impacts on the buyers of insurance.

The situation, also, the insurance companies are more exposed because of the fact that the—and this has been discussed in the morning, that the percentages that the insurance companies have to assume has gone from 7½ percent up to as much as 20 percent next year, and in addition, to the extent that the—that an event would pierce the 50 million and pierce the retention that they have, the insurance companies now have to co-share with the government 15 percent of whatever it goes above that.

The impact that that has had on the insurance—on the buyers of insurance is that insurance companies are not putting out the kind of limits that they were putting out prior to—in the year or two prior to that. They are concerned that—putting up big limits. They are insurance companies that were putting up $100 million and $200 million of exposure, are now putting up $25 million and $50 million.

Many insurance companies have come to the conclusion that they cannot afford to provide terrorism insurance. Since you cannot write property insurance without having terrorism insurance, a lot of these companies have stopped writing altogether.

We have some very large portfolios. We have large construction projects going on. We have a very large construction project that was in progress, that is in progress, and the builders risk—there are very few insurance companies that are providing builders risk insurance for Manhattan construction—large construction projects.

When we took this project to the insurance marketplace through one of the major brokers, the insurance companies turned around and said we will not provide you any insurance unless you agree in advance not to buy terrorism coverage. So, we had to go out and buy it without terrorism coverage in order to get them to buy all-risk coverage, and then we had to go to the stand-alone terrorism market at enormous prices and with tremendous deficiencies in coverage.

Mrs. KELLY. Mr. Shapiro, I would appreciate it if you could please sum up. The red light is on, and if you could sum up, it would be appreciated.

Mr. SHAPIRO. A couple of things I just wanted to mention. The insurance industry is now being managed by the rating agencies.

There are insurance companies that are willing to put up a lot of capacity. The rating agencies are threatening these insurance companies and saying to them that we will reduce your ratings if you continue to write terrorism. So, we have had insurance companies that have basically pulled back from the marketplace because they had to, not because they wanted to.

Mrs. KELLY. You understand, Mr. Shapiro, your full testimony is a part of the record. We have all read that.

Mr. SHAPIRO. Okay.

Mrs. KELLY. So, let me explain for Mr. Knipe, in case you have not testified before us before, the box sitting in front of you has three lights in it. One is green, the middle one is yellow, and when it is read, it means the time is up. You each have 5 minutes for your testimony. Mr. Shapiro, if you have not finished, please do.

Mr. SHAPIRO. Just one final paragraph.

Clearly, a long-term payment permanent solution is needed. A workable solution will require government involvement. Let me just say one thing off the paper. I think the government wants to move back from the exposure, and I think the best way to do that is the pooling arrangement. It puts the pooling arrangement between the government and the insurance companies, which I think would be the ultimate situation.

Mrs. KELLY. Thank you.

Mr. SHAPIRO. Thank you.

[The prepared statement of Mr. Shapiro can be found on page 159 of the appenidx.]

Mrs. KELLY. We hear next from Jonathan Knipe, a senior vice president, general counsel, and director of business affairs at World Trade Center Properties, LLC. He is responsible for managing the legal and business aspects of the Silverstein organization's to rebuild the World Trade Center site. Prior to joining Silverstein Properties, Mr. Knipe was the general counsel for Fisher Brothers, a New York City-based real estate development and finance company. Mr. Knipe, we appreciate your being here. You have heard about the lights. So, we look forward to your testimony.

Thank you.

STATEMENT OF JONATHAN W. KNIPE, SENIOR VICE PRESIDENT, GENERAL COUNSEL AND DIRECTOR OF BUSINESS AFFAIRS, WORLD TRADE CENTER PROPERTIES, LLC

Mr. KNIPE. I think I have all of the lights figured out. Thank you, Chairwoman Kelly, and Ranking Member Kanjorski. We really appreciate you allowing us to participate today.

I would also like to thank the other distinguished members from New York, in addition to Chairwoman Kelly, for your continued hard work and support over the last several years, as we have dealt with the various terrorism insurance concerns, particularly Congressman Crowley, Congressman Fossella, Congresswoman Maloney, Congresswoman McCarthy, Congressman Israel, and of course, again, Chairwoman Kelly.

As the lights are getting away from me in thanking everybody, as most of you know, our companies leased the commercial office portions of the World Trade Center site from the Port Authority of New York and New Jersey just 6 weeks prior to September 11, 2001. Since that terrible day, our entire effort has been focused on rebuilding what was lost.

Last Thursday, as most of you know, marked an extremely gratifying and long overdue milestone for those of us involved in the redevelopment of the World Trade Center. The business deal between Silverstein Properties and the Port Authority was formally agreed upon and approved. This means that the entire World Trade Center site, with four exceptional skyscrapers, designed by four of the most talented and renowned architects in the world, should be entirely rebuilt by 2012.

These office towers will be a magnificent addition to the rebirth of lower Manhattan, creating vibrant retail and office space, and joining the Santiago Calatrava-designed PATH transportation hub and our own Seven World Trade Center, the David Childs-designed building that our company completed and moved into at the beginning of this year, to make lower Manhattan, once again, one of the more exceptional destinations in the world.

The new skyline that will be created will be worthy of a new 21st century downtown, restoring New York City's historic birthplace. That and the World Trade Center memorial will honor the memory of the heroes of the attacks of 9/11.

Now that Silverstein Properties and our partners at the port authority have designed these great buildings and resolved our business issues and received the full support of the City of New York, the State of New York, and the State of New Jersey, we need to face our other remaining challenges. Along those lines, the timing of this testimony is ideal, because we face no greater obstacles to our redevelopment efforts than our insurance concerns.

Our first insurance concern does not have anything to do with TRIA. It is our current litigation against several of the large insurance companies that insured the Twin Towers that were destroyed on 9/11 and are refusing to pay what they owe.

Our second big obstacle is the reason for this hearing today, and that is the current lack of terrorism insurance capacity in the lower Manhattan market. We are scheduled to begin construction on the three office buildings to be owned by our companies January 1, 2008.

As you all know, the extension of TRIA expires one day prior to this, on December 31, 2007. I am not an insurance expert, like my colleagues to my right, nor are most real estate developers. However, we have instructed our consultants and brokers to scour the markets and determine how we can secure adequate terrorism insurance for our buildings.

The most recent information we have been given, as you all know and as you learned even more about today, paints a very bleak picture. Even with the current TRIA extension in place, if we had to go out and buy a builder's risk policy today, we are told that there is less than $500 million worth of coverage available in the entire lower Manhattan market.

Our consultants have also informed us that they see no viable alternative beyond the traditional private marketplace, and that without some sort of permanent, workable, governmental backstop in place, there will essentially be zero terrorism insurance capacity in downtown New York City at the end of 2007, when we commence construction of our buildings.

As you can imagine, this reality is staggering to us. Even more shocking to us was that our professionals told us that there is currently no identifiable insurance, reinsurance, or capital market solution that could finance the potential losses in the absence of a national framework.

We cannot finance office buildings that cost billions of dollars without adequate terrorism insurance coverage. While a substantial portion of the $8 billion needed to rebuild the World Trade Center comes from insurance proceeds, we will also need to obtain billions of dollars worth of financing in the form of liberty bonds.

To obtain this financing, our lenders will require terrorism insurance. It would not currently be possible, even with the current TRIA extension in place, to adequately insure even one of the four office towers on the World Trade Center site, and this does not take into consideration the other construction going on in downtown Manhattan, like the Goldman Sachs buildings and the other major construction projects.

Without a permanent workable solution and despite all of the collective hard work, the redevelopment of the World Trade Center site will come to a grinding halt without a permanent workable solution with a government backstop.

Thank you again for allowing us to participate today, and we welcome any questions you may have.

[The prepared statement of Mr. Knipe can be found on page 145 of the appendix.]

Mrs. KELLY. Thank you, Mr. Knipe.

Mr. Knipe, you have testified that TRIA has been essential in moving forward on the Freedom Tower project. Would it be fair to say that if we do not make TRIA permanent in some form, the terrorists will not only have destroyed the World Trade Center, but also prevented it from being rebuilt, with the help of Congress?

Mr. KNIPE. Absolutely. Without adequate terrorism coverage, which does not exist, from everything that we have been told by all the best people in the business, the new towers will not be built.

Mrs. KELLY. I also will be submitting testimony, Mr. Knipe, on behalf of the New York labor union members who are working on your project, who also support the renewal of TRIA.

I would like you to explain, if you would, to the committee, the importance of TRIA to the union members, the men and women who help build our country.

Mr. KNIPE. In New York City, over the course of the next 5 or 6 years—I think I have my statistics correct—there will be over $15 billion inserted directly into the economy, as well as over 8,000 jobs, as these four skyscrapers are built. So, 8,000 jobs is a whole lot of union employees and whole lot of people who are looking to make a living. So, certainly, it would have a great effect on that.

Mrs. KELLY. Thank you. I ask unanimous consent for testimony of the National Association of Realtors and National Construction Alliance be admitted to the record.

So moved.

Mr. Heck, you note the specific difficulties small mutual companies have in the terrorism risk environment.

I would like you to elaborate, if you would, on the challenges of raising risk capital in a terrorism risk market with a mutual structure.

Mr. HECK. Well, it is very difficult for a mutual company to raise capital. All of the capital that my company has, which is about $300 million, was earned out of operations, and so, we purchase reinsurance, which is another way of increasing your capital.

Unfortunately, as you have heard all day, there is not enough reinsurance available for terrorism. We still buy quite a bit of it, and we are fortunate enough to be able to buy it, but it is extremely expensive.

As the retentions go up and as the triggers are increased, it requires more reinsurance coverage, and we cannot afford to pay for the coverage, because we cannot charge enough for our policies. So, it is a very serious problem.

Without having TRIA to cover the industry, it would be difficult for us to continue to do what we have been doing in the last 5 years.

Mrs. KELLY. Mr. Shapiro, when you were speaking, I was mindful of the fact that a real estate entity arrived in my office with a picture, a graph, if you will, of what it took for them to put together the amount of terrorism risk insurance that they needed to carry prior to 9/11, and then they showed me the picture of what it took to even get one-half of that after 9/11, and I was interested in the fact that, no matter what they did, they still could not come back up to the coverage they had had prior to 9/11.

I would assume that you would agree with me that, if TRIA had been in place when they first started looking, after 9/11—they were looking immediately before we had enacted TRIA—I would imagine they would have been able to get better coverage.

Would you agree with that?

Mr. SHAPIRO. Yes. Before 9/11, terrorism was not even considered a peril. It was an all-risk policy with no terrorism exclusion, and nobody ever gave any thought to the fact that terrorism was going to happen. Terrorism came into place after 9/11, before TRIA, when insurance companies started to exclude terrorism.

Before 9/11, you could put together, with a half-a-dozen companies, or even more, a billion dollars worth of coverage to cover an entire project. To do it after 9/11, it did not get—it did not become a problem right away after 9/11.

The policies that had been written before 9/11 had 12 months, 11 months, 10 months to go. So, those companies were okay. Towards the end of 2002, it was not too far before TRIA came into place. Then you had reinsurance treaties; 70 percent of them expire at the end of 12/31, but there was still 30 percent of those reinsurance companies going through to the end of April or the end of July. So, after 9/11, it was not as bad as everybody thought it was.

2002 was a bad year, because—when basically all the treaties were gone. You cannot get a billion dollars from anybody anymore. Now, the most—and if I had to go back a year or a year-and-a-half, you could get $200 million from an insurance company.

Now, we are seeing $25 million, $15 million, $50 million. That is about it, and when you get these big projects which have a billion dollars or $1.2 billion, in one case, for my client, it is almost impossible to find enough insurance companies to fill that up. Many insurance companies have dropped out completely. They just cannot afford the retentions, so they are just not participating.

Mrs. KELLY. Thank you.

Ms. ABRAHAM. Mrs. Kelly, if I could add to and build on Mr. Heck's comment very briefly, we are similar in structure to a mutual insurance company. We are a reciprocal. So, all of our policies are held—all of our capital are held in the name of our insureds, our educational institutions, and since 2001, we have gone back to them and asked them to contribute capital.

They have—so that we could provide the breadth of coverage that we do. We have gone back to our members, our policyholders, and raised additional capital, but without the Federal backstop in providing TRIA, we would not be able to go forward.

So, they are will to contribute, they are willing to make investments in risk management and in capital, but we need them—we need you to be part of the solution.

Thank you.

Mrs. KELLY. Thank you.

I was going to ask you, Ms. Abraham, about how your members are responding to the challenge of continuing overseas research that I know that they do, and also, the outreach and admittance of foreign students in this kind of an environment must also affect your ability with regard to insurance.

Ms. ABRAHAM. It absolutely has, Chairwoman Kelly. As you know, we are great importers of students. Students from all over the world come and study with our educational institutions.

After September 11, 2001, there was a blip in the number of students who come over, particularly in the graduate research programs. So, much of the research has slowed down. It is beginning to pick up.

The institutions have made additional risk management steps, background checks, working with the Federal Government on USA Patriot Act, and they are doing significant additional work, unfunded mandates, if you will, in order to reach—try to create a secure campus, still have the research, still have the exchange of ideas, but it has added an additional challenge to them in order to meet the open campus, the ongoing research, and continue to attract students from all over the world in order to study here.

In addition, our students are going overseas. That is good. That makes better global citizens, but it has added an additional burden for terrorism here, and we do provide terrorism coverage, internationally or domestically.

So, that is a coverage that we feel has to be provided, going forward.

Mrs. KELLY. Thank you.

I have finished with my questions, and I have an appointment in my office. So, I am turning the chair over to my colleague from New York, Mr. Fossella.

Mr. FOSSELLA. [presiding] Good afternoon. This will be fast.

Thank you all for your testimony.

I think the inherent irony in all of it—and it has been stated in a couple of different ways, but it bears repeating—inasmuch as that the site will not commence construction till January 2008, the one project that will definitely not be covered under TRIA is the basis of why we are here, the rebuilding of the World Trade Center site, and I find that utterly ironic, as we deal with this issue, that the one guarantee we will have under the current law is that the trade center site will not be redeveloped, which brings me to Mr. Knipe's point, in part, raised regarding the litigation and insurance proceeds.

I understand much of the rebuilding is going to be done through insurance proceeds. Can you give us—describe the current status of those proceedings, and what is the minimum required of insurance that has been paid?

Mr. KNIPE. First of all, Congressman Fossella, thank you for being here today, and on behalf of Silverstein Properties, we want to thank you for your years and years of hard work, not only on our behalf, but on the entire lower Manhattan community's behalf, to help with the rebuilding of downtown, and I also wanted to touch upon one of the things you said before I get into the new insurance—the other insurance issue, which is the Freedom Tower, which is now controlled by the Port Authority, actually construction has commenced on the Freedom Tower, and it will be up to grade level by the end of next year.

So, it is just the three towers that will be owned by Silverstein Properties that we are not starting to build until January 1, 2008, after the appropriate excavation work has been done. As far as the state of the current litigation, thank you for asking about that, as well.

As you know, juries have decided that this was a two-event attack, and that several of the major insurers have to pay for the two events. Unfortunately, several of the major insurers, particularly Aleons, Royal, Swiss Re, Gulf, Wasaw, and Zurich, have not even paid for the one event coverage, and we are just in a horrible litigation that drags on and on, and they are dead wrong.

We now have, you know, unanimous support, letters being written by the day from every level of government to these insurance companies to get them to pay what they owe, and you know, this money is desperately needed to rebuild downtown.

Mr. FOSSELLA. To what extent will that impact the framework that has been established among the Port Authority, the City of New York and the State of New York and your company?

Mr. KNIPE. Well, they are arguing everything they can get their hands onto, the insurance companies. We really—it has just become clear that they are looking to be an impediment to construction.

One of the theories that they came up with that would enable them not to pay what they owe is that this conceptual framework agreement, which transfers ownership of the Freedom Tower and Tower 5 to the Port Authority, is contradictory to an anti-assignment provision within the insurance policies.

In fact, the Port Authority is a named insured on those policies, and there is just no question, as a matter of law, that they do not have a leg to stand on with this fight. If they do not agree to pay up—and again, there are several insurers—I mean I want to make clear, the vast majority of the insurers have agreed to honor their commitment and pay what they owe, but there are still several insurers—Aleons, Travelers, Royal, and Swiss Re—that owe a total of $1.12 billion in insurance money. Again, the buildings just will not be built without that money. It would completely thwart the conceptual framework, and there would be no deal, in effect, and no buildings, if they do not pay what they owe.

Mr. FOSSELLA. To clarify what I talked about before, about the irony, is we first met to discuss TRIA to redevelop the Trade Center site in its entirety, and the buildings that your company is discharged with the responsibility of building could be left out in the cold.

Is that true?

Mr. KNIPE. Yes, absolutely.

Mr. FOSSELLA. Finally—I know it has sort of been dealt with in different ways, but in the long term—and any of the panelists could comment, if they so choose. If not, we will end the hearing.

What are the key factors that will determine the amount of private market insurer and reinsurer capacity available for terrorism risk insurance coverage in the long term? Anybody want to offer that opinion?

Ms. ABRAHAM. Thank you very much.

I think the first issue is we need to recognize that there is a three-part partnership. The first is the business—in my case, the educational institution—the second is the insurance companies, and the third is the government.

The second is the stability, that we need to have a long-term plan to know that whatever happens will need to be phased in.

It is not something, whether it is a pool, which is a concept that needs additional research, but something that we know we are working towards.

A 2-year solution, a 3-year solution will not help us, but all parties that I have talked to in the insurance and the business world are interested in taking significant risk and phasing out over a very long period of time the government's role.

What we need is a long-term solution rather than these quick 2 years, so that we can plan for it, and a pooling arrangement, particularly, will take many years in order to provide the adequate support that we need.

We heard this morning the European countries have been working at this, and South Africa, for a very long period of time.

We are anxious to get engaged in that and start that funding sooner rather than later.

Mr. SHAPIRO. To add to that, I believe that the pooling arrangement satisfies both the needs of the buyers, the insurance companies, and the government. The government is trying to remove itself from the smaller exposures.

The insurance companies are troubled with—they cannot afford to take those exposures, and the pooling would sit right in the middle of that, so that the insurance companies can come back into the marketplace and take some risk, get the pooling in between that and the government, and would actually remove the government further away from exposures, and that will take over a period of time, but it will work. It is the only way it is going to work.

Mr. HECK. I would like to also say that NAMIC, working with the CEO Roundtable, does have a plan, and it involves a public and private arrangement bewteen the Federal Government and the insurance carriers. There is a middle layer, which is really a reinsurance layer, to help the smaller companies that need to buy down their deductible.

We talked about cap bonds. If that could develop, it would be very important to providing capacity. We talked about tax-free reserves. When you think of how large an undertaking it is, to cover the catastrophic loss. Potential from terrorism risk, you need to employ all means at your disposal to increase capacity, and it is going to take time to build that capacity.

It is not something that can be done in just a few years. It would probably take 10 to 20 years, but if we can all agree on some type of a solution, we can begin to implement it. As time goes on, the government would have less and less exposure, and the private sector would take up more of the exposure. It is not something that can be done overnight.

Mr. HARPER. If I could add, a member of the committee this morning brought up a concept which I think is important and fundamental to understanding where we should be going with a solution, and that was—he referred to the war on terrorism which we have to win.

I think it is not inappropriate to think of the risk we are looking at as a war risk, and as there were several programs during World War II and prior wars that—where Congress enacted legislation for the duration of the war. Maybe we should look at terrorism risk insurance as something that would be enacted for the duration against terrorism, because war is ultimately and fundamentally a governmental responsibility, and it can be so devastating to the economy and to the civilization of our country that there is no limit to how much could be involved, and therefore, if the government can do anything to define the risk that the private sector is taking and, in effect, it is asking the private sector to take on behalf of the government, I think that would do a lot to bring back reinsurance and to revitalize the capacities for the private sector to take care of the Nation's needs.

Dr. EMEK. I would like to add that the Independent Insurance Agents and Brokers of America—we believe that we need to explore ways to strengthen the program and maximize, you know, the private market participation, whether it is from a risk-sharing mechanism, capital reserve accounts or, you know, tax-free reserves, cap bonds, but it has to be a long-term solution.

It is so disruptive to the marketplace when, every 2 years or 3 years, we have to worry about terrorism insurance.

What happens—it drives capacity out of the marketplace, and if you take a look at New York, where you cannot exclude terrorism, without TRIA being reauthorized in some way, or some mechanism over the long term, carriers will not be able to write in downtown Manhattan or in Manhattan or the surrounding area, and you will find that small businesses, large businesses just will not be able to pay the price for the cost of insurance.

Without capacity, even property insurance goes up. So, what happens if nobody is writing, or very few companies are writing in downtown, there is less competition; less competition, prices go up, and then it is a burden to the businesses in the city, or anywhere in the country that will face the same problem.

Mr. FOSSELLA. Along those lines, with respect to price and the rising premiums, how is that ultimately passed on to the tenants in the forms of, you know, the higher premiums or rents?

What is the impact or has been the impact over the last several years?

Can anybody comment on that?

Mr. HECK. I could say something about that. I think the fact that TRIA was passed in 2002 went a long way to help the consumers in the business community. Without it, prices would have been much, much higher, and I believe that if there is no government backstop after 2007, there will be a shortage of insurance availablity, and that will push prices up.

Dr. EMEK. I would concur with that. I have a client who owns a number of industrial buildings, and they are in New Jersey, they are not in New York, and they face that same problem.

When premiums went up because of the terrorism issue, they had to pass on that cost to their tenants. So, their tenants' rents up, and TRIA will help stabilize that, by continuing TRIA. Without some form of extension of this, premiums will definitely go up, and that will definitely impact what tenants will have to pay.

Mr. SHAPIRO. I can add to that, that nationally, insurance prices have gone down in the last year, with the exception of property insurance in the major cities. In the major cities, property insurance is going up, and primarily because a lot of insurance companies are dropping out or providing low capacity, and it is causing price increases.

Mr. FOSSELLA. Is there a way to quantify this? You say it is going to go up or it has gone up or will continue to go up. Is there any way to put like a dollar per square foot—

Dr. EMEK. Well, I could give you—not necessarily a dollar per square foot, but an example, just in a small business.

Because of the higher retention for the carriers, a number of the small, you know, and regionals are really not writing very much in the city, and so, now you have smaller businesses who have had to buy insurance from larger carriers, and they are paying more, but in terms of just terrorism, I have seen a small business who paid maybe $500 for their office policy for terrorism insurance this year paying $2,500.

Now, for a small business, that has dramatic impact on their bottom line and just because there is a higher retention—so, imagine the effect that then has on all businesses in the city.

So, I cannot quantify it per square foot, but I could tell you that it does impact, and it does not just impact on the cost of their rent, but it is impacting their own particular insurance premiums.

Mr. KNIPE. Let me also try to address that from our unique perspective, and I am glad you asked it, Congressman.

We are not even looking at price.

Obviously, it has to be something that enables us to build our buildings and have tenants that can afford their rent.

In our particular situation, which, albeit, is unique, as a main consumer of insurance at the World Trade Center site, the capacity is just not there, at any price, and that is the bottom line.

It is not that the private sector is coming after us and charging us a premium.

It just not available.

Mr. FOSSELLA. How does that translate—you know, everything is fungible, right, and if a prospective tenant has to incur an additional cost with respect to—because terrorism risk insurance is—or the premiums have gone up, does that put places like New York City at a competitive disadvantage with other areas because of an increase in rents, or is that a specious argument?

Mr. SHAPIRO. I think New York City is New York City, and there a lot of companies that are not going to move out just because the pricing is going up. The real estate owners can afford the price increases, as was said here.

It is getting the capacity and getting the right terms and conditions that are the problem, but those costs on commercial buildings are being passed through to tenants, and some of those increases are very substantial.

So, it is not hurting the real estate companies as much as it is the tenants.

Mr. FOSSELLA. Is there any way we can get that number? People throw around numbers—substantial, a lot, large. It's pretty subjective.

Is there a way to say that, in this particular building, we have seen rents go up by a dollar-fifty a square foot because of this, or is that possible or no?

Mr. SHAPIRO. Rents are definitely going up, and the real estate board in New York will do everything possible to try to keep that under control.

The situation is such that one of the major insurance companies who writes the primary layers on these programs has basically come out and said that we are going to give 10 to 20 percent increases on our policies. That is not going to say that every one is going to be 10 to 20 percent, but that is what they are trying to put out there. It is a big increase.

Mr. FOSSELLA. Okay. The hearing is adjourned.

Thank you very much.

[Whereupon, at 2:26 p.m., the hearing was adjourned.]

A P P E N D I X

September 27, 2006

STATEMENT OF REPRESENTATIVE GARY L. ACKERMAN
HOUSE FINANCIAL SERVICES COMMITTEE

HEARING ENTITLED
"PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK"

WEDNESDAY, SEPTEMBER 27, 2006

Chairman Baker, Chairwoman Kelly, Ranking Member Kanjorski, and Ranking Member Gutierrez, thank you for arranging this joint hearing to discuss the very important issue of terrorism insurance.

In light of the Government Accountability Office's (GAO) recent conclusion that a market-driven expansion of Nuclear, Biological, Chemical, and Radiological (NBCR) insurance coverage is highly unlikely, it is clear that Congress must act before the Terrorism Risk Insurance Extension Act (TRIEA) expires in December 2007.

Congress first enacted the Terrorism Risk Insurance Act (TRIA) on November 26, 2002 to help secure our economy against the devastation that might come from another terrorist attack. TRIA and TRIEA were intended to be temporary. Our expectation was that the private market would develop its own terrorism insurance capacity; however, such a market has not yet emerged. As a result, there is still an overwhelming reliance on the federal backstop provided by TRIEA. Without this backstop, it is likely that we will return to the same highly uncertain business environment that we saw in the months after 9/11, and before the enactment of TRIA, where companies either went out of business or struggled to find coverage and then paid a hefty premium for the insurance coverage they needed.

Unless we want to return to these conditions, we need to turn our attention to the development of a long-term solution. I look forward to hearing from our witnesses and I am hopeful that today's discussion will be the first step towards the creation of legislation what will meet the insurance needs of our economy while placing the minimum burden necessary to provide market security on the government.

OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS
TERRORISM RISK INSURANCE
SEPTEMER 27, 2006

Mr. Chairman, while it is true that nuclear, biological, chemical and radiological threats present unique risks in both size and scope, conventional terrorism, like that at the World Trade Center, still remains a threat.

In addition, the contention that TRIA is crowding out private market solutions to the reinsurance situation is absolutely false. TRIA not only is not crowding out private market solutions, it seems to have resulted in more market innovation. Furthermore, TRIA has not negatively impacted the amount of reinsurance available since we last renewed the Act.

Mr. Chairman, based on what I have read and heard here today, I think it remains extremely important that we, the federal government, continue to collaborate with the private sector, in some form, on this issue. It is absolutely necessary that we maintain a public-private partnership for these risks in order to keep this insurance coverage available.

Additionally, I hope that, in the future, we will revisit the flood insurance legislation and the impact the 100 year floodplain mapping will have on one of the poorest counties in the country - Hidalgo County – located in my district, the fifteenth district of Texas.

I yield back the remainder of my time.

OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

JOINT SUBCOMMITTEE HEARING ON PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK

WEDNESDAY, SEPTEMBER 27, 2006

Mr. Chairman, we return this morning to a question that we have often discussed in the last five years: how best to protect the American economy from terrorism risk.

After the al-Qaeda attacks five years ago, reinsurers curtailed the supply of terrorism reinsurance and insurers began to exclude such coverage from policies. In response, Congress belatedly enacted the Terrorism Risk Insurance Act to address these pressing problems. Last year, after encountering an unnecessary delay, we decided to extend this law for two more years.

TRIA is critical to protecting our nation's economic security. We also designed TRIA to be a temporary backstop to get our Nation through a period of 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.

That said, however, it has become increasingly clear that it will take some time for the private marketplace to develop and offer terrorism reinsurance products, particularly for nuclear, biological, chemical, and radiological threats. Yesterday's report by the Government Accountability Office concludes that these risks are distinctly different from those hazards that are predictable, measurable in dollar terms, random, and unlikely to result in catastrophic losses for an insurer. Given these challenges, the GAO found that "any purely market-driven expansion of coverage" for these specialized terrorism risks is "highly unlikely in the foreseeable future."

Late last year, when the House passed its initial bill to extend TRIA, we included language to provide protection against nuclear, biological, chemical and radioactive terrorism incidents. We also included provisions to provide protection against domestic terrorism events and incorporate group life insurance as a covered line. Unfortunately, the final agreement adopted none of these reforms.

We need to revisit each of these matters in the coming year before TRIA once again expires. We additionally need to work to develop a comprehensive long-term solution to the problem of insuring terrorism risk, rather than continuing to address the issue on an *ad hoc* basis every two years and creating unnecessary uncertainty for the marketplace.

To the extent possible, I continue to believe that any workable solution should allow for the private sector to underwrite the terrorism risks that it can cover. However, because terrorism risk is a societal problem and because the size of certain catastrophic terrorism risks would likely exceed the resources of the private sector, the federal government will likely need to play some role in this new system.

Many of our witnesses today have already begun to think about what a long-term solution to these matters should look like. I look forward to hearing those ideas. I also want to assure them that I have an open mind on these matters.

In closing, Mr. Chairman, I have regularly noted that the provision of terrorism insurance is not a Democratic or Republican issue. It is an American issue, a business issue, an economic security issue. I therefore continue to stand ready to work with all interested parties on these important matters.

Congressman Stephen Lynch

House Financial Services Committee
Subcommittee on Oversight & Investigations
and
Subcommittee on Capital Markets
"Protecting Americans from Catastrophic Terrorism Risk"

September 27, 2006

Opening Statement

THANK YOU, CHAIRMAN BAKER, MADAM CHAIR, AND RANKING MEMBERS KANJORSKI AND GUTIERREZ.

WITH THE FIVE-YEAR ANNIVERSARY OF THE HORRIFIC 9/11 TERRORIST ATTACKS JUST A COUPLE WEEKS AGO, IT BEHOOVES US TO CONSIDER ALL ASPECTS OF THOSE ATTACKS, INCLUDING THEIR IMPACT ON OUR COUNTRY'S CAPITAL MARKETS, WHICH IS THE SUBJECT OF TODAY'S IMPORTANT HEARING.

I WILL KEEP MY REMARKS BRIEF, AS WE HAVE TWO FULL AND DISTINGUISHED PANELS, WHICH I LOOK FORWARD TO HEARING FROM, BUT LET ME JUST SAY A FEW WORDS ABOUT THE TERRORISM RISK INSURANCE ACT, OR TRIA.

AFTER 9/11, IT HIT HOME FOR ALL OF US THAT THE WORLD HAS BECOME A VERY DANGEROUS PLACE. WE HAVE CERTAINLY MADE SOME PROGRESS IN SHORING UP OUR INFRASTRUCTURE PROTECTION AND INTELLIGENCE-SHARING SINCE THE SEPTEMBER 11TH ATTACKS. BUT THERE IS MORE TO BE DONE.

WE MUST NOT ONLY ENSURE THAT OUR CRITICAL INFRASTRUCTURE IS PROTECTED, BUT WE MUST ALSO PREPARE TO MITIGATE THE SEVERE ECONOMIC FALLOUT THAT COULD ACCOMPANY ANOTHER CATASTROPHIC ATTACK.

THE 9/11 COMMISSION ACKNOWLEDGED THAT NEARLY 85% OF THE CRITICAL INFRASTRUCTURE IN THIS COUNTRY IS CONTROLLED BY THE PRIVATE SECTOR.

THE SEPTEMBER 11TH ATTACKS RESULTED IN APPROXIMATELY $35 BILLION IN INSURED LOSSES. FOLLOWING THAT EXPERIENCE, WE BEGAN TO SEE MANY INSURERS AND REINSURERS EXCLUDE TERRORISM COVERAGE FROM

COMMERCIAL INSURANCE POLICIES. IN RESPONSE, CONGRESS PASSED THE TERRORISM RISK INSURANCE ACT OF 2002 (TRIA) TO ADDRESS CONCERNS THAT THE LACK OF TERRORISM INSURANCE COULD IMPAIR ECONOMIC GROWTH.

THE PURPOSE OF TRIA WAS TO MAKE TERRORISM INSURANCE MORE WIDELY AVAILABLE AND AFFORDABLE IN THE IMMEDIATE FUTURE. ADDITIONALLY, TRIA ESTABLISHED A TRANSITIONAL PERIOD DURING WHICH INSURANCE MARKET PARTICIPANTS COULD DIVERSIFY THEIR EXPOSURE AND DEVELOP MECHANISMS FOR ESTABLISHING A PRIVATE MARKET IN THE FUTURE.

AS WE ALL KNOW, THE PROGRAM WAS MODIFIED AND EXTENDED, AND IS NOW SET TO EXPIRE ON DECEMBER 31ST, 2007.

AS A FORMER IRONWORKER, I KNOW FIRST-HAND THE IMPORTANCE OF THE CONSTRUCTION INDUSTRY TO BOSTON'S ECONOMY. OUR LOCAL ECONOMY CANNOT AFFORD TO SEE A SLOWDOWN IN DEVELOPMENT BECAUSE OF THE UNCERTAINTIES SURROUNDING THE FUTURE OF TERRORISM INSURANCE.

I READ TED KELLY'S TESTIMONY, AND HE MAKES A VERY GOOD POINT ILLUSTRATING THE IMPACT OF A TERRORIST ATTACK ON OUR WORKERS' COMPENSATION SYSTEMS. THE NUMBERS TED CITES REGARDING A POSSIBLE EVENT IN MASSACHUSETTS ARE SOBERING. AS THIS COMMITTEE ADDRESSES TRIEA NEXT YEAR, I LOOK FORWARD TO ENSURING THAT THE UNIQUE ASPECTS OF OUR WORKERS' COMPENSATION SYSTEM ARE TAKEN INTO ACCOUNT.

I RECOGNIZE THE VALIDITY OF THE CONCERNS RAISED BY THE INSURANCE INDUSTRY AND AM PARTICULARLY CONCERNED ABOUT THE HEIGHTENED THREAT A PROMINENT CITY LIKE BOSTON FACES. THE GOVERNMENT SHOULD BE THOUGHTFUL ABOUT TERRORISM POLICY AND TAKE MEASURED STEPS TO PREVENT A POTENTIAL FINANCIAL DISASTER FROM LACK OF TERRORISM INSURANCE COVERAGE. IF THAT SHOULD HAPPEN, THEN WE WILL SIMPLY BE FORCED TO ATTEMPT TO BAIL-OUT THOSE VULNERABLE GROUPS THAT ARE NOT SUFFICIENTLY INSURED.

THANK YOU, MR. CHAIRMAN, I YIELD BACK THE REMAINDER OF MY TIME, AND I LOOK FORWARD TO HEARING FROM OUR WITNESSES.

**TESTIMONY OF JANICE M. ABRAHAM
ON BEHALF OF
THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA
BEFORE A JOINT MEETING OF THE
SUBCOMMITTEES ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES AND THE OVERSIGHT AND
INVESTIGATION SUBCOMMITTEES OF THE HOUSE FINANCIAL SERVICES
COMMITTEE**

SEPTEMBER 27, 2006

Introduction

My name is Janice M. Abraham and I am President and CEO of the United Educators a Reciprocal Risk Retention Group and a member of the Board of Governors of the Property Casualty Insurers Association of America (PCI). I am here on behalf of my company and PCI. PCI is a trade association representing over 1,000 property/casualty insurers, located in 49 of our 50 states, and writing almost 40 percent of the property-casualty insurance sold in the United States. PCI members write all of the lines of business covered by TRIA, including workers compensation, commercial property insurance, and general liability coverage. Because of this, we're deeply interested in securing a new federal terrorism reinsurance program to replace TRIA when it expires next year. We thank you for your attention to this issue and for the opportunity to appear before you today and to present our views about it.

Education and Terrorism: Why We Need This Protection

You have heard, or will hear, from many insurers about the need for ongoing, long-term federal terrorism reinsurance protection for the workers compensation system, our commercial real estate markets, and many other aspects of our nation's economy. You have also heard, or will soon hear, that the Government Accountability Office agrees that, given the challenges faced by insurers in providing coverage for, and pricing, terrorism risks, any purely market-driven expansion of coverage, in the absence of a federal role, is highly unlikely in the foreseeable future. We support these views and, as PCI's representative here today, assure you that our association will be working with you to enact a program that extends vital protection to insurers and insurance buyers throughout the nation and protects our economy.

However, I also want to use this time to tell you about my company and why this issue is so important to us. United Educators is a reciprocal risk retention group founded in 1987 to provide general liability insurance protection to our member educational institutions. Today, we insure over 1,200 universities, colleges, and schools. These schools enroll approximately 7 million students, served by approximately 500,000 faculty and teachers. We are committed to helping our member educational institutions advance their missions of teaching, research, and service to our country. We insure all types of colleges and schools, from large public universities to small rural K-12 schools. We insure institutions all over the country, including Tulane, Xavier University of Louisiana, Loyola the University of New Orleans, Cornell University, California Institute of Technology, MIT, University of Michigan, Notre Dame, and school districts in New York State and Miami Dade. Our company exists solely for the purpose of assisting these institutions manage the risks they face.

To the casual observer, the idea that international terrorists might strike an educational institution may seem implausible. The 9/11 attacks, after all, targeted the federal government and American business interests. Consider, though, some attributes of the American educational system that illustrate the vulnerabilities our members face:

- *Well-known Symbols.* Many American universities are known throughout the world for their research, teaching, and role in the community. They are strong symbols of an ordered and free American society. Experts tell us that Al Quaeda is particularly interested in attacks on symbols of American society. As such, our universities must be recognized as potential targets.
- *Mass Gatherings.* Colleges and universities host many large gatherings. A graduation may involve thousands of students, family members, and invited dignitaries. Presidential and vice-presidential debates, televised nationally, are held on campuses.[1] Athletic sports competitions, such as NCAA Division 1A football and basketball, attract huge audiences and worldwide attention. The University of Alabama football stadium, for example, holds 84,000 spectators and the University of Nebraska, Lincoln, football team plays before 74,000 fans. The

[1] Venues for the 2004 and 2000 federal election debates included: Washington University in St. Louis; Case Western Reserve University; Arizona State University; the University of Massachusetts at Boston; the University of San Diego; Wake Forest University; and Centre College in Kentucky.

"Big House" at the University of Michigan in Ann Arbor seats even more. Educational institutions sponsor mass gatherings in urban and rural settings. Given the nature of many of these events – open to the public and as major expressions of our national culture – it is impossible to wall them off or protect them completely against terrorist attacks.

- *Wide-ranging Political Expression.* American educational institutions promote the free expression of ideas, including political ideas. They invite controversial speakers who sometimes spark dissent and confrontation. Campus disputes regularly make national and even international news.
- *Research with Dangerous Substances.* Higher education laboratories conduct research using many dangerous substances. Much of this research is done under contract with the federal government. Working on the cutting edge of science, investigators probe pathogens such as botulism, anthrax, and ebola. It is not unthinkable that a terrorist might steal harmful biological agents from a university laboratory. In anticipation of this possibility, Congress imposed new requirements on dangerous research in the 2002 USA PATRIOT Act. Nevertheless, universities engaged in this type of research clearly feel that they are at risk from this type of attack.
- *Students as Past Terror Victims.* In September 2004, Chechen rebels seized a school in the Russian town of Beslan. More than 300 children and adults died in this terrible attack. While international terrorists have not struck an American school to date, the possibility is very real. Domestic terrorists such as the Unabomber and some extreme animal rights activities have targeted universities in the past. We cannot dismiss the possibility of facing this type of threat in the future here in our country.
- *"Soft" Targets.* Security experts often distinguish between hard and soft targets based on their vulnerability. A hard target is well-protected against attack. The White House, for example, has very limited entry points and rigorous screening and identification procedures for access. It is walled off, well guarded, and set back from a street. In the past several years, American facilities such as airports, government structures, and commercial buildings have increased their security. Educational institutions, in contrast, remain relatively soft and vulnerable targets. They often lack perimeter security and impose few, if any, restrictions on entry. As other potential targets increase security, educational institutions may become

> more attractive to terrorists. As one observer has noted, "Like the flow of water, terrorists follow the path of least resistance."[2]

In each of these cases, our member institutions face the possibility not only of workers compensation and property damage losses (which we do not insure), but also serious questions of liability should they ever be the victims of such an attack. These institutions are today being asked to prepare for and protect against risks they did not face before 9/11 and for which there are often no good security procedures available. How, for instance, can an institution change the fact that a graduation ceremony will attract thousands of citizens to a single facility at a single point in time, thus making them a potentially attractive target for a terrorist organization. Obviously, it can't.

Faced with these disturbing realities, United Educators has been working to protect our member institutions from liability should a terrorist event occur. Since the company's founding in 1987, we have offered broad "all risks" general liability coverage with very high limits of liability coverage that included acts of terrorism. After the tragedies of 9/11, our reinsurers questioned our terrorism coverage, seeking to understand our plans for underwriting and pricing the exposure. We knew that we needed to act in order to continue having reinsurance coverage for this important liability risk. We embarked on a process to identify key terrorism exposures, aid our member institutions in better managing those exposures, and underwriting for the risks. Throughout the process we maintained close contact with our reinsurers. Ultimately the reinsurers were satisfied that the underwriting and risk management steps we were taking, combined with the added protection of the Terrorism Risk Insurance Act, would allow continuation of our reinsurance.

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[2] A report prepared for the Office of Management and Budget explained: "[Some] federal regulations are designed to harden a specific class of targets within the USA, and so reduce their vulnerability to a terrorist attack. These have the benefit of reducing the attack risk at these targets. However, the costs of these … regulations should allow for the negative externality of risk transfer to alternative softer targets. For example, the hardening of one class of industrial facility (e.g. oil refineries) may enhance the risk to another class (e.g. chemical plants). Similarly, hardening airports against surface-to-air missile attack may divert terrorists to launching such attacks over less protected urban areas. Like the flow of water, terrorists follow the path of least resistance." "The Benefits and Costs of Homeland Security Rules" by Dr. Gordon Woo, March 2003, www.whitehouse.gov/omb/inforeg/2003report/15.pdf.

When TRIA's extension was being considered last year, we supported modifications to enhance the existing public private partnership and, over time, increase the private role in providing this coverage. At the same time, we felt strongly that the program must remain in place and that general liability should continue to be a part of TRIA. We were pleased to see the program extended as TRIEA and that general liability coverage continued in the program. With TRIEA now facing its own end next December, we find ourselves in almost the identical situation as last year. We feel the same way we did then about the need for this program.

If TRIA lapses with no replacement, United Educators anticipates several serious consequences:

- Without a federal backstop, we expect to have limited coverage for terrorism exposures on policies we write beginning on January 1, 2007. One option might be to sub-limit the exposure to a very small level, but that solution would be essentially useless to the institutions.
- United Educators and other small insurance companies cannot offer significant coverage for this risk in the absence of reinsurance. TRIEA, or some other federal protection and participation is critical to our ability to obtain reinsurance and continue to offer protection to our insureds. Our participation (and that of many smaller insurers) in this market is, in turn, critical to our policyholders' access to a competitive market for their insurance needs.
- Without liability insurance for terrorism, some universities might be forced to limit or discontinue events that gather many people, limit research on dangerous substances, and close themselves off from free political discourse. In "hardening" themselves as targets, they would seriously diminish their contributions to American society.

What Do We Need?

We believe a long-term program should replace TRIA when it expires next year. We believe insurance policyholders and insurance markets generally will benefit significantly from the predictability and structure a long-term program would provide. In addition, we do not believe the Congress wants to be, or should be, asked to revisit this issue every two years. We believe a new or extended federal program should be enacted before the end of next year and should cover a long-term period, perhaps as long as ten years with a sunset for review.

We believe the same lines of business should be included in the program as are included now. As I noted above, having protection for general liability risks is critically important to my company and our insureds, but we also believe that workers compensation, commercial property insurance, and the other lines of business included in TRIA need and deserve protection. We note that during last year's TRIA extension debate, some lines of business were removed. We believe that those remaining under the protection of this program very much need that coverage.

We believe a true, public-private partnership between the government and private markets is needed for this risk. We believe a structure can be established that continues to increase the role private markets play, but we believe such changes must be gradual and track the real ability of private markets to absorb this risk. As part of our review of this issue and exploration of alternative approaches, we have discussed terrorism risk with significant participants in non-insurance private capital markets. While there are encouraging signs of experimentation and innovation in these markets (and we believe it should be strongly encouraged), it is clear to us that these markets are not prepared to assume significant additional amounts of risk at this time. They cannot replace the role and function the federal government is now performing through TRIA.

We believe a future federal program should cover all losses caused by terrorism and should not draw distinctions between those losses caused by some types of perils or terrorists and not by others. For example, we do not believe a future program should continue the distinction that currently exists between "foreign" and "domestic" terrorism. As we've seen in the London bombings last year and the most recent news of planned attacks on airlines, extremely serious attacks can arise from domestic as well as foreign sources of terrorism. This distinction makes no sense and should be ended in a future program. Further, even though several of my examples involve biochemical threats, we do not believe that a future program should only attempt to cover losses arising from that peril. We do not know what weapon terrorists may attempt to use in the future, but we believe the program must cover any losses that arise.

We also believe the program must be accessible to insurers of all sizes. United Educators is a small company – we write approximately $135 million in gross premiums each year. But for our member institutions, we are a major source of critically-needed liability protection. We were founded to provide services and protection our member institutions need and to give them choices in a competitive market. We, and they, cannot afford to lose our access to this program because its triggers or insurer deductibles are set at levels inaccessible to smaller carriers. In particular, we urge you and your colleagues to consider using the 2006 program trigger ($50 million) as the long-term level for this program. If individual insurer deductibles must be increased over time, we believe it should occur gradually in order to allow markets to adjust to the increased risk such changes imply.

Finally, we believe the program should provide opportunities and incentives for insurers to work together to spread the increased risks they're likely to assume in any long-term program. Our members have repeatedly emphasized the need for such alternatives and opportunities to exist. We have been working throughout this year, and continue to do so, with our colleagues in the industry to develop the specific structure for such a program. I am not here today to describe such an approach in detail, but want to emphasize to you the importance of the future program allowing or creating such opportunities for companies such as mine. This will be a major focus of PCI's work over the next several months to prepare specific proposals for your consideration.

Conclusion

I want to conclude by thanking you once again for the opportunity to appear before you today to express my company's and my trade association's views on this issue. In closing, I'd like to emphasize again three points. First, we need a long-term program to be enacted before the expiration of TRIA on December 31st next year. This is simply too important an issue to be left to chance. It must be done. Second, this long-term program must cover the same exposures currently covered in TRIA. Purchasers of workers compensation, commercial property insurance, and general liability are all significantly exposed to catastrophic terrorism losses and need this protection. Third, the long-term program must be accessible to all insurers, regardless of size, and offer meaningful opportunities for risk-spreading to all. Smaller insurers, such as my company, provide essential competition in the market today. We need program triggers and deductibles that are accessible to smaller and medium-size insurers and meaningful ways for all insurers to spread the increased risk they are likely to assume in the future. We believe these principles can be met in a future program. I pledge to you the assistance and cooperation of my company and of my association, PCI, in designing and enacting such a program.

September 27, 2006

Testimony before the Joint Subcommittees on Capital Markets, Insurance, and Government Sponsored Enterprises and Oversight and Investigation of the House Financial Services Committee of the U.S. House of Representatives

Ramani Ayer
Chairman, President and Chief Executive Officer
The Hartford Financial Services Group

Chairman Baker, Chairwoman Kelly, Ranking Member Kanjorski, Ranking Member Gutierrez and Members of the Subcommittees,

Thank you for the opportunity to appear before you today to provide my insight on a singularly important issue before our country and our economy in the post 9/11 world: How should we manage terrorism risk effectively and fairly?

My objective today is to convey a simple, fundamental message: **terrorism is a unique peril because it is a public risk and not privately insurable without a federal backstop.** Right now it presents an insurmountable challenge for the private markets alone to understand or manage. Hence, terrorism risk can only be managed effectively and fairly in partnership with the federal government. The insurance industry has always played a critical role in the U.S. economy, and we will continue to do so. But the potential risk of a large scale terrorist event is beyond the resources of our industry.

As our nation's second oldest insurer, we at The Hartford pride ourselves on having been there for our policyholders when they've needed us for almost two hundred years. Policyholders from Abraham Lincoln to Babe Ruth have relied on us to fulfill our promise to meet our obligations to them. We were there during the Great Chicago Fire, and the 1906 San Francisco earthquake. We were there on 9/11.

As I survey The Hartford's 196-year history and my own experience in this industry for more than three decades, I see no other peril quite like terrorism. Here's why:

Terrorism is a unique risk

One characteristic that makes terrorism unique is that it is a public risk. Our government's leaders and leading terrorism experts have described it as the 21st century's version of war. Terrorist attacks are explicitly designed to threaten our national security. They target the entire country and our government, no matter where they occur or who they harm or kill.

Terrorism is also a public risk given the magnitude of potential attacks on the entire economy. The American Academy of Actuaries has published insured loss estimates for attacks on select U.S. cities using nuclear, biological, chemical or radiological weapons (NBCR). For a large NBCR attack on New York City that estimate totals $778 billion. A similar NBCR event in Washington, D.C. would result in an insured loss of almost $200 billion; in San Francisco it could cause an insured loss of $171 billion. Even a medium NBCR event could trigger $446 billion in insured losses in New York City, $106 billion in Washington, D.C. and $92 billion in San Francisco. A terrorist attack employing a suitcase nuclear device in an urban area will far exceed the private insurance market's capacity to manage it. The capital of the entire P&C industry is $427 billion, and much of this is devoted to products which bear minimal risk to terrorism losses.

For a national carrier like The Hartford, reinsurance capacity for certified terrorism losses on property coverage ranges from extremely limited to non-existent. For example, The Hartford's 2006 retention under the Terrorism Risk Insurance Extension Act (TRIEA) is just over $1 billion. Within this TRIEA retention, reinsurance protection against property losses from certified terrorism events is effectively unavailable. In contrast, for natural catastrophe losses, The Hartford's principal catastrophe reinsurance treaty alone provides more than $600 million in coverage for individual loss events in excess of a $175 million retention. Nothing in TRIEA today is preventing the markets from providing reinsurance coverage within our retention, like they do for natural catastrophes. The market appetite hasn't appeared in any significant way. Why? The problem is the uninsurable nature of this peril.

Terrorism is uninsurable

As a risk, terrorism is also unique because it is uninsurable. In private insurance markets, efficiency is achieved by ensuring that the premium charged for each policyholder is based on the amount of risk that each policyholder contributes to the overall pool. In other words, we align costs with responsibility. Private insurance works properly only when insurers have the ability to effectively pool the loss experience of policyholders exposed to relatively *homogeneous*, *random* and *independent* risks, and where the underlying sources of risk are *well understood* and, therefore, appropriately priced.

The problem with terrorism is that it fails each of the prerequisites for insurability.

First, the risks are not homogeneous. The risk of terrorism to any one location may vary greatly by such factors as geographical location, industry, company reputation, and level of defensive preparation. Adding to the problem is the fact that these factors may change over time.

Second, the risks are by definition not random. Unlike storms or car accidents, terrorist attacks involve the purposeful, coordinated selection of targets based on the terrorists' objective of inflicting maximum potential damage to the economy.

Third, terrorism risks are not independent. Terrorism experts and federal officials have identified a large number of plausible terrorism scenarios that could involve losses of such a large scale that the attack would simultaneously impact a large proportion of any insured portfolio.

Finally, the risks are not well understood. Unlike other catastrophe risks like hurricanes and earthquakes, where a tremendous amount of data is available on the probability and severity of loss events, no credible data or models exist to price or manage the risk of terrorism. Absent information necessary to understand the probability of a terrorist attack, the risk cannot be priced, and therefore remains uninsurable. The risk cannot be priced. Without the ability to price, no market for terrorism risk will form.

We Do Not Operate in a Free Market

It is helpful to keep in mind the operating environment of primary insurance carriers like The Hartford. Our market is carefully regulated by each of the 50 states, and we must often receive permission from state regulators to enter a state, design a product for sale and the price for which to sell it. Insurers also often need to secure approval to stop covering a peril or quit writing this business altogether. As our private reinsurance has evaporated after 9/11, we have been vigilant to ensure that some public backstop remains in place. Without private reinsurance and without federal terrorism coverage, individual insurers may have no choice but to leave an entire section of the market, and, sometimes, a state, altogether – an outcome that we in the industry do not believe it in the best interest of our policyholders.

This is especially the case for workers compensation insurance, where the insurer is responsible for covering a loss, regardless of how a worker dies – including by a terrorist-delivered weapon. Since workers compensation is a statutory policy, state regulators could not delete terrorism coverage even if they chose to.

Lastly, state regulators also decide how much insurance companies may charge for premiums, including terrorism. Even if we had a reliable way to price terrorism, it would be up to each state to decide whether or not we could charge that amount. Consequently, insurers might receive a "market" rate from reinsurers and other suppliers of capital, but our rates to our customers are strictly regulated and often restricted.

In contrast, the reinsurance companies we work with to manage our risks operate under different rules which allow them much greater flexibility. Reinsurers, like primary insurers, understand that terrorism is uninsurable. Unlike primary insurers, reinsurers had the option to stop covering the terrorism peril, so after 9/11, they have largely withdrawn from the market.

Role for the U.S. Government

Given these factors, one fact stands out: managing terrorism risk successfully requires a public/private partnership. Nearly every civilized country that has been the victim of repeated terrorist attacks has accepted this risk as a public one. Either the government bears the risk alone or in concert with the private market. The United Kingdom, Spain, South Africa, Australia, Israel, France, Germany, the Netherlands, India and Pakistan all have some form of government backing to facilitate insurance coverage for terrorism.

The United States has been no exception. In the wake of 9/11, the Congress passed the Terrorism Risk Insurance Act (TRIA), and last year it extended this program through 2007. TRIA has been shown thus far to be a successful partnership between the federal government, insurers and policyholders to protect the economy in the event of an attack.

Of course, in the U.S., terrorism is not the only peril that has been managed by a partnership between the government and the private sector. Aviation accidents, nuclear mishaps, floods and riots have all prompted similar public/private partnership arrangements. In addition, through the Overseas Private Investment Corporation, our government provides terrorism coverage for U.S. companies' overseas operations.

A solution must be long term

As a nation, we can take some comfort in the fact that since 9/11, terrorists have not succeeded in attacking U.S. interests on our own soil. Still, other countries in the world have been less fortunate. We should listen to and act on the judgment of our most senior government leaders. They constantly remind us that the risk of terrorist attacks in the U.S. remains high and that this risk will be with us for many years to come.

The inescapable conclusion is that as long as this terrible risk threatens our way of life, we need to have a way to fortify our economy against it. The insurance industry is willing to play an integral role to finance this risk, working together with policyholders and the government, but we cannot do it alone.

Work Continues on a Long Term Solution

The Hartford is willing and eager to work with any group of interested parties on finding a permanent solution. Indeed, I have collaborated with the companies and associations on today's panel. And I have visited with many of you and your colleagues in the Senate over the past 5 ½ years as you have developed TRIA and TRIEA. We have spent considerable time and energy ensuring that the two Acts work and trying to construct a long-term solution which will work for all. I cannot say that we have "cracked the code" yet.

As we continue this work, I believe that the following principles must necessarily be part of the answer:

- Our Federal Government must play a role, including, if necessary, preempting any state impediments to a workable national solution;
- Congress needs to give special attention to the terrorists' new and horrific tools of war; and,
- The solution must last as long as the threat of terrorism does.

Thank you.

Statement of Gregory Case

President and CEO, Aon Corporation

Before a Joint Hearing of the House Financial Services Committee

Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

and Subcommittee on Oversight and Investigations

"Protecting Americans from Catastrophic Terrorism Risk"

September 27, 2006

Chairman Baker, Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez, and members of the Subcommittees, thank you for the opportunity to testify before you today on protecting America from catastrophic terrorism risk. My name is Gregory Case. I am the President and Chief Executive Officer of Aon Corporation. My testimony today is on behalf of my firm, as well as the member firms of the Council of Insurance Agents and Brokers (The Council).

Aon Corporation (www.aon.com) is a leading provider of risk management services, insurance and reinsurance brokerage, human capital and management consulting, and specialty insurance underwriting. We have 47,000 employees working in Aon's 500 offices in more than 120 countries. Backed by broad resources, industry knowledge and technical expertise, Aon consultants, brokers, economists and actuaries help a wide range of clients develop effective risk management and workforce productivity solutions.

The Council represents the nation's largest, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than

3,000 locations, employ more than 120,000 people, and annually place more than 80 percent – well over $90 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

Aon and the members of The Council share your belief that terrorism risk protection is an issue of utmost importance and a critical element in our Nation's efforts to confront and defeat the terrorist threat. Your subcommittees, as well as the full Committee, have been leaders in this effort and we commend you for all of your hard work, including the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the Terrorism Risk Insurance Extension Act (TRIEA) last year.

Introduction

We recently commemorated the fifth anniversary of the terrorist attacks of September 11, 2001. For many of us, it is difficult to believe it has been five years since thousands of our fellow Americans, our friends, colleagues and family members, were killed. For Aon, which lost 176 employees that terrible day, and for other Council members who suffered a similar catastrophe, the loss was personal.

One of the most important of the many steps that Congress and the President have taken to protect Americans from the effects of terror attacks was the enactment of TRIA in 2002, and its extension in 2005. Passage of TRIA was critical for individual businesses and for the economy as a whole. Although the spotlight was on the insurance industry's capacity to withstand further terror attacks and to cover terror risks going forward, the national risk was – and is – much broader. Because insurance provides individuals and businesses with the ability to take the risks that are essential to the functioning of our economy, constraining that ability would be economically devastating. TRIA has prevented that from happening. Indeed, not only have federal funds provided by the TRIA "backstop" never been tapped and not one taxpayer dollar spent, the program has proved to be an unqualified success in stabilizing the insurance markets, allowing insurers to provide much-needed terrorism coverage to consumers at prices they are able to afford. TRIA is not about protecting the balance sheets of insurers and brokers – it is about creating and sustaining a national economy that encourages investment and development.

When TRIA was originally adopted in 2002, the assumption was that the private sector would be able to create a market for terror insurance coverage and that the federal program would simply be a stop-gap measure to ensure stability while that market developed. Since that time, however, it has become clear that the private sector – insurance companies, capital markets and rating agencies - have a very limited ability to insure and rate terrorism risks that are only questionably quantifiable, totally unpredictable and, thus, essentially impossible to underwrite.

Given these realities, Aon and the members of The Council believe development of a long-term solution to the terrorism insurance crisis is essential and that the federal government will continue to have an important role to play in terrorism risk coverage for the foreseeable future. The insurance market needs some level of stability and predictability. The prospect of TRIA's demise – or the periodic renewal or extension of the program every few years – is not viable for the long-term. Failure to implement a permanent fix before TRIA expires next year will not only vastly decrease risk transfer options, it will expose the U.S. economy to potentially devastating uninsured economic loss in the event of another catastrophic terrorism attack. Thus, the issue before Congress is not whether the government will be the insurer of last resort in the event of such an attack, but rather whether the government will work with the insurance industry to thoughtfully and deliberately develop a plan to maximize private sector coverage of the massive damages that will result before an attack, rather than reacting in crisis mode after an attack occurs. Better TRIA than FEMA.

Insurance Brokers' Interest in Terrorism Insurance

The role of insurance agents and brokers (producers) in general, and Aon and Council members in particular, is to help our clients manage risks and secure the insurance coverage they need to protect them from the risk of loss. As the insurance experts closest to insurance consumers and the insurance marketplace, we understand our clients' needs and the needs and appetite of the market, and thus bring a unique perspective to the discussion of terrorism insurance coverage. Commercial insureds need terrorism coverage not just for piece of mind, but for their businesses. Indeed, in many cases, purchase of terrorism coverage is mandatory – it is required to obtain a mortgage or financing for new construction, the expansion of a business or a new entrepreneurial venture, sometimes by state laws and regulations and often by contract. The most important issue for the broker community, therefore, is maintaining consumer access to coverage at a price at which businesses can afford. In order to get this access, we need insurers who are able and willing to provide the coverage.

Aon's business is not dependent on any Federal backstop. We will continue to help our clients mitigate their risks by the best means available. But insurance is an important component in a comprehensive risk management program, and the availability and affordability of terror coverage is a critical issue for our clients and the US economy. We supported TRIA in 2002, 2005 and today because of our clients' need for terror coverage, the lack of capacity in the private market, and the high cost of the small amount of coverage that was available absent TRIA. For the same reasons, and because TRIA successfully brought stability to the private market for terrorism risk insurance, Aon and the Council believe the creation of a permanent solution to the terrorism insurance affordability and availability crisis is essential. There is no more important policy issue for Council members.

The Success of TRIA

Since its inception in 2002, TRIA has been incredibly successful in providing the commercial property and casualty market, and insurance buyers, with increased terrorism capacity and significantly decreased pricing without costing taxpayers one dollar. In addition to providing readily available and affordable terrorism capacity for U.S. based risks, the program has also allowed the private markets to progressively increase its role in terms of retained terrorism exposures under TRIA.

Coverage that is both available and affordable is directly due to the existence of the federal backstop. Since TRIA's enactment, as the availability of terrorism coverage has grown and premium prices have dropped, take-up rates for terrorism coverage have steadily increased. A brief history of the terrorism insurance marketplace since 9/11 illustrates TRIA's success:

- Prior to September 11, 2001, coverage for terrorism was generally included at no additional cost in most property and casualty policies; it was not treated as a separate risk.

- Between 9/11 and the enactment of TRIA, terrorism insurance became almost entirely unavailable, and the small amount that was available was extremely expensive. The consequences of this lack of coverage rippled far beyond the insurance industry. For example, innumerable construction projects and real estate financing arrangements were derailed or delayed due to a lack of adequate terrorism insurance protection.
- In the months after enactment of TRIA, the initial pricing was high and the take-up was low.
- Since that time, however, the purchase of terrorism insurance has been steadily increasing. Aon's commercial property benchmarking shows a nearly 100% increase in take-up rates among our clients between 2002 and year-to-date in 2006. For example, in 2003, the first full year of the program, less than 40% of large- and mid-sized U.S. businesses obtained insurance to cover property terrorism risks; in 2004, that number increased to nearly 50%; in 2005, the take-up rate grew towards 60 percent; and this year the take up rate is in excess of 60%.

The increase in take-up rates reflects the increasing demand by America's business community for terrorism coverage at commercially viable prices. Statistics show that the average rates for terrorism coverage dropped 25% between 2004 and 2005, providing more stability to the market. This has enabled business transactions that were previously stalled due to lack of insurance coverage to go forward without threatening the solvency of the parties involved or their insurers. Policyholders – the businesses of our economy - have not had to deal with dramatically volatile terrorism insurance costs and have been able to budget for their existing and expanding business plans.

Terrorism risk is not limited to urban, coastal areas. Policyholders across the country – and across industries – are rightly concerned about the risks they face and will purchase coverage when it is available at an affordable price. According to industry reports, take-up rates are higher for companies with a higher perceived risk, whether due to size, location, industry or other factors. One of the most interesting and important industry findings is that the take-up rates are high across the country and across industries. According to industry reports, take-up rates were highest in the Northeast and Midwest, followed by the South and West. Take-up rates in major cities in the Midwest, South and East were over 50%, and were only slightly lower in Los Angeles and San Francisco. Within specific industrial sectors, the largest percentage of insureds buying terrorism insurance were in real estate, financial services, health care, media, hospitality, transportation and education. Even companies in the sectors with comparatively low take-up rates – energy and manufacturing, for example – each had take-up rates exceeding 33 percent in 2004. These relatively high rates show not only demand, but that we are making progress toward the public policy goal of encouraging coverage in affected areas and industries. By comparison, in California – where the likelihood of a major earthquake can be better modeled, understood and underwritten – price and complexity have capped take up rates of earthquake insurance at only 11%.

The Development of a Long-Term Solution to Terrorism Risk Coverage

TRIA has stabilized the insurance market and allowed insurers to become more comfortable offering terrorism coverage *within the TRIA framework.* Nonetheless, capacity in the terrorism insurance market clearly remains limited. And the capital markets have no appetite for hedging terrorism risk absent a Federal backstop.

We don't have to guess what the post TRIA market will look like if the TRIA program is allowed to lapse unrenewed at the end of 2007. Renewal activity in the latter half of 2005 – before TRIA was extended – as well as pre-2002 TRIA provides a clear roadmap. According to industry reports, during late 2005, the availability of coverage and the pricing of coverage varied greatly according to the exposure. For medium and large insureds with little or no exposure – i.e., businesses in low risk industries located away from high risk areas – property coverage for terrorism was generally available at reasonable prices. In contrast, insureds in areas with high concentrations of risk (generally urban areas), in high-risk industries, or properties perceived as "targets," capacity was low and prices were high. This is also true of large insureds seeking large amounts of terror coverage. Thus, without TRIA, reasonably priced coverage will not be available for the major ports, oil refineries, sporting venues, hospitals, universities, airports, train stations and others that need it most.

It is also not realistic to rely on the private reinsurance market to fill the terrorism reinsurance capacity hole that TRIA's expiration will create. If there is no permanent solution when the program ends at the end of next year, we will see an increased demand for private market reinsurance. The increase in demand and the limited reinsurance capacity will cause rates to rise dramatically.

In addition, the entire global surplus capacity for P&C companies of $425B for all perils – national catastrophe, workers, compensation, normal course – is committed. We need only look to the Gulf post-Katrina to see how the commercial P&C market will react when faced with increased rating pressure, liquidity impairment loss scenarios and very highly priced and scarce private market reinsurance capacity: an overwhelming portion of the P&C market will look to either exclude or severely sublimit terrorism exposures. This will create an immediate imbalance in terms of available supply for terrorism capacity versus demand at the primary insurance level. Market exit creates availability constraints, which drives up pricing, which decreases the take up rate which – ultimately – transfers the risk back onto the government. The economy will need capital to recover from any event and if that capital does not come from the private market via a vehicle like TRIA, it will come from the public one.

We recognize that a long-term solution to this issue could take any of a number of forms, although at this point, the form of the solution is less important than the content: increased affordability, increased availability, and increased certainty in the terrorism insurance marketplace. Because of the unique characteristics of terrorism risk – unpredictability, the political dynamic, the catastrophic nature of the losses – any workable solution must involve the federal government. Indeed, with respect to nuclear, biological, chemical and radiological (NBCR) risks, we agree with Ramani Ayer, CEO of the Hartford and a co-panelist at today's hearing, that the insurance industry is not capable of insuring against such an act of war and the Federal government should provide first dollar coverage for such losses. Even with respect to non-NBCR risks, we see a necessary role for the federal government, most efficiently by providing a backstop that provides the implicit reinsurance that the capital and reinsurance markets will not provide. As is referenced in the Aon proposal below, in exchange for the Federal participation, there should be a mechanism that increases the payback of any government funds used to cover insured terrorism losses.

One of the common themes of several proposals is a pooling mechanism. A pooling mechanism would allow the insurance industry to essentially "backstop" itself by growing the capacity to handle a catastrophic attack like those of September 11. The growing premium base of a terrorism insurance pool and backstop could bring reinsurers back into the market, further expanding capacity. Growth in capacity will bring prices down and decrease the need for the federal backstop over time or increase the dollar amount at which such a backstop would kick-in.

In general, a terrorism insurance pool would be financed by participating insurers which would each deposit some percentage of their written premium covered by the program into the pool. In order to avoid adverse selection, contributions to the pool would be based on each individual company's entire premium for lines of insurance covered by the pool, not select lines or policies. In the unfortunate circumstance that a qualifying loss from a terrorist incident occurs, participating insurers would first pay down a pre-established deductible (all or part of which could be covered by the premium deposits); once deductibles are fully paid, funds from the pool would be tapped; when the pool is drained, the federal backstop would kick in, up to a pre-set limit. The federal backstop is more likely to be tapped in early years, before the pool has a chance to fully develop, and the government's potential short-term liability will decrease as the pool grows. All federal backstop payments would be repaid through policyholder surcharges or other means.

Along those lines, Aon has developed a solution that would engage the private market while maintaining the Federal backstop. The Aon proposal would:

- Create an industry funded insurance pool capable of covering two consecutive $40 billion events. (Aon considers $40 billion to be a 1 in 100 year occurrence, similar in scale to the attacks on 9/11).
- Industry would be required to contribute annual premiums of $2 billion per year. The fund would build up over 20 years to $40 billion. The Federal Government would cover excess losses up to $100 billion.
- Should a calamitous event occur prior to the pool reaching $40 billion, the pool will be funded through the issuance of post-event bonds to be repaid through assessments on all policies from covered lines for the life of the bonds.
- Bond repayments would not cripple the industry. To cover two $40 billion events in a four year period, premiums by covered lines would rise by only 1.4% through the life of the post-event bonds.

We also believe participation in the pool should be on an individual company basis, rather than a "family of companies," holding-company-wide basis. The holding company approach penalizes the largest insurers because the size of their deductibles renders the program somewhat superfluous for them. It also punishes them for exploring areas of business that are new for them, including areas in which terrorism coverage may be a component. Allowing individual insurers in a holding company family to participate in the pool separately would allow the maximum amount of flexibility and entrepreneurship as those companies explore the various ways through which to address terrorism coverage concerns. The insurance industry is renowned for its ability to come up with new ways to solve problems old and new, and providing this type of flexibility should maximize the extent of that entrepreneurship that is needed so desperately here. This approach also would allow many families of insurers to experiment with the pooling concept – to dip their toes in, so to speak, before deciding whether or not to dive. In the long run, we believe that allowing individual companies to participate in such a pool will maximize the availability of terrorism coverage in the private marketplace and thereby help to reduce the government's on-going role in providing the terrorism backstop.

Conclusion

In closing, thank you once again for your diligent work on this issue, which is critical to the insurance industry, policyholders, and the Nation. We are deeply appreciative of the bipartisan consensus that has existed on the Financial Services Committee – and these Subcommittees – with respect to this issue since 2001, thus enabling the TRIA program to do its job. TRIA has stabilized the terrorism insurance marketplace and provided the structure around which the private market can play an effective role and facilitate a long-term private sector solution. The work is not done, however, and there remains an essential role for the federal government to provide stability and certainty to facilitate a long-term solution for terrorism risk protection. We offer our assistance in any way as the industry, policyholders and policymakers work next year to develop lasting public-private solutions that minimize risk to the Treasury while allowing policyholders to secure coverage to protect them against the financial risks of terror.

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TESTIMONY

OF

JACQUES E. DUBOIS
PRESIDENT AND CEO
SWISS RE AMERICA HOLDING CORPORATION

CATASTROPHIC TERRORISM RISK

BEFORE

CAPITAL MARKETS
INSURANCE AND GOVERNMENT SPONSORED
ENTERPRISES SUBCOMMITTEE
AND
OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE
OF
FINANCIAL SERVICES COMMITTEE
US HOUSE OF REPRESENTATIVES

SEPTEMBER 27, 2006

My name is Jacques E. Dubois and I am President and CEO of Swiss Re America Holding Corp. I am also here on behalf of the Reinsurance Association of America (RAA). First, a few words about Swiss Re. Founded in Zurich, Switzerland in 1863, Swiss Re has operated in the US since 1880. Swiss Re is the largest reinsurer in North America and the world. Our company insures risks globally, operating from 70 offices in 30 countries. We incurred over $19 billion in claims for all lines of business on a worldwide basis in 2005. Swiss Re has three businesses: Property & Casualty reinsurance, Life & Health reinsurance and Financial Services. Swiss Re is also a member of the American Council of Life Insurers.

The RAA is a national trade association based in Washington, DC and incorporated in 1969. It is the sole organization representing the U.S. property and casualty reinsurance industry. RAA's membership consists of U.S. domestic reinsurers and reinsurance brokers.

Before I begin my testimony, I want to thank Chairmen Oxley, Baker, Kelly, Ranking Member Kanjorski, and many members of this Committee for the leadership you all have shown on the terrorism insurance issue. Your leadership has been critical to the adoption and continuation of the successful TRIEA program. The reinsurance industry commends you all for the hard work and tremendous support you have provided on this most important issue. When one considers the potential damage terrorism events could do to this country, both in human suffering and general economic consequences, the importance of a TRIEA renewal is a case that must be made.

Reinsurance is commonly referred to as insurance for insurance companies. Reinsurance plays a critical role in maintaining the financial health of the insurance marketplace and ensuring the availability of property and casualty insurance for U.S. citizens. Reinsurance can be used by insurers for several reasons. One of the most important purposes is to protect insurers from catastrophic losses from various perils including hurricanes, earthquakes, fire and floods. To that end, reinsurers, Swiss Re among them, have financially responded to every major U.S. catastrophe for more than a century. It is important to note that two-thirds of the insured losses from the September 11 terrorism attack were absorbed by the reinsurance industry.

Swiss Re and the RAA strongly supported the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the extension in 2005. The program has worked very well to fill a vacuum in reinsurance capacity and has brought stability to the market place and the economy. TRIEA has enabled insurers to provide insurance coverage to support economic activity, and it should reduce disaster assistance should another terrorist act occur in the U.S. It is worth noting that this program has proven to be an effective and efficient program. In providing its backstop to the insurance industry, TRIEA has preformed as designed and has cost little to administer (albeit in the absence of a significant payout).

My comments are intended to provide the Committee with: (1) a better understanding of the significant challenges the reinsurance industry is facing in providing private terrorism reinsurance capacity, and (2) why the reinsurance industry strongly believes that a public/private partnership is necessary to help stabilize the commercial insurance markets that underpin our free-market economy.

Creation of TRIA/TRIEA

As you are very well aware, TRIA was enacted in response to the tragic attacks of September 11, 2001. In the history of our nation, no hurricane, earthquake or other catastrophic event so fundamentally changed the American landscape and the insurance and reinsurance industries.

These attacks forced all Americans to confront the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil. Although the insurance and reinsurance industry responded unwaveringly to the catastrophic losses of September 11, the events shook the financial foundation of the industry and forever changed the way it views this risk. The simple fact is that the U.S. insurance and reinsurance industry cannot underwrite and model the number, the scale or frequency of future terrorist attacks that we may face in our nation. The insurance and reinsurance industry cannot provide significant terrorism coverage for this country, especially NRBC risks, without TRIEA's public/private partnership. Will this change in the future? If terrorism risk lessens in the world, the need for a public-private backstop should also ameliorate. But absent these world improvements, Swiss Re does not see a time in the foreseeable future when frequency or severity of terrorism risk can be successfully modeled and underwritten.

TRIA was created to provide a federal backstop, which was essential to allow the primary insurance industry to provide terrorism coverage to our nation's businesses. A client survey by Marsh & McLennan, the global insurance broker, finds that the take-up rate for terrorism coverage has risen steadily from 23% in 2003Q2 to 64% in 2005Q4.[1] TRIA has bolstered take-up rates in two ways. First, its requirement that insurers make coverage for "certified acts" of terrorism available to policyholders on terms and conditions not materially different from the policy's other property and casualty coverages has increased the supply of coverage. Second, the TRIA backstop has reduced the cost of property terrorism coverage by more than 25 percent from 2004 to 2005.[2]

Swiss Re and the RAA believe that TRIA/TRIEA has fulfilled its purpose of enabling primary insurers to provide terrorism insurance coverage to commercial policyholders in both

[1,2] Marsh & McLennan, *Marketwatch: Terrorism insurance 2006*

urban and rural areas. By limiting insurers' exposure to catastrophic terrorism losses, TRIEA has improved the market for such coverage and has had, therefore, a stabilizing influence on the economy.

Reinsurance Challenges to Underwriting Terrorism Risk

Over the last several years, insurers and reinsurers have worked hard to develop a better understanding of terrorism risk. Reinsurance companies have consulted military and intelligence experts, hired specialty risk modeling firms, invested in new research and development, and developed new underwriting standards.

Despite these considerable efforts, the basic facts have not changed: terrorism risk poses great challenges as an insurable risk. As noted in Swiss Re's *sigma* publication No. 4/2005, "Innovating to insure the uninsurable", insurable risks are measurable; have independent loss occurrences; contain manageable and predictable average and maximum losses; premium rates acceptable to both insurer and insured and adequate industry capacity. Terrorism risk fails to meet these criteria.

A key struggle in the development of a private market is that terrorism risk is not conventional. The Federal government, in fact, is telling us that we are at war on terrorism. War, by nature, is not insurable. Terrorism risk also has characteristics regarding frequency, severity and correlation that make it unlike any other insured peril or risk. These characteristics include the following:

Frequency

1. The frequency of loss is unpredictable, with little historical track record to project future loss experience. In addition, the insurance industry does not have access to all existing information about terrorism, targets and potential attacks due to national security interests.
2. Terrorists learn from their attacks and thus will attempt to defeat loss prevention and mitigation methods used by policyholders, insurers and reinsurers. This also suggests that history will never be a reliable predictor of future terrorism losses.

Severity

1. Terrorist acts are willful and intended to inflict maximum damage. These are not random or fortuitous acts.

2. The potential size of loss is enormous, with total destruction of multiple insured properties likely. The introduction of nuclear, biological, chemical and radiological weapons can greatly magnify losses to property and life. As an example, the American Academy of Actuaries has modeled insured losses totaling $778 billion stemming from a NRBC event in New York City. These extreme loss scenarios would cause losses that outstrip insurer financial resources and are uninsurable.

Correlation

1. The potential size of loss is compounded by the aggregation of losses arising from multiple clients and from multiple insurance products implicated in the occurrence.
2. Unlike natural disaster risk, reinsurers achieve virtually no spread of risk with terrorism coverage. Hurricanes in Japan and Florida are not correlated. Premiums

can be collected from each risk knowing that one loss will not lead to another. Terrorism risk in Europe and North America, however, may be highly correlated and thus minimize any benefit of risk spreading geographically.

3. At the same time, terrorism events can lead to major disruptions in the financial markets. In the event of a large loss, reinsurers may be liquidating assets to pay claims. The asset values themselves may be under market pressure due to investors' concerns over the terrorist attack.

Terrorism risk has many qualities that make it challenging to write. In a free market insurers limit or avoid exposures that lack insurability characteristics. Terrorism risk poses such significant challenges that market failure can result and actuarially fair pricing on a broad scale may not be economically feasible.

Reinsurers' Role Under TRIEA

TRIEA provides reinsurance-like protection for primary commercial insurance exposures. For 2006, 90 percent of the commercial terror loss for primary insurance companies is covered up to an industry total of $100 billion. This coverage is subject to individual company retention of 17.5 percent of 2005 direct earned premium on commercial lines or approximately $35 billion. (It's important to note that property and business interruption losses from September 11 totaled about $20 billion. This amount is within the current retention required by TRIEA and, as such, the losses would not have been covered by the TRIEA program if it had been in existence.) These individual company retentions and the 10 percent co-pay for losses above the retention require commercial insurance companies to absorb significant losses before TRIEA funding is available.

Primary insurers seek private reinsurance to help reduce the large gap in terror exposure they face between the individual company's normal retention and loss-sharing/retention provisions under TRIEA. Some have expressed the concern that TRIEA preempted the private reinsurance market. This is absolutely not the case. In fact, the opposite is true. By establishing definitive loss parameters, TRIEA has provided a defined layer for reinsurers to participate in sharing the retained risk of loss that primary companies face under the federal terrorism program.

Reinsurance Terrorism Capacity

Working with client companies to manage their substantial retained exposure under TRIEA, reinsurers have been willing to put limited capital at risk to manage terror-related losses. Swiss Re is active in this limited market. Reinsurers like Swiss Re typically seek to offer terror coverage in a stand-alone contract rather than within a traditional all perils catastrophe contract, especially for insurer clients writing a national portfolio. Some regional carriers, with exposures limited to rural or suburban areas, have secured terrorism coverage within their standard reinsurance programs, usually with some limitations as to the nature of the subject risk or size of subject event.

The RAA surveyed both reinsurance brokers and reinsurance underwriters to estimate how much terrorism reinsurance capacity the private reinsurance marketplace is providing. This coverage generally includes TRIEA "covered acts" as well as domestic terrorism and personal lines exposure where requested. Overall, the RAA estimates the global reinsurance capacity available in the United States for 2006 at about $6 to 8 billion for TRIEA certified, stand-alone and treaty reinsurance. Favorable loss experience and surplus growth may increase the supply of private terrorism reinsurance but availability would still be very modest and will not fill the capacity needs of the primary industry, with or without TRIEA. The survey suggests terrorism capacity for an individual company's reinsurance program may range up to $600 million on an annual aggregate basis for property and workers' compensation. According to RAA, some market observers also believe that hedge funds may have some interest in providing capacity although estimates are for no more than $3 to 4 billion – if at all.

With regard to workers' compensation, some insurers have been able to add the terrorism peril to their reinsurance programs, but this coverage typically excludes nuclear, radiological biological, and chemical, (NRBC) losses.

Regarding NRBC generally, there is very little reinsurance appetite for this risk. According to the RAA, knowledgeable market participants believe NRBC capacity to be 15 to 20 percent of non-NRBC capacity for terrorism risk. And, when it is available, pricing for coverage including NRBC is at a significant premium and coverage amounts are restricted.

Swiss Re and the RAA believe that in the foreseeable future reinsurers will be unable to provide enough capacity to replace TRIEA coverage. Although progress has been made in modeling terrorism loss scenarios, forecasts of the frequency and the severity of terrorism losses are extremely problematic. Reinsurers can provide only limited capacity for terrorism because the potential losses would otherwise place these companies at risk of insolvency. Reinsurers' capital is necessary to support many other outstanding underwriting commitments reinsurers face, including natural disasters, workers' compensation and other casualty coverages. As a reinsurer, our business is to provide risk protection to our client companies on a sustainable basis. After all, the only way we make money is if we actually provide coverage. If the terrorism risk market were sustainable, Swiss Re and our competitors would be writing significantly more protection.

Capital Markets Limited Impact On Terrorism Risk Capacity

Some have suggested the possibility that the capital markets could assume terrorism risk. Catastrophe bonds, the most mature segment of the Insurance Linked Securities (ILS) market, were first issued in 1994. Of the over $3 billion in cat bonds issued so far in 2006, over $2 billion was underwritten by Swiss Re Capital Markets and/or sponsored by Swiss Re. In 2006, issuance of cat bonds and other capital market vehicles will likely exceed $6 billion. Swiss Re experts estimate cat bond issuance to grow to $10 billion by 2010.

This amount, however, is dwarfed by the total value of privately-owned commercial structures in the US. According to Bureau of Economic Analysis, these structures had an estimated value of $8.8 trillion at yearend 2005, of which commercial and office buildings accounted for $3 trillion; power and communication $1.4 trillion; manufacturing plants $1.1 trillion and medical facilities $0.6 trillion. Thus, even if all $10 billion of projected future cat bond issuance covered terrorism risk, it would amount to a mere fraction of a percent of the cover needed.

Since Hurricane Katrina, an additional $4 to 6 billion in capital has been dedicated to cat bonds and other capital market vehicles. An additional $7.8 billion in capital has been raised for Bermuda reinsurance start-ups, and $12.1 billion has been raised by existing insurance/reinsurance companies. The total amount of capital raised since Katrina is $25 billion. None of this money, however, has been dedicated to terrorism risk. It is quite telling that even after the most expensive hurricane season in 2005, on the heals of the costly 2004 season, the capital markets have responded by investing in hurricane risk. At the same time, there has been no appetite from the capital markets to dedicate much, if any, capital to terrorism risk.

Acts of terrorism present much greater underwriting and pricing challenges than natural catastrophe risk to the insurance and reinsurance industry and, of course, to those issuing and investing in catastrophe bonds. There is no reason to believe terrorism bonds are likely to be a significant provider of terrorism coverage in the foreseeable future. The capital markets face the same problems as insurers: inability to assess frequency of attack, a lack of predictive experience, correlation of loss to other exposures such as a stock market decline, and potentially devastating financial loss. Rating agencies have to date been unwilling to rate terrorism-only bonds.

Some have suggested allowing insurers to set up tax-free catastrophe reserves to increase the industry capacity for terrorism risk. Unless this was accomplished through a pooling mechanism, there would be no assurance that this would result in the allocation of more capacity toward terrorism risk. On an individual company basis, it would be difficult to determine the appropriate size for such a tax-free reserve because the modeling used to determine terrorism risk is not yet sufficiently reliable.

An Explicit Backstop Expedites Recovery Post Attack

One important point that is often lost in the TRIEA debate is that, absent TRIEA; the Federal government would lack an explicit backstop for major terrorist attacks. Many observers believe that the government would nonetheless be forced to provide aid, whether to insurers, other businesses or individuals who suffer devastating losses due to a terrorist event. There is ample reason for this belief. To cite just one example, twelve days after the 9/11 event, the September 11th Victim Compensation Fund of 2001 (P.L. 107-42) became law. The $6 billion program compensated individuals (or the personal representative of deceased individuals) who were physically injured or killed as a result of the attack.

The confusion – about whether the government would step in post terrorism attack– is clearly not constructive. The belief in an implicit government backstop undercuts demand for terrorism insurance, as many see no reason to insure against events that government would cover anyway. It likewise reduces incentives for businesses and individuals to buy insurance coverage or to take risk mitigation efforts such as hiring extra security or relocating.

If some expect a government bailout while others do not, there is a free rider problem. Those who purchase insurance are punished for their prudence, relative to those who failed to insure. And hastily-arranged aid packages may be more costly and less effective than carefully planned aid.

An explicit government terrorism risk backstop offers numerous advantages. It reduces ambiguity both pre- and post-event. It also enhances transparency by making it clear who will pay how much for what, should an event occur. This clarity helps facilitate actuarial pricing of risks and strengthens the incentives to purchase terrorism insurance and to mitigate risks. By reducing uncertainty, a backstop also reduces the risk of financial market disruption in the wake of an attack.

A final but important point to make about TRIEA is this is by no means a bailout for the insurance industry. TRIEA expressly provides that the Federal government can be compensated for payouts through premium charges to policyholders.

A Public/Private Partnership Is Necessary to Address Terrorism Risk

Certain group life writers have petitioned for inclusion of group life insurance in TRIA. Swiss Re is the largest reinsurer of group life writers in the US and we support their petition. Adding group life to TRIA will provide group life insurers the protection they need to insure the lives of people in the workplace. Group life insurers are not free to manage their risk through terrorism exclusions. Most state regulators will not allow it. As a public policy matter, state regulators have decided that this basic insurance covering 167 million Americans is vital. We urge you to add group life insurance to a permanent backstop.

Swiss Re and the RAA continue to work with industry task forces to determine the most effective federal program. Key to these ongoing discussions is the participation and consensus from the policyholder community. Several solutions have emerged. Swiss Re will continue to work with our clients on the most effective and efficient program design. We welcome the opportunity to work with this Committee, the Congress at large, the Administration and all private sector stakeholders to craft a public/private partnership to address this most important national issue.

In conclusion, due to the nature of the terrorism peril, we believe that private market mechanisms are insufficient at this time to spread the risk of catastrophic terrorism loss. Without some form of a federal backstop we would expect less coverage available at the policyholder level, increased prices for terrorism cover and limited private reinsurance capacity.

Thank you for the opportunity to provide testimony on this important issue.

Independent Insurance Agents
& Brokers of America, Inc.

**STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA**

**SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS**

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

September 27, 2006

Good morning, Subcommittee Chairmen Baker and Kelly, and Ranking Members Kanjorski and Gutierrez. My name is Sharon Emek, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA) to present our association's perspective on terrorism insurance. I am a managing director and partner at the CBS Coverage Group, a regional full service insurance agency with locations in New York City, Plainview, Saratoga and West Hampton Beach, NY. I also serve as Chair of the Board for the Independent Insurance Agents & Brokers of New York.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, representing a network of more than 300,000 agents, brokers, and employees nationwide. IIABA represents small, medium, and large businesses that offer consumers a choice of policies from a variety of insurance companies. Independent agents and brokers offer a variety of insurance products -- property, casualty, health, life, employee benefit plans and retirement products -- and sell nearly 80 percent of all commercial lines policies in the country. Members of the Big "I", as we are known, write the coverage for America's businesses and serve as the conduit between consumers and insurance companies, and therefore we understand the capabilities and challenges of the insurance market. From this unique perspective, we urge Congress to develop a long-term solution for terrorism insurance that enables the private sector to serve consumers and that limits federal intervention and protects taxpayers.

Please let me begin by complimenting Chairman Oxley, Ranking Member Frank and Members of this Committee and Congress for recognizing the importance of a federal role in terrorism insurance and enacting the Terrorism Risk Insurance Extension Act (TRIEA) of 2005. This extension Act and the original law, the Terrorism Risk Insurance Act (TRIA) of 2002, have worked to ensure that terrorism insurance is available and more affordable, protecting our nation's economic security.

We applaud Subcommittee Chairmen Baker and Kelly, and Ranking Members Kanjorski and Gutierrez for holding today's hearing to examine the future of terrorism insurance. Clearly, the leadership of this Committee understands that the insurance market's ability to protect the American economy from the financial consequences of terrorism risk is a critical component of our national security and vitality during the ongoing war on terror. Your efforts are crucial to finding long-term solutions for the economic and physical risks associated with terrorism, and we thank you for your continued leadership.

Background

It is well known that the insurance community performed admirably in the immediate aftermath of September 11th, 2001, honoring its commitment and providing resources needed to quickly and fully pay claims and thus playing a pivotal role in the recovery-and-rebuilding process. However, even though the insurance marketplace responded effectively to the 9/11 losses, it was quickly apparent, and remains so today, that insurers could not handle the risk of further large-scale terrorist events without a federal backstop.

Not unexpectedly, insurers reacted in late 2001 and 2002 to the new perception of exposure and lack of scientific terrorism modeling with exclusion clauses and outright cancellations of coverage. This left agents and brokers in the always difficult position of being unable to meet consumers' needs for coverage. But beyond our own professional dilemma, it quickly became clear that the absence of coverage presented an immediate threat to our country's economy that had to be addressed – construction and other important economic activity were being impacted by the lack of coverage.

Fortunately, through the leadership of the Administration and many in Congress, particularly in this Committee, the government did respond to address problems in the marketplace with TRIA. Those of us in the market, however, do not need to be reminded of how acute the problem was before Congress and the President enacted the Terrorism Risk Insurance Act in late 2002. Economic activity, especially significant new construction projects, was beginning to be impacted by the inability of owners to satisfy demands of current or prospective lenders to demonstrate adequate insurance coverage. Fortunately, TRIA was put in place before the worst effects of this availability and affordability crisis further injured our national economy.

However, as TRIA neared expiration at the end of 2005, many insurance policies covering businesses of all sizes and types extended past the program's December 31, 2005, sunset date. Because state insurance regulators have approved conditional terrorism exclusions in most states to protect insurance company solvency after TRIA, there were continued concerns that that policyholders could again face potentially harmful gaps in coverage as the Act expired. With the risk of catastrophic attacks on U.S. soil still very real, and the capability of both insurers and reinsurers to offer comprehensive terrorism coverage for an uninsurable risk still very limited, Congress wisely passed

TRIEA, which provided a two-year extension of the federal backstop under TRIA with some modifications to encourage the private sector to take on additional risk.

The current public-private partnership created by TRIA, and extended in TRIEA, has worked well and generally as intended, allowing businesses across America to continue operating and growing, and preserving jobs in the process. TRIA and TRIEA have saved our economy millions of dollars by making terrorism insurance broadly available to all businesses that want and need this coverage at virtually no cost to the federal government. Prices have come down, capacity has grown, and demand is up in many geographic areas.

Unfortunately, the program is scheduled to expire at the end of 2007, and there is no reason to believe that the threat of terrorism is on the decline, or that the private insurance markets alone can adequately meet our nation's need for coverage. As such, IIABA encourages Congress to develop a long-term solution to this problem, and we applaud the Committee for holding this hearing to explore these important issues.

Post-TRIA Availability of Terrorism Risk Insurance

Although potential terrorism losses in the United States have been estimated at over $100 billion, current reinsurance capacity is only estimated at $6 to 8 billion.[1] As former Federal Reserve Chairman Alan Greenspan and other notable experts have asserted, the private insurance market is simply not in a position to handle the unpredictable nature and possible immense size and scope of terrorist attacks.[2] Despite the warnings of these experts, a specific plan for developing a private reinsurance mechanism to spread catastrophic risk from terrorism has yet to emerge.[3] Now is the time to develop a long-term public-private partnership.

The original enactment of TRIA in 2002 and its extension late last year have been successful in stabilizing the insurance marketplace and have helped eliminate the market disruptions and uncertainties that were witnessed in the immediate wake of September 11th. A failure to reauthorize the federal program could have meant economic hardship for countless small and large communities across this country and would have had an especially devastating impact on financial and commercial centers, such as New York. As a result of the enactment of TRIA and TRIEA, our members are currently able to offer consumers options with respect to terrorism coverage.

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[1] *See* Franklin W. Nutter, President, Reinsurance Association of America, Testimony at the Public Hearing of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners 5-6 (Mar. 29, 2006), *available at* http://www.naic.org/documents/topics_tria_testimony0603_RAA.pdf. Some industry representatives, however, fear that capacity is much smaller. *See* Warren W. Heck, Chairman and CEO, Greater New York Mutual Insurance Company, Testimony at the Public Hearing of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners 4 (Mar. 29, 2006), *available at* http://www.naic.org/documents/topics_tria_testimony0603_NY_Mutual.pdf.

[2] *Greater N.Y. Mutual CEO Makes Case for Terror Coverage*, Insurance Journal, July 27, 2005.

[3] In fact, the Department of Treasury's (Treasury) June 30, 2005 report to Congress concerning the terrorism risk insurance program did not analyze this problem. *See* U.S. Dep't. of Treasury Office of Economic Policy, *Report to Congress: Assessment: The Terrorism Risk Insurance Act of 2002* 5 (June 30, 2005).

However, months before the extension of TRIA in December 2005, these interested policyholders were concerned that exclusions and sunset clauses would eliminate their coverage as insurers prepared for the termination of the TRIA backstop. Although TRIA was extended, these policyholders – including small and mid-sized businesses – continue to worry about the impact of terrorist events in this country and their access to insurance coverage to help them get back on their feet should another event occur. This concern is evident in the increased take-up rates for terrorism insurance as consumer demand for terrorism insurance continues to grow.

Policyholder concerns are fueled not only by memories of the exclusions that they faced immediately after September 11th and in the months before TRIA's original expiration, but also by their current experiences in the post-2005 hurricane market. Substantial insured losses during the recent hurricane season have diminished the insurance industry's capacity for catastrophic losses in general. Under pressure from rating agencies to limit exposure, insurers are reevaluating their exposure to catastrophic losses in general and terrorism losses in particular. As underwriters continue to focus on the aggregation of losses, our members and the policyholders they serve remain concerned about how many insurance companies, particularly small and monoline insurers, will continue to write terrorism risk insurance after the expiration of the federal backstop.

We would like to stress that the interest in, and the need for, a terrorism insurance backstop is NOT confined solely to large urban areas or to large businesses. IIABA represents agents and brokers selling coverage to consumers across the country. Our collective experience establishes that terrorism insurance coverage is not just a 'big city' or a 'big business' problem. It is a business customer problem throughout the country; this is truly a national issue. As take-up rates have gone up across the country, we have seen terrorism coverage purchased by a wide and diverse variety of interests, from small towns in Mississippi to small and large businesses in New York City. As the intermediaries between those customers and the insurers, our members remain concerned that the needs of many policyholders will not be met with affordable and good quality coverage for this peril if there is no terrorism insurance program in place after December 31, 2007.

Long-term Availability and Affordability of Terrorism Risk Insurance Coverage

In addition to the potential magnitude of losses from a future terrorist attack, a number of other factors will determine the long-term availability and affordability of terrorism risk insurance coverage, including: (1) the ability to accurately predict the severity and, most importantly, the frequency of terrorism given the increased threat; (2) the effectiveness of mitigation efforts; (3) the insurance market's capacity for substantial catastrophic losses combined with policyholder take-up rates for terrorism coverage; and (4) whether or not insurers are required to "make available" coverage for terrorism risk. Although most of these factors are considered in the context of many types of perils, their impact on the availability and affordability of terrorism is unique due to the nature of terrorism risk.

While modeling has shown us that the size and severity of a terrorist attack could easily threaten the capacity of the insurance market, the risk cannot be assessed in traditional ways. Insurers lack confidence in modeling terrorism risk due to the lack of past statistical records for such risk.[4]

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[4] *See* Letter from Dennis Fasking, Chairman, Extreme Events Committee, American Academy of Actuaries, to Rep. Richard Baker, Chairman, Subcommittee on Capital Markets, U.S. House of Representatives (August 2, 2005), *available at* http://www.actuary.org/pdf/casualty/tria_080205.pdf.

Unlike other types of catastrophic risks, insurers and actuaries know very little about where or when terrorism might occur; how it might occur; how often it might occur; or the nature, effects, and costs of such an attack. Much of the information that does exist is available only to governmental agencies that fiercely guard it for security and law enforcement reasons. As a result, underwriters shied away from terrorism risk before the creation of the TRIA backstop. Indeed, since the enactment of TRIA, insurers have proven unable to introduce wide-ranging, new products for insuring terrorism risk. There is currently no indication that the ability to accurately predict and underwrite terrorism risk will improve significantly in the future and certainly not before the Act's expiration at the end of 2007.

The unpredictable nature of terrorism also hinders the ability of the consumers who agents and brokers serve to effectively mitigate against acts of terrorism. Although policyholders may invest in increased security measures to thwart the efforts of terrorists, the effectiveness of these measures is limited due to the proven adaptability of terrorists. Moreover, the incentives offered by insurers frequently fail to match the expense of such measures.

Notwithstanding the gap between potential losses and available capacity, policyholder take-up rates for terrorism risk insurance coverage have increased since the enactment of TRIA.[5] Increased take-up rates translate into greater capacity to cover losses and spread risk, in addition to reducing taxpayer exposure to post-event and ad-hoc government funding. Likewise, as capacity grows, policyholder take-up rates should continue to increase.

While our members remain opposed to federal intervention in the insurance market in general, they nevertheless acknowledge that the terrorism risk insurance coverage currently available to the policyholders whom they serve would not exist without TRIA. This is a clear case of marketplace failure, and in those rare instances, limited federal involvement in a reinsurance capacity is warranted. Once the backstop expires, the challenges discussed above will likely paralyze the private insurance market's ability to make terrorism risk insurance coverage available and affordable for policyholders. federal legislation is necessary to ensure that policyholders continue to have access to such coverage and that the insurance market's capacity to cover terrorism losses continues to grow.

Potential Solutions to Increase Private-Market Insurer and Reinsurer Capacity for Terrorism Risk

Any analysis of the long-term availability of terrorism risk insurance must acknowledge the unique nature of terrorism risk. Terrorist acts are nearly impossible to predict because they are intentional and heinous acts committed by those who wish to attack our country, our institutions, our livelihood, and our sense of security. Given the unique nature of terrorism risk, the insurance market has proved unable to make meaningful assessments or judgments about possible terrorist events. Accordingly, IIABA believes that increasing private insurance and reinsurance market capacity will

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[5]A survey conducted by the Mortgage Bankers' Association and reports by the RAND Center for Terrorism Risk Management and Marsh suggests that policyholder take-up rates have increased since the enactment of TRIA. *See* Survey: Lack of Terror Coverage Would Hurt Commercial Mortgage Market, *Insurance Journal*, June 8, 2004; Peter Chalk et al., *Trends on Terrorism: Threats to the United States and the Future of the Terrorism Risk Act* 8 (RAND Center for Terrorism Risk Management Policy 2005), *available at* http://www.rand.org/pubs/monographs/2005/RAND_MG393.pdf; Marsh, *Marketwatch: Terrorism Insurance 2005* 6-14 (2005), *available at* http://www.marsh.dk/files/Marketwatch_Terrorism_Insurance_2005.pdf.

depend on the introduction of private capital from non-insurance sources and the continuation of a public-private partnership.

Specifically, IIABA believes that a private-public partnership – in some form – remains essential to the challenge of making terrorism risk insurance available after the expiration of the Act at the end of 2007. Although some potential solutions might allow for the reduction or even elimination of federal involvement in the years to come, it may be difficult to eliminate such a role in the immediate future without disrupting the market. Indeed, it will take decades for the industry to close the gap between the estimated $6 to 8 billion in current reinsurance capacity and potentially hundreds of billions of dollars in losses from a terrorist attack. [6] As such, public participation is necessary to encourage private markets to get in and stay in the business of insuring terrorism risk. [7] At a minimum, federal legislation is necessary to facilitate private sector solutions, such as risk-sharing mechanisms and capital reserve accounts. We remain optimistic that the industry and policymakers can develop solutions that will reduce the role of the federal government (and taxpayers) over time and enable the private market to build up greater capacity and ultimately shoulder more of the burden.

Tax-incentives could also prove instrumental in encouraging new sources of capital. IIABA supports efforts to allow insurers to proactively build tax-free reserves for terrorist events on a pre-event basis, and we believe that this concept is worth further consideration in the context of a broader long-term solution. This option would help insurers build capacity over time, and, given the national nature of terrorism risk, it is entirely appropriate that federal tax policy be adjusted to encourage the private sector to do so.

The NAIC is appropriately considering the role that pooling and syndication might play in expanding capacity, and we encourage continued exploration in this area. As a key stakeholder in the process, IIABA believes that variations on such mechanisms – whether voluntary or not and whether single or multiple in form – should remain under consideration in the debate as a potentially important, if not exclusive, means of building capacity to insure terrorism risk.

Finally, FAIR Plans and other residual market mechanisms, with appropriate modifications, could potentially play a limited role in the long-term solution to terrorism insurance availability, but this option alone cannot substitute for the participation of the federal government. In addition, terrorism and the risks posed by such attacks are inextricably linked to federal and foreign policy, and this peril cannot be solely addressed at the state level without federal government assistance.

Now is the time to analyze these potential solutions. The creation of an effective and long-term mechanism is essential for managing the risk posed by terrorist events. Without some form of meaningful solution, terrorism coverage will be extremely difficult – if not impossible – for most to obtain after December 31, 2007, and, as noted above, the impact will likely be felt before then. Such an outcome would be especially troubling for small and medium-sized businesses, which are already challenged by the current environment and are not in a position to self-insure. The vast majority of businesses in this country are of this size, and the nonexistence of some form of a terrorism insurance

[6] *See* Marsh, *Marketwatch: Terrorism Insurance 2005* 33 (2005), *available at* http://www.marsh.dk/files/Marketwatch_Terrorism_Insurance_2005.pdf.

[7] Countries such as the U.K., France and Spain, which have a longer history of protecting against terrorist threats, have long accepted that government must play a role in insuring against terrorism losses.

program could have devastating effects on the national economy. For these reasons, IIABA urges Congress to continue analyzing long-term strategies, including the solutions mentioned above, before the expiration of the federal backstop next year.

In order to facilitate a long-term solution for terrorism insurance, the Big "I" also supports H.R. 4619, the Commission on Terrorism Risk Insurance Act of 2005, introduced by Reps. Vito Fossella (R-N.Y.) and Carolyn Maloney (D-N.Y.). This legislation would create a national commission on terrorism insurance comprised of 11 stakeholders, including an independent insurance agent and a broker, to review the current program and make recommendations to assist the market after the Act's expiration.

Insurance Coverage for NBCR Events

We believe that any long-term solution to protect the nation's economy in the face of substantial terrorism losses must address potential losses from nuclear, biological, chemical or radiological (NBCR) events. Other than coverage included in statutorily mandated lines (e.g., workers compensation), little coverage is available for NBCR events. Although NBCR losses are perhaps the most catastrophic types of terrorist attacks, coverage for these types of losses is currently excluded from most existing terrorism risk insurance coverage.

The American Academy of Actuaries (AAA) recently estimated that insured losses from a conventional truck bomb attack, as well as medium and large NBCR events caused by terrorism, could total $778 billion.[8] The AAA estimated that losses in four U.S. cities could reach the following levels:[9]

	Losses from a Truck Bomb Attack	**Losses from a Medium NBCR Event**	**Losses from a Large NBCR Event**
New York City	$11.8 billion	446.5 billion	$778 billion
Washington, D.C.	$5.5 billion	$106.2 billion	$196.8 billion
San Francisco	$8.8 billion	$92.2 billion	$171.2 billion
Des Moines	$3 billion	$27.3 billion	$42.3 billion

The difficulties of developing adequate capacity to cover terrorism losses due to terrorism and diversifying risk are aggravated in the context of NBCR events. Currently, there is essentially no reinsurance capacity for NBCR losses. NBCR terrorism risk is even more difficult to predict and underwrite than non-NBCR terrorism risk. Moreover, as discussed during the NAIC Terrorism Insurance Implementation Working Group's public hearing on terrorism insurance availability earlier this year, it could take many years to quantify the damages from a NBCR attack.

During our participation in the development and extension of TRIA, IIABA supported mandatory availability of insurance coverage for NBCR losses. Based on our experience in the market,

[8] *See* Emily Crane, IIABA, *The Potential Costs of Terrorism*, Insurance News & Views, Apr. 6, 2006, *available at* http://www.iiaba.net/IAMag/NewsViews/040606.html.

[9] *Id.*

we know that policyholders desire a long-term solution to the availability of terrorism risk insurance, including coverage for NBCR events. Policyholders want certainty for their business planning and operations, and they clearly do not want to be subject to on-again, off-again terrorism insurance mechanisms, and exclusions for NBCR losses. Terrorism is perhaps the greatest threat to our nation's economic future, and we believe that the reality of potentially large losses from NBCR events must be addressed to protect our economy, as well as policyholders and taxpayers.

Given the potential magnitude of NBCR losses, a catastrophic attack in a line not covered under the TRIA program (e.g., NBCR) would almost certainly lead to a substantial government bailout. In light of the potentially enormous burden that taxpayers could face as a result of NBCR risk, it is imperative that policymakers work to help develop the private insurance market's capacity for losses. As demonstrated with non-NBCR coverage under TRIA, we do not expect the private insurance market to view NBCR risks as insurable or move toward developing capacity to cover such risks without encouragement from the federal government. Public participation is a vital requirement for any long-term solution for increasing private market capacity to cover these types of events.

We urge policymakers to develop a system of public-private compensation for NBCR losses that offers taxpayer payback protections similar to those currently available with respect to TRIA-covered lines.[10] Otherwise, taxpayers face a much larger, unexpected payout in the wake of a substantial NBCR event.

Nationwide Need for Terrorism Risk Insurance

In addition to the capacity problem, we believe that insurers' ability to diversify risk will also pose challenges to the long-term availability and affordability of terrorism insurance. The nature of the risk presented by terrorism requires that any long-term solution enable the market to spread the risks associated with terrorism and develop as broad a funding base as possible. This means focusing on increasing take-up rates in all communities, which is closely related to the availability and affordability of coverage. As former Washington, D.C. Insurance Commissioner Larry Mirel noted in his testimony to the House Financial Services Committee last summer, businesses in New York City, Washington, and other prominent "target" areas pay very high premiums for terrorism coverage – even with the existence of the federal program – yet they are not the true targets of terrorists.[11] Terrorists, as the Commissioner noted, want to attack America, and an attack on any particular town or city is actually an attack on our nation as a whole.[12] Accordingly, it is both appropriate and fair for policymakers to identify solutions that truly help protect America's national economy and identity through a wide spreading of this distinctive risk.

[10] As discussed below, we believe that it is important that such a system avoid distinguishing domestic terrorism from foreign terrorism.

[11] The Future of Terrorism Risk Insurance: Hearing Before the Subcomm. on Markets, Insurance and Government Sponsored Enterprise of the H. Financial Services Comm. 3 (July, 27, 2005) (statement of Laurence H. Mirel, Commissioner, District of Columbia Department of Insurance, Securities and Banking, Testimony before the House Financial Services Committee); *available at* http://financialservices.house.gov/media/pdf/072705lm.pdf.

[12] *Id.*

Domestic v. International Terrorism

Although domestic terrorism is excluded from the current federal terrorism risk insurance program, we would recommend that any long-term response eliminate the distinction between domestic and international terrorism. Domestic terrorism, which presents many of the same characteristics of international terrorism, is a very serious threat and coverage for this risk is largely unobtainable in the marketplace today. IIABA believes that such distinctions are likely to prove irresolvable in the aftermath of an attack. Distinguishing between domestic and international terrorism can be difficult (if not impossible) as the anthrax incidents of 2001 and the London Underground bombings of last summer demonstrated. In short, IIABA continues to believe that the terrorism peril should be treated on a seamless basis without such distinctions.

Conclusion

IIABA applauds Congress for not ending TRIA abruptly last year and for having the foresight to try to "phase-out" the program only as markets are able to develop. This type of thoughtful approach, which recognizes market capabilities and restraints, will be essential to ensuring long-term affordability and availability of terrorism insurance as well as capacity in both the short-term and long-term.

Although the terrorism insurance program was only recently extended less than a year ago, it is time to start looking ahead, and we thank the Committee for beginning this process today. The need for action is actually more urgent than many might realize, and it will not be long until policyholders are renewing policies with contract terms that extend beyond December 31, 2007. If a solution is not in place well in advance of the end of next year, insurance markets may once again face significant disruption and uncertainty, and we anticipate that insurers would exclude terrorism risks from policies where authorized.

We also hope that any solution will draw on the experiences of the current program in order to assist the private markets in handling this risk. For example, despite the fact that TRIA does backstop losses arising from NBCR attacks, commercial customers generally are unable to get that type of coverage in the market today.

IIABA members, along with many in the insurer and policyholder community, recognize that we must find a long-term and market-based solution to our nation's terrorism insurance problem and are committed to this process. We look forward to working with Congress on this matter that is crucial to our country's economic security.

Statement of

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on behalf of the

American Council of Life Insurers

on

Protecting Americans From
Catastrophic Terrorism Risk

before the

Subcommittee on Capital Markets, Insurance and Government
Sponsored Enterprises
and
Subcommittee on Oversight and Investigations

of the

House Financial Services Committee

of the

United States Congress

September 27, 2006

Introduction

Chairman Baker, Chairwoman Kelly and members of the Subcommittees, my name is Ed Harper and I am Senior Vice President at Assurant - a premier provider of specialized insurance products (including group life insurance) and related services in North America and other selected markets.

Assurant is a multi-line insurer with approximately $24 billion in assets and $7 billion in revenues with more than 12,000 employees. The company is headquartered in New York City at One Chase Manhattan Plaza. Our offices used to be located in the North Tower of the World Trade Center when it was first bombed in 1993.

I am here today on behalf of the American Council of Life Insurers (ACLI). The ACLI is the primary trade association of the life insurance industry, representing 377 member companies that account for 91-percent of the industry's total assets in the United States. ACLI members offer life insurance, annuities, pensions (including 401(k) plans), long-term care insurance, disability income insurance, reinsurance and other retirement and financial protection products.

I am also chair of the Group Life Coalition (an organization of some of the industry's top group life carriers) and the ACLI's Federal Legislative Strategy Group for Group Life.

Overview

I would like to thank the Subcommittees for holding this hearing on protecting Americans from catastrophic terrorism risk. Having just passed the fifth anniversary of the September 11, 2001 attacks, we are all, unfortunately, very well aware of the risks that our country continues to face from various domestic and international extremist and terrorist groups. I will never forget that fateful September morning, walking through the smell of quenched fire and looking down from my office window onto the gigantic hole in the ground which was the site of the World Trade Center – "Ground Zero."

In addition to implementing effective homeland security measures that will help prevent large-scale terrorist attacks, we must also sufficiently insure our nation's most vulnerable assets (including its critical infrastructure) and its citizens in case such attacks do take place. Terrorism insurance is a vital component of maintaining our robust economy and providing a safety net to those who financially depend on the victims of such attacks.

While much of today's discussion has focused on the need for adequate terrorism insurance within the property and casualty (P&C) insurance industry, it is also important to discuss how this issue affects the life insurance industry and its policyholders, particularly with regard to group life insurance. We respect the need for adequate insurance for buildings, but does it make sense to insure buildings and not the people whose lives might be lost if those buildings go down as a result of a terrorist attack?

I am here today to urge the Subcommittees to include group life insurance in any workable long-term, public/private solution that would help make terrorism insurance (and reinsurance) more available and affordable throughout this country.

In addition, to the extent that Congress extends the Terrorism Risk Insurance Act (TRIA) beyond 2007, I urge you to add group life insurance as a covered line (as it was in the House version of the extension bill). The ACLI also believes that any TRIA extension should include group life, and the National Association of Insurance Commissioners (NAIC) has adopted a resolution in support of group life's inclusion as well. Howard Mills, New York's Superintendent of Insurance, recently restated his support for group life inclusion during a meeting at the NAIC's Fall National Meeting in St. Louis.

<u>The Importance of Group Life Insurance</u>

Group life insurance is a critical employee benefit. For millions of Americans, especially lower-income workers, it is the only life insurance that their families have and can rely on if they were to unexpectedly die. Group life is usually part of an employee's benefit package that contains medical, disability and other coverages, and remains available and affordable (as it did before 9/11).

At the end of 2004, there were about 165 million certificate holders of group policies, with an average coverage amount of $46,250. Almost $19 billion was paid to group life beneficiaries in 2004. Group life insurance represents about 44% of all life insurance in force - $7.63 trillion out of a total $17.5 trillion at the end of 2004.

In addition, 60% of ACLI member companies sell group life insurance. For some of these insurers, it makes up all or most of their business. Group life insurers received about $27.7 billion in net group life insurance premiums (which is almost 20% of the $139.7 billion of total net life insurance premiums).

<u>Potential Exposure to Group Life Death Claims</u>

Unlike individual life policies whose insured individuals are generally scattered throughout a particular area(s) or region(s), group life policies usually have very high concentration risks. By its very nature, most, if not all, individuals of an insured group are often gathered in one or several locations (e.g., office buildings, factories) and a single catastrophic event in a particular city could cause many or all of them to die at once, resulting in a high number of death claims.

For example, if a terrorist attack were to kill 20,000 individuals insured under one or more group plans, based on an average coverage amount of $46,250, group life insurers could collectively be liable for almost $925 million in death claims. If 100,000, 500,000, or one million people were to perish, potential claims would increase to $4.6 billion, $23.1 billion and $46.2 billion, respectively.

While these death totals and claims amounts may sound dramatic, they are not inconceivable, especially if a nuclear, biological, chemical or radiological (NBCR) attack were to strike in a densely populated area (e.g., New York City, Washington, D.C, Chicago, San Francisco). The amount of loss that a particular group insurer would incur would depend on several factors, including the amount of catastrophic reinsurance it has (if any) and the amount of available surplus that can be used to pay off its claims.

Insurers Limited Capacity to Cover Catastrophic Losses

Life insurers are required to put aside reserves and maintain surplus accounts for expected and unexpected death claims. For deaths that fall within a company's expected mortality rates, claims are paid from allocated reserves and pooled mortality charges. For deaths that exceed its expected mortality rates (such as those resulting from a major terrorist attack), payments come from allocated reserves and its surplus accounts.

However, only a portion of a company's surplus is generally available for unexpected claims (approximately 40-50%), and this amount may not be enough to meet its financial obligations. If surplus funds are insufficient and a company becomes insolvent, state guaranty associations would have to step in to provide a mechanism for outstanding claims to be paid to beneficiaries (up to certain statutory limits). In order to obtain the necessary funds to pay off these claims, these associations would then assess the remaining healthy insurers according to certain formulas (e.g., premium volume). Most states have separate guaranty associations for P&C and life/health insurance companies.

Therefore, while the life insurance industry as a whole would be able to absorb tens of billions of dollars in death claims resulting from a catastrophic attack(s), those small to medium-sized insurers, and possibly some large-sized insurers, that receive an unexpectedly high number of claims (especially those whose main line of business is group life) would be forced into insolvency.

It is worth mentioning that some life insurers that are not domiciled in New York State have created separate subsidiaries in New York. These subsidiaries have less overall surplus funds from which they can draw upon to pay unexpected claims. This, in turn, increases the risk of insolvency for these New York companies, as well as the non-payment of claims to those beneficiaries that reside in New York.

Group Life Insurers' Vulnerability to Large-Scale Attacks

In addition to concentration risk, there are several other reasons why group insurers are highly vulnerable to major terrorist attacks and reinsurers do not like the group life risk. First, group policies are not currently designed or priced to account for the immediate or short-term deaths of hundreds of thousands or more people from a terrorist attack.

Unlike deaths from accidents, diseases, murders and natural disasters, which have been tabulated and analyzed over dozens of years and incorporated into mortality and morbidity tables (which helps determine pricing of policies), there is insufficient historical data in this country for deaths from terrorism that can be factored into such tables. Furthermore, terrorism is, by its nature, unpredictable, so it cannot be accurately forecasted or priced. However, group insurers are compelled to include group life policies in its benefit packages at low cost for competitive reasons. Bids on employer benefit packages can be won or lost on just a few pennies per employee covered.

Second, since 9/11, group life insurers have generally been unable to obtain catastrophic reinsurance for terrorism risks, especially for NBCR events. To the extent such reinsurance is available, it is limited in coverage and very expensive. Reinsurance is a fundamental risk spreading mechanism underpinning the insurance industry. Without adequate catastrophic reinsurance, many group life insurers risk financial ruin if a significant terrorist attack(s) were to occur in the U.S.

In addition, Assurant, as well as the ACLI, are not aware of the use of terrorism exclusions (including those for NBCR events) by life insurers in either individual or group policies. We are also unaware of any states that allow such exclusions (except for KS and NC under very limited circumstances). Furthermore, even if an insurer does business in a state(s) that allows for terrorism exclusions, it is very likely that it would not include them in its policies or deny terrorism-related claims (if such exclusions are included in its policies) for business and public policy reasons.

Group Life Should be Part of a Long-Term Public/Private Solution

Since group life insurance is an important benefit for many Americans, it needs to be part of a viable and financially sound long-term solution that makes terrorism insurance (including catastrophic reinsurance) available and affordable. Until then, insurers, policyholders and beneficiaries will remain vulnerable to a major terrorist attack.

Our industry is currently reviewing the terrorism reinsurance pooling mechanism (which is based on the United Kingdom's Pool Re program) that was recently developed by the Real Estate Roundtable. We are also open to other ideas or proposals that would help make terrorism insurance more readily available within the P&C and life insurance industries.

Group Life Should Also Be Included in any TRIA Extension

The initial TRIA bill that was signed into law in November, 2002 gave Treasury the authority to include group life in the program if catastrophic reinsurance and group life insurance "is not or will not be reasonably available to both insurers and consumers." While Treasury agreed that there was a general lack of catastrophic reinsurance, it decided not to extend group life to TRIA since it found "no appreciable reduction in the availability of group life insurance coverage for consumers." While group life has been readily available (for competitive reasons, as mentioned above), if a major terrorist attack were to occur, it is highly likely that some or many group insurers would be unable to fully pay their death claims. In addition, group life coverage would probably not be widely available after such an event since many providers would decide to exit the marketplace.

Group life insurance is also very similar to workers compensation – in that most workers across the country are covered by both. The latter was included in TRIA (and its extension) and, as a result, experienced an increase in the availability of related reinsurance. We are confident that catastrophic reinsurance would become more available and affordable for group life if it were added as a covered line in any TRIA extension. This additional reinsurance capacity would significantly reduce that risk of insolvency that many group insurers would surely face if a large-scale terrorist attack(s) were to occur.

Therefore, if TRIA is extended beyond December 31, 2007, we respectfully request that group life be included as it was in the House-passed extension bill (H.R. 4314), which included a mandatory recoupment provision.

Conclusion

We look forward to working with your Subcommittees, the Financial Services Committee and others in Congress, at Treasury and in the Administration. Thank you for allowing me the opportunity to express our views on this very important matter. I will be glad to answer any questions that you may have.

STATEMENT OF WARREN HECK
CHAIRMAN AND CEO

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

ON BEHALF OF
THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

AT THE HEARING ON

"PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK "

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES

AND

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

HOUSE FINANCIAL SERVICES COMMITTEE

SEPTEMBER 27, 2006

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Since 9/11 we have been working on improvements to our modeling technology in an attempt to quantify our terrorism exposures and reduce our concentrations in New York City. As previously mentioned, we have also geographically diversified our writings by expanding into suburban regions in other states. However, there is no guarantee that, for example, limiting one's exposure in New York City by underwriting risks in the U.S. heartland will succeed, as low-tech attacks such as those in Madrid and London could cause enormous economic harm if replicated in shopping malls in the South and Midwest. Even greater harm could be caused in these areas if terrorists attacked chemical plants or the food supply.

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

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

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

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

While the private market cannot cover events of such magnitude without either bankrupting insurers and reinsurers or wiping out so much insurer surplus that they could not meet their obligations on other lines of insurers, the private market does have the ability to cover lesser, clearly defined losses. TRIA and TRIEA were both reasonable attempts to limit the maximum exposure of insurers so that the private market can play a role in terrorism risk insurance. These statutes made a private/public bargain: Insurers would offer terrorism coverage in return for a guarantee from the federal government that it would pick up losses beyond the insurers' capacity. The purpose is to make sure that the economy can recover in as orderly a fashion as possible from the next terrorist event.

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

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

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

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

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

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

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

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

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

The NAMIC TRIA Task Force to which I referred earlier made an important observation concerning the effect of the current TRIEA program's escalating event trigger level on the ability of small and medium-sized insurers to participate in providing terrorism risk insurance. The Task Force concluded that for such companies, the event trigger is the key to their ability to continue to provide coverage. Too high a trigger would drive them from the market because reinsurance costs would be too high, making primary coverage unaffordable. As a medium-sized insurer in New York that covers some very large buildings, I can tell you that a trigger in excess of $50 million would severely limit GNY's ability to offer as much coverage as it now offers. I simply could not justify to policyholders or state regulators my company's decision to take such a large risk relative to the size of the company's surplus. Furthermore, my company would risk a downgrade in our financial strength rating by rating agencies under new requirements that insurers provide information about their exposure to terrorism risk including estimated potential insured losses resulting from simulated terrorism events.

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

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

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

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

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

ATTACHMENT

NAMIC STATEMENT OF PRINICPLES ON TERRORISM RISK INSURANCE

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

- o Initially it might cover losses of about $10 billion to determine how much private sector capacity can be developed from the capital markets.
- o U.S. companies eligible to access recoveries from this facility would fund the initial and ongoing capitalization through a policyholder surcharge.
- o The facility should be authorized to purchase reinsurance protection.
- o The facility would collect premiums and provide Industry Loss Warranty (ILW) reinsurance to insurers and reinsurers.

3. The third layer would be a private/public partnership that would provide a liquidity backstop in the wake of catastrophic terrorist events.
    - o Outlays would be recovered, in part, by a fixed annual policyholder surcharge.
    - o Aggregate annual financial protection would be provided for 90 percent of all eligible losses, losses beyond those covered by the first two tiers, up to $100 billion.

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

Testimony of

Edmund F. Kelly
Chairman, President and Chief Executive Officer
Liberty Mutual Group

U.S. House of Representatives
Committee on Financial Services

Joint Hearing

Subcommittee on Capital Markets, Insurance, and
Government Sponsored Enterprises
and
Subcommittee on Oversight and Investigations

"Protecting Americans from Catastrophic Terrorism Risk"

September 27, 2006

Liberty Mutual appreciates the opportunity to submit this testimony in support of a continuing public-private partnership to protect Americans from catastrophic terrorism risk. The Terrorism Risk Insurance Act of 2002 (TRIA) and its successor, the Terrorism Risk Insurance Extension Act of 2005 (TRIEA), were short-term legislative responses to a long-term challenge facing our nation. Following the House vote to accept the Senate's slimmed-down version of the TRIA extension, Chairman Oxley aptly noted, "What we did is simply kick the can down the road." TRIEA leaves unresolved the questions of whether and how private insurance markets can offer terrorism risk insurance beyond 2007.

For several reasons outlined below, a significant public-private partnership is essential for ensuring the availability of terrorism risk insurance.

1) A MISUNDERSTANDING OF AVAILABLE CAPITAL IN INSURANCE

Some have suggested that since capital within the insurance industry exceeds $600 billion, the industry has sufficient capacity to assume the risk of terrorism. These estimates, however, include capital in the life insurance industry, which is not available for the terrorism risk addressed by TRIA—as well as capital that underpins other business line risks. For example, at Liberty Mutual we have in excess of $10B in surplus, which supports all our policyholders including our homeowners exposed to hurricane risk, our automobile owners exposed to accidents, workers exposed to lost time and medical expense from workplace accidents, and others; our surplus is not just set aside to cover exposure to terrorist events.

Many terrorism loss scenarios are modeled at costs exceeding $100 billion and some very plausible events at $700 billion or more. Yet, the entire property and casualty insurance industry has only an estimated $150 billion of capital backing all risks—including fire, wind, accident or other insured perils— covered by TRIEA-backstopped policies.

There is the very real potential that terrorism-related losses would overwhelm the industry's ability to pay its customers' losses.

There are limited sources of new capital.

Sources of new capital are few and limited. Organic growth (operating income and investment returns) is slow, subject to taxation, and inadequate to the terrorism risk. Stock and debt issuance are limited by prudent financial management, investors, regulators and rating agencies. Reinsurance is an option but global capacity is very limited for terrorism risk (estimated $6-8 billion) and almost none exists for NBCR (nuclear, biological, chemical, and radiological risk).

2) TERRORISM INSURANCE IS NOT A FREE MARKET

Many people suggest government should get out of terrorism insurance completely. They say let the free market handle terrorism. At Liberty Mutual, we fully believe—in an ideal world—free markets are better. Wherever we operate, we push hard for free markets. But terrorism insurance is not a free market. In a free market, providers of products and services compete to sell those products and services. If the terms, conditions, or prices are inadequate, or if the risk of loss is too large, the provider has the option to withdraw. We cannot withdraw from terrorism insurance. In each and every state, as discussed further below, workers compensation must cover all loss from terrorism. If pricing is inadequate, or exposure too great, the only way to avoid the risk, is to completely withdraw from the workers compensation market.

Highly-Regulated Markets Present Distinct Challenges

Insurers operate in highly regulated environments. State insurance laws and regulations constrain capital and significantly limit the choices insurers can make to protect themselves from essentially unlimited terrorism exposure. Workers compensation is a particularly good example. Under state workers compensation laws, employers must purchase coverage to protect their employees. Insurers that provide this critically important insurance are required to do so without exclusions or limits of any kind. Thus the potential for large losses from terrorism, even for a single employer can be very great. For example, the value of survivor's benefits for a 42-year-old spouse with two children is about $4 million in Massachusetts. A terrorist attack resulting in 1,000 deaths at a Liberty Mutual insured workplace in Massachusetts would cost us $4 billion – or nearly half of our surplus. As we learned on September 11th, 1,000 deaths from a single terrorist attack is a very real risk.

Regulatory requirements on commercial property insurance further accentuate the challenge. Insurers face mandatory "fire following" coverage in standard fire policies in certain major market states including California, Illinois, and New York. Therefore, terrorism risk cannot be effectively excluded. Beyond commercial property, insurers are constrained by rate and form regulation in all lines of insurance. For example, Florida, Georgia, and New York do permit terrorism exclusions only with TRIEA and its mandatory "make available" requirement. Absent TRIEA, the industry would have to provide the coverage in all cases or withdraw from the market.

Finally, insurers are required to participate in funding residual market coverage for those who cannot obtain insurance in the voluntary market. And, insurers must pay assessments so that guaranty funds in each state can pay the claims of customers of insolvent insurers. Thus, whether or not we reduce our exposure to terrorism risk, Liberty Mutual remains exposed to the losses and underwriting judgment of others.

These regulatory constraints restrict the industry's ability to manage its exposure to unpredictable and large-scale terrorism risk.

3) EVERY COMPANY HAS A FIDUCIARY OBLIGATION TO PROTECT ITS CAPITAL

There is a limited amount of capital any company could make available to underwrite terrorism risk. While each company has its own risk parameters, its own risk appetite, its own return objectives, its own view of the risk, and how to allocate capital to various risks—in the end, every company has a limited amount of capital to make available to underwrite terrorism; to expose more than that to the risk would be a breach of fiduciary responsibility.

The Only Alternative to Additional Capital is to Reduce Exposure to Terrorism Risk

In the absence of TRIEA or a similar public-private partnership, insurers would be unable to add sufficient capacity from private sector sources; therefore, we would have to significantly reduce exposure to terrorism risk. First, we could try to reduce exposure by using coverage exclusions or limits. But, as discussed, those tools are not available anywhere in workers compensation or for property insurance in certain standard fire policy states. Second, we could manage risk concentrations to ensure against over-exposure to terrorism risk in certain customer locations and geographic areas. To do so, we utilize geo-coding and other data on the number of policies, employees, and property values in specific locations. To keep concentrations low, we would shed risk by ceasing to write certain risks in certain areas or by not renewing existing coverages. These choices, while not made easily, would be necessary in the absence of TRIEA. These choices would also have a hugely negative effect on the economy as businesses would be unable to get insurance coverage.

4) TRIA PROTECTS AGAINST FINANCIAL RUIN, NOT AGAINST SIGNIFICANT FINANCIAL DAMAGE

Since company deductibles are so large, TRIEA would reimburse the industry only if a truly significant event occurred. At Liberty Mutual for example, our TRIEA deductible is approximately $1.5 billion. A backstop that protects us from a loss exceeding $1.5 Billion is hardly a handout —especially considering we're offering coverage we would otherwise not offer, or would offer on significantly different terms.

So the challenge moving forward is to create a mechanism that achieves two goals: First, to make certain needed insurance is available for economic growth by creating a structure in which insurance companies can write the coverages businesses need to manage their risk without exposing themselves to financial ruin. And second, we need a vehicle that encourages the private market to develop financial responses to terrorism.

AMERICA NEEDS AN IMPROVED, LONG-TERM TERRORISM RISK INSURANCE PROGRAM

Liberty Mutual believes the industry needs a better terrorism risk insurance program to promote the stability of insurance and financial markets for the long-term; a program that will maximize private market capacity by facilitating new capital and encouraging government to do only what private markets cannot.

What we cannot do: NBCR Risk is Uninsurable and Requires Separate Treatment

Terrorist attacks using weapons of mass destruction – so-called NBCR (nuclear, biological, chemical, and radiological) risk – present unique and daunting challenges for our industry and our country. The potential human and economic consequences of an NBCR event are frightening. According to modeling by the American Academy of Actuaries, a single large-scale NBCR attack has the potential to cause insured losses of $700 billion or more depending on weapon type and location. A medium scale NBCR attack in a major U.S. city could result in insured losses in excess of $100 billion. Beyond the costs of compensation, NBCR attacks would disrupt the economy and shut off sources of insurance industry capital to pay current and future claims – both related to the terrorist event and the ongoing claims. Moreover, losses from NBCR attacks could take years to quantify. Unlike damages from conventional attacks, NBCR damages will take much longer to determine given the latent nature of potential injuries. Also, the public's reaction to such an event can bring additional, yet unforeseen economic and emotional damages. Such extreme and long-term uncertainty means the insurance industry cannot assume the risk.

Given the unique properties of NBCR risk, insurers and reinsurers excluded such risk from their contracts long before September 11th. The major exceptions are workers compensation and, in some states, property insurance where exclusions by primary insurers are not permitted – although reinsurers routinely exclude all NBCR. NBCR risk remains outside the capability and capacity of the insurance industry. NBCR risk must receive separate treatment, distinct from the risk of conventional terrorism, in any legislative successor to TRIEA.

What we can do: In January 2006, the Property and Casualty CEO Roundtable (a non-advocacy group of more than a dozen large company CEOs currently chaired by Ted Kelly, Liberty Mutual CEO) initiated a process to design a program for long-term federal terrorism risk insurance. Through the process, the insurance industry has achieved significant consensus around a framework for long-term federal terrorism risk insurance. This framework will serve as a guide for the industry as further policy details are developed.

The framework envisions a two-part structure for financing both NBCR and non-NBCR (conventional) terrorism risk:

- NBCR
  - The federal government would assume NBCR risk on a reinsurance basis for losses covered by insurers (e.g., workers compensation).
  - The federal government would assume NBCR risk on a "follow-form" basis (subject to terms and conditions of the policy) for losses that would be covered but for NBCR exclusions (e.g., property insurance).
- Non-NBCR
  - A TRIEA-like structure would be maintained for non-NBCR losses. Insurer deductibles would gradually increase (e.g., one additional point per year for ten years) or adjust subject to Treasury determination of available capacity.
  - Legislation would facilitate creation of federally chartered entity to provide additional private insurance capacity and the sale of industry loss warranty (ILW) contracts to help fund the insurance residual exposure.

Covered lines – same as TRIEA

We believe this two-part program will effectively address the NBCR risk that is today uninsurable in the private sector. The program effectively backstops industry capacity for large non-NBCR terrorism events and encourages the development of new private sector financial mechanisms to manage the risk, so reducing the role of government over time. This approach forces the industry to work with its customers to better protect against terrorism risk. With such a plan in place, real estate can be developed, people can be employed, and buildings can be constructed; all, despite exposure to significant loss from terrorism. And, since individual insurers continue to face the potential of major loss, we will all work with the capital markets to develop creative solutions.

Liberty Mutual and others in the insurance industry are working to flesh-out the details of this framework. We are committed to working with this Committee and others in our industry and in the policyholder community to establish a public/private partnership that makes terrorism insurance coverage available for the long-term.

SILVERSTEIN PROPERTIES

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Submitted via electronic mail to fsctestimony@mail.house.gov

Statement of Jonathan W. Knipe
before a Joint Hearing of
the Financial Services Committee's
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
and the Subcommittee on Oversight and Investigations

September 27, 2006

Introduction:

My name is Jonathan Knipe. I am General Counsel and Director of Business Affairs for World Trade Center Properties LLC, an affiliate of Silverstein Properties. Chairwoman Kelly and Chairman Baker -- thank you for holding this joint hearing today. I'd also like to thank the distinguished Members from New York for your continued hard work and support over the last several years as we have dealt with the various terrorism insurance concerns.

Background:

As most of you know, our companies leased the commercial office portions of the World Trade Center site from the Port Authority of New York and New Jersey just six weeks prior to September 11, 2001. Since that terrible day, our entire effort has been focused on rebuilding what was lost.

SILVERSTEIN PROPERTIES

Last Thursday, September 21st, marked an extremely gratifying and long overdue milestone for those of us involved in the redevelopment of the World Trade Center. The business deal between Silverstein Properties and the Port Authority of New York and New Jersey was formally agreed upon and approved -- this means that the entire World Trade Center site -- with four exceptional skyscrapers designed by four of the most talented and renowned architects in the world -- should be rebuilt by 2012. These office towers will be a magnificent addition to the rebirth of Lower Manhattan -- creating vibrant retail and office space -- and joining the Santiago Calatrava-designed PATH Transportation Hub to make Lower Manhattan one of the more exceptional destinations in the world. The new skyline that will be created will be worthy of a new 21st century downtown, restoring New York City's historic birthplace. That, and the World Trade Center Memorial, will honor the memory of the heroes of the attacks of 9/11.

The redevelopment of the site will also have a substantial positive impact on the New York area economy. According to a report of the Lower Manhattan Development Corporation, "the rebuilding of the World Trade Center will generate $15 billion in total economic output in New York City and an average of 8,000 jobs each year throughout the redevelopment process."

Now that Silverstein Properties and the Port Authority have designed the buildings and resolved our business issues -- and have the support of the City of New York, State of New York and State of New Jersey – we need to face our other remaining challenges. Along those lines, the timing of this testimony is ideal because we face no single greater obstacle to our redevelopment efforts than the current lack of terrorism insurance capacity.

We are scheduled to begin construction on the three office buildings to be owned by our companies on January 1, 2008. As you all know, the extension to TRIA expires on December 31, 2007.

Capacity:

I am not an insurance expert, nor are most real estate developers. However, we have instructed our consultants and brokers to scour the markets and determine how we can secure adequate terrorism insurance for our buildings. The most recent information we have been given paints a very bleak picture. Even with the current TRIA extension in place, if we had to go out and buy a builders risk policy today, we are told that there is less than $500 million dollars worth of coverage available in the entire Lower Manhattan market – period. Our consultants have also informed us that they see no viable alternative beyond the traditional private market place – and that without some sort of permanent, workable governmental backstop in place – there will essentially be zero terrorism insurance capacity in downtown New York City at the end of 2007.

SILVERSTEIN PROPERTIES

As you can imagine, this reality was staggering to us. Even more shocking to us was that our professionals told us that that there is currently no identifiable insurance, reinsurance or capital markets solution that could finance the potential losses in the absence of a national framework.

Conclusion:

Unfortunately, we cannot finance office buildings that cost billions of dollars without adequate terrorism insurance coverage. While a substantial portion of the $8 billion needed to rebuild the WTC will come from insurance proceeds, we will also need to obtain billions of dollars worth of financing in the form of Liberty Bonds. To obtain this financing, our lenders will require terrorism insurance.

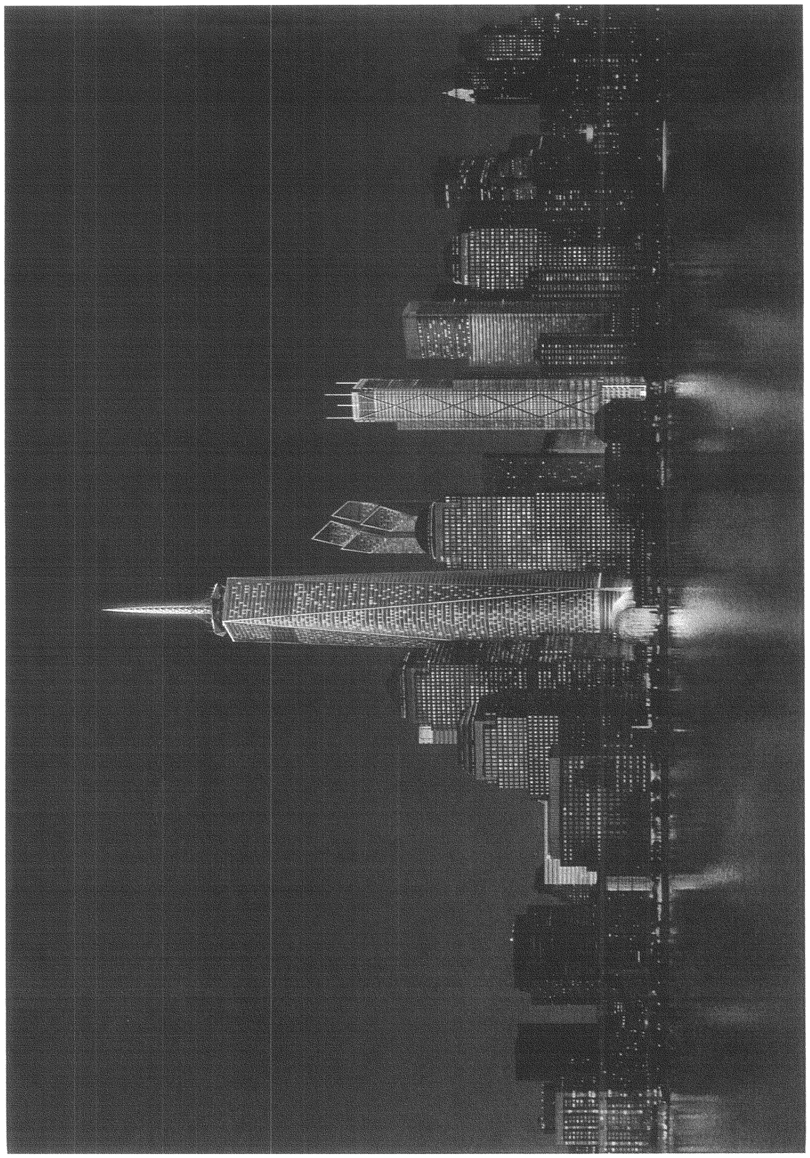
According to our insurance professionals, it would not currently be possible, even with the TRIA extension in place -- to adequately insure even one of the four office buildings that will be constructed on the World Trade Center site. Unfortunately, this doesn't take into consideration that several other office buildings will be constructed nearby, lessening capacity even further. In order to assure that commercial development thrives in Lower Manhattan and, indeed, in all major urban centers, it is critical that the Government continue to work closely with the private sector and develop a permanent, workable solution.

Otherwise, without such a permanent, workable solution -- and despite all of our collective hard work -- the redevelopment of the World Trade Center site will come to a grinding halt.

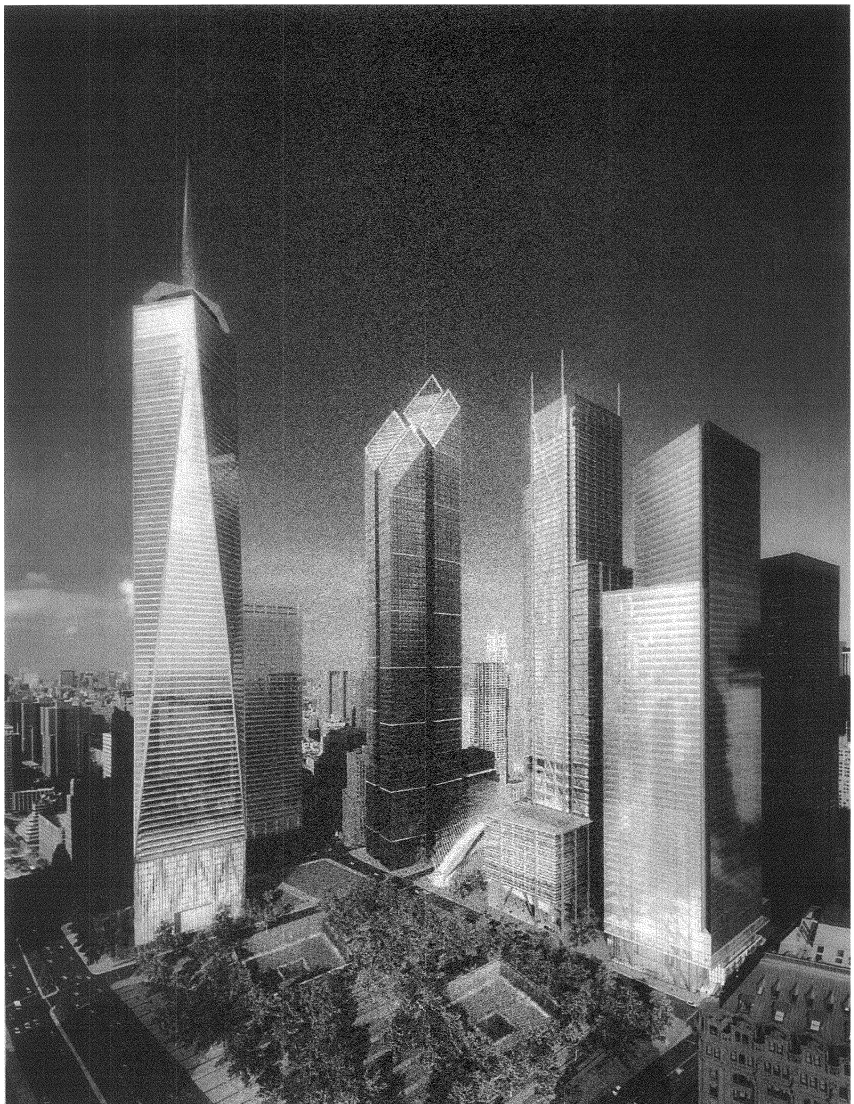
Thank you again for allowing us to participate today.

[See attached photos depicting the future of Downtown New York City]

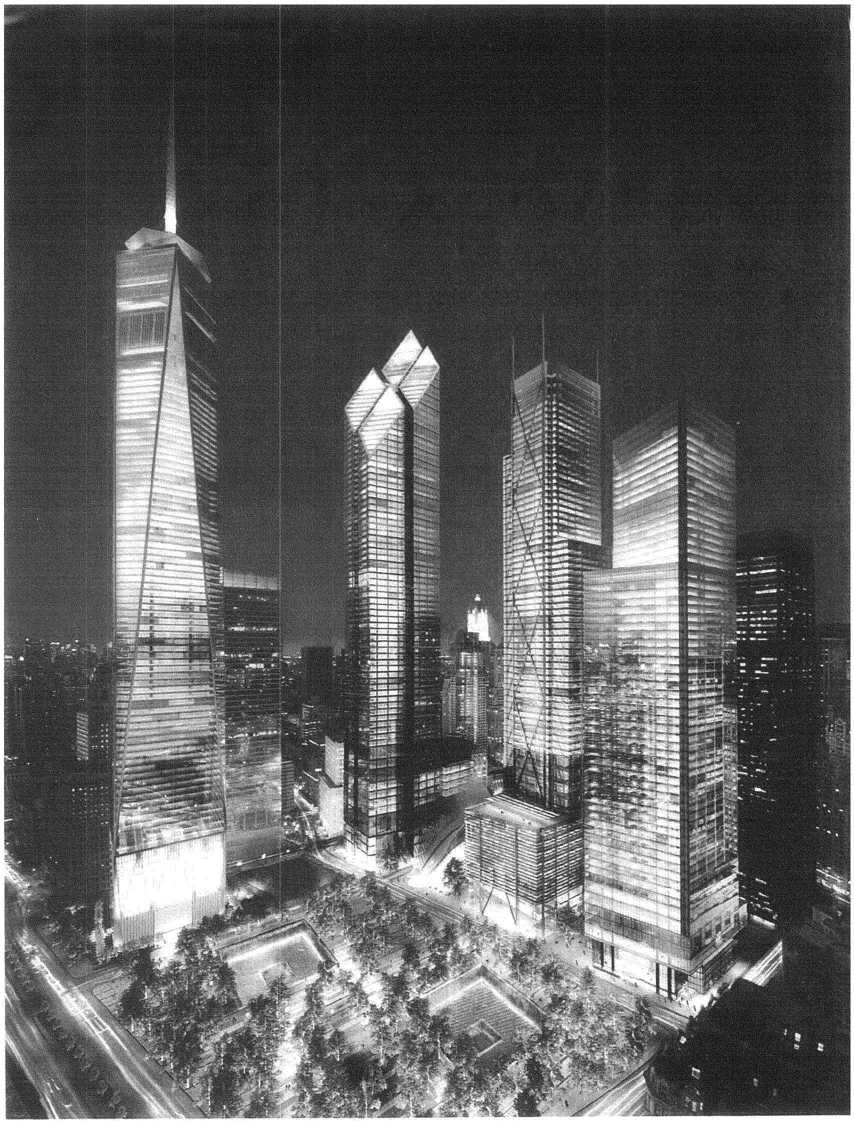
The Future Skyline of Downtown New York



Night View of Downtown Skyline



Day View of the World Trade Center



Night View of the World Trade Center

STATEMENT OF CHRISTOPHER NASSETTA
CEO, HOST HOTELS AND RESORTS, INC.
ON BEHALF OF
THE COALITION TO INSURE AGAINST TERRORISM

BEFORE A JOINT HEARING OF

THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES
AND
THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
OF
THE HOUSE COMMITTEE ON FINANCIAL SERVICES

REGARDING

PROTECTING AMERICANS FROM CATASTROPHIC TERRORISM RISK

September 27, 2006

Good morning Chairman Baker, Chairwoman Kelly, Ranking Members Kanjorski and Gutierrez, and members of both subcommittees. I applaud you for holding this important hearing on the terrorism insurance market. My name is Christopher Nassetta, and I am the CEO of Host Hotels and Resorts, Inc., a publicly traded real estate investment trust. Host owns or has controlling interest in 129 luxury and upscale hotel properties in 28 States and the District of Columbia. I am also the Chairman of The Real Estate Roundtable and the Vice Chairman of the National Association of Real Estate Investment Trusts, but am appearing today on behalf of the Coalition to Insure Against Terrorism (CIAT).

CIAT is a broad coalition of insurance consumers that was formed in the months following 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. As part of its effort, CIAT joined with the Administration and those in Congress who recognized that only the Federal government could provide the framework to make this coverage available to all those who required it. The diverse CIAT membership represents a broad range of businesses and organizations from virtually every sector of the U.S. economy: hotels, banking, energy, construction, entertainment, real estate, stadium owners, manufacturing, transportation, as well as public sector buyers of insurance. For example, the U.S. Chamber of Commerce, the National Association of Manufacturers, and the National Retail Federation are members. So are, to name a few sectors, transportation interests (e.g., the Association of American Railroads, the General Aviation Manufacturers Association, and the Taxicab, Limousine and Paratransit Association), utilities (e.g., American Gas Association, American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association), finance (e.g., American Bankers Association, America's Community Bankers, Mortgage Bankers Association of America), real estate (American Resort Development Association, National Association of REALTORS, Building Owners and Manufacturers International, International Council of Shopping Centers, and National Association of Industrial and Office Properties) and sports (e.g., the Baseball Commissioner, NCAA, NBA, NFL, and NHL).

Simply put, CIAT is the true consumer voice with respect to the subject of terrorism risk insurance. Collectively, the businesses and governmental organizations that form our coalition are the principal consumers of commercial property and casualty insurance in the United States. It is from this perspective that we offer our testimony today.

I am grateful to your subcommittees for holding this important joint hearing today, and for your invitation to testify. I would like to leave you today with three main points: first, that the key market conditions that necessitated TRIA's enactment have not changed; second, that, as proven in fourteen other industrial nations, there is a need for a long-term public-private partnership with a role for the federal government; and third, that we stand ready to assist your subcommittees and Congress in general in finding the proper long-term partnership.

TRIA and the Terrorism Insurance Marketplace

Prior to 9/11, insurers implicitly included terrorism coverage in all policies because the risks of loss from terrorist acts were perceived as minimal. It is important to note that on 9/11, everyone who had insurance had coverage for terrorism. I should point out that my company owned the World Trade Center Marriott which was destroyed by the collapses of the World

Trade Center towers; we lost not only property but valued personnel. In the aftermath of that terrible day, insurers and reinsurers had to reassess this threat substantially. Reinsurers, in particular, found that they could not quantify the risks posed by terrorism and effectively withdrew from the market. Primary insurers, consequently, were unable to effectively manage their exposure to terrorism risk since they were mostly unable to obtain reinsurance. Thus, when permitted by law, these primary insurers withdrew from the market as well – mostly by writing terrorism exclusions into their policies.

The tremendous economic impact of this market condition must not be forgotten. A Real Estate Roundtable study of the 14-month post-9/11, pre-TRIA period revealed that more that $15 billion in real estate related transactions were either stalled or cancelled because of a lack of terrorism insurance. The White House Council of Economic Advisors indicated that approximately 300,000 jobs were lost during that period. Fortunately, Congress and the President recognized the problem and joined together to enact TRIA in November 2002.

One of the purposes of this legislation was to ensure that the economy was strong enough to withstand a future attack. While there is no question that the economy has rebounded since 9/11, that purpose remains as important today as it was in November 2002. Simply put, the government has a responsibility to ensure that terrorism insurance will remain available: it is an essential part of our economic response to the threat of terrorism. It should be regarded as an integral part of our nation's Homeland Security strategy.

As much as TRIA has helped the insurance market – and the economy in general – there are a number of facts surrounding today's insurance market that have not changed since the statute's enactment in 2002.

First, and most unfortunately, the threat of terrorism remains. Terrorists continue to attempt acts against our governmental polices and our way of life. Where, how, and when they will strike continues to be an evolving picture. Quite simply, the threat of terrorism is an unpredictable, man-made risk. Not surprisingly, therefore, insurers and reinsurers have an extremely difficult time assessing and pricing terrorism risk insurance. This will, unfortunately, be the case until we see clear evidence that the overall threat to our society has subsided.

It is a simple, indisputable fact that markets like certainty. Unfortunately, there is almost nothing that can be considered "certain" about terrorism risks. This is why rating agencies such as Moodys and Fitch conclude that there will be numerous market repercussions if the federal backstop expires. Nowhere is this more evident than the commercial real estate market. For example, commercial mortgage backed security (CMBS) borrowers face the threat of default and potential bond downgrades in the absence of terrorism insurance coverage. In fact, based on its review of the coverage in place and the ongoing loan requirements for coverage, Fitch has declined to rate certain transactions.

Second, the reinsurance market currently only provides a fraction of the capacity needed to protect the U.S. economy from catastrophic terrorism losses. About two-thirds of the roughly $33 billion in 9/11 related claims paid were borne by reinsurers. After 9/11, reinsurers concluded that they could no longer quantify the tremendous risks of loss posed by the terrorism threat, and they effectively withdrew from the market. Today, the reinsurance industry estimates that there is only about $6 to $8 billion in global terrorism reinsurance capacity available – and only $1 to $2 billion in capacity available for nuclear, biological, chemical and radiological (NBCR) coverage. Meanwhile, it is estimated that potential terrorism losses could top $100 billion and that losses from a large NBCR event in New York City alone could reach $778 billion. Current capacity is nowhere near the level needed to provide protection to our economy without the TRIA backstop. Furthermore, even with the TRIA backstop, reinsurers are not meeting the capacity demand of primary insurers for their deductible and coinsurance layers. This suggests that private reinsurers simply want very little exposure to terrorism risk, and refutes the notion that the federal backstop is crowding out the private market.

Third, primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses without adequate reinsurance availability or a federal backstop. We saw this quite clearly last year when policies were written to include "springing exclusions" that would have voided terrorism coverage beginning January 1, 2006, had TRIEA not been enacted.

According to a Moody's report, 50-75% of all policies written prior to TRIEA's enactment included such exclusions. As the expiration of TRIEA next year draws near, we are beginning to see this phenomenon again. Many policyholders now shopping for policies with terms that run past year-end 2007 are again being asked to accept springing exclusions. This does not bode well for terrorism insurance availability in the absence of federal involvement. To put it bluntly: we saw the effect this had on the economy in the post 9/11, pre-TRIA period, and I certainly hope we are not doomed to repeat that history.

Fourth, even though TRIA covers NBCR perils, we have not seen any evidence that such coverage is being written except where mandated for workers compensation. Although industries and policymakers are concerned with these exposures, NBCR coverage was not included in TRIA's "make available" requirement, and unfortunately the private markets have thus far failed in this area. I am aware of no evidence to suggest this trend will change – particularly if federal involvement were to cease.

We applaud Financial Services Committee Chairman Oxley for requesting that GAO study the extent to which NBCR risks are measurable and insurable. As GAO notes, "insurability occurs along a continuum" and the fact that some NBCR coverage is available in some lines is no reason to believe that general availability will develop across most lines or most areas. The potential magnitude of catastrophic losses, the lack of knowledge about long-term consequences, and the United States' lack of historical experience with NBCR attacks makes insuring NBCR risks "distinctly different from insuring other risks." Indeed, "given the challenges faced by insurers in providing coverage for, and pricing NBCR risks, any purely market-driven expansion of coverage is highly unlikely in the foreseeable future."

A Long-Term Public/Private Partnership Is the Right Solution

The evidence is clear: simply allowing the federal backstop to expire will have dire economic consequences of the nature seen in the post-9/11, pre-TRIA period. It is imperative that lawmakers, insurers, policyholders and all other stakeholders come together to work on a long-term solution to the availability problem. For this reason, we applaud these subcommittees for holding today's important hearing and urge you to continue your examination as TRIEA's expiration draws nearer.

CIAT is aware of several proposals circulating for a long-term solution, and we are studying them with interest. The Real Estate Roundtable has developed an interesting proposal that would create a new mutual reinsurer to go between primary insurers and the federal government. Over time, the federal backstop would shift from the primary insurers to the mutual, and would only be activated if the terrorism losses exceeded a certain level.

Meanwhile, the American Insurance Association has come up with a set of principles that differentiates between NBCR terrorist attacks and "conventional" terrorism. Under this proposal, a long-term TRIA-like backstop would be in place for conventional terrorism, while the federal government would assume financial responsibility for all NBCR attacks – with the ability to recoup up to $10 billion through a policyholder assessment.

At present, CIAT has not endorsed any specific proposal. However, what we like about them is that they involve a public-private partnership that recognizes the federal government's responsibility to assist markets to function appropriately and to retain a federal backstop for only the most catastrophic losses that the insurance industry and the economy simply cannot absorb. Terrorism is not aimed at a specific business or property owner; it is aimed at our governmental policies and our way of life. Government assistance to help the market function appropriately must continue to be part of our economic response to the threat of terrorism. Contrary to what some would like to think is true, TRIEA is not crowding out the development of private terrorism insurance markets.

Another key element of these proposals is that they are long-term solutions. While the political realities of the day necessitated that TRIA be a temporary program, our experience sincc then has shown that this market is simply not going to fully resume as long as the threat of terrorism persists. And it does the market no good to have the threat of a backstop expiration hanging over our heads every few years. A long-term solution will give all market participants an element of what we crave the most: certainty.

Conclusion

Again, CIAT is not yet wedded to any one proposal for a long-term solution. Rather, we applaud them all for advancing the national dialogue on the issue, and they all deserve serious consideration. Going forward, we are committed to working with Congress, insurers, policyholders and other stakeholders on crafting a long-term solution that includes a role for the federal government.

Once again, we applaud the chairs and ranking members of these subcommittees for holding this important hearing today.

Protecting Americans from Catastrophic Terrorism Risk

September 27, 2006
Statement of Ira Shapiro to the House Financial Services Committee, Capital Markets, Insurance & Government Sponsored Enterprises Subcommittee and Oversight and Investigations Subcommittee

Thank you for convening this important hearing.

I am the CEO of Fisher Harris Shapiro, a risk management and insurance consulting firm specializing in the real estate business. I am here today on behalf of the Real Estate Board of New York, New York's leading association representing owners and builders of high rise offices and apartment buildings. Our firm currently serves over thirty major real estate portfolios and large construction projects, most of which are New York City based clients. The total insured values of the portfolios that we manage are approximately $45 billion, including 900 million square feet of commercial property and 71 thousand residential units.

The present state of the real estate property insurance marketplace in New York City is deteriorating almost on a daily basis, even with TRIA (TREIA) still in effect through 12/31/07. This year is the most difficult year I have seen, including the months immediately following 9/11, to place insurance on large portfolios. I expect that renewing or placing large portfolios in the New Year will mean serious problems in terms of coverage, capacity, availability and cost increases.

While New York City and other urban centers face serious concentration of risk issues, the problem is national in scope. Today, virtually all mortgages are securitized, and these securities are held by pension funds, mutual funds and individuals. Without TRIA, these commercial mortgage-backed securities (CMBS) are in danger of the underlying mortgages being in default, or the bonds being downgraded. This would impact millions of Americans.

The question is why is there such a problem in obtaining terrorism coverage in 2006 with TRIA (TRIEA) still in effect? The following is a summary of the issues that have impacted terrorism coverage in 2006:

- TRIA initially presented a reasonable program that was satisfactory to insurers and policyholders and it brought stability to the economy and the marketplace. Under TRIEA, the damage threshold under which the federal backstop kicks in was raised to $50M from $5M. Insurance industry modeling of the extent of damages resulting from terrorist attacks in various sized cities showed considerable damage, but 90% of the time below the TRIEA threshold. [1] TRIEA would not cover any of the damages from a nuclear, biological, chemical of radiological attack.

[1] American Academy of Actuaries, 3/31/06 and 4/27/06

- Insurers must retain 17.5% of their premiums written in 2006 and 20% in 2007. This is a huge number.

- Insurers have to share 10% in 2006 (15% in 2007) of any losses loaned by the Federal Government.

The combination of these three factors has caused insurers to back out of the marketplace or significantly limit their participation based on limits and location.

One of the most critical problems is the lack of builders risk insurance, which are multi-year policies for large construction projects. For example, one of our clients has been told that insurers would provide capacity for "all risk" coverage only if the developer would agree in advance to reject TRIA, forcing him to purchase the very minimal amount of stand-alone coverage that he was able to obtain. It was the lack of availability of terrorism coverage for builders risk policies that caused several large construction projects to nearly come to a halt immediately after 9/11. The stand-alone market for terrorism provides very limited coverage today.[2]

Both buyers and lenders, especially for securitized loans, require substantial ratings of their insurers. The rating agencies, having modeled various terrorist attack scenarios, are advising insurers that if their writings exceed the threshold models, they could be subject to lower ratings.[3] Insurers are very protective of their ratings since it is their bread and butter.

For example, one of the major insurers in New York City which used to provide terrorism coverage is terminating most of their relationships due to the fear of a ratings downgrade. Their participation is now extremely limited in capacity, and they are either refusing to renew policies or lowering their capacity from as much as $200M to no more than $25M and then only in selected areas. One client recently purchased insurance at a 70% increase in premiums with coverage that was severely inadequate for its needs. Another major insurer was also a participant in terrorism but has been told by the rating agencies to stop writing terrorism coverage for the balance of this year.

The very few insurers that are still providing insurance with terrorism coverage are lowering their capacity or dropping out because of concentration of risk or aggregation issues. With each policy that is written, coverage is restricted for the next buyer. For example, one of our clients had $815M of limits in the fall of 2005 with full terrorism coverage. The lender for the largest building of that portfolio decided to model the exposure because of other buildings within a few blocks of the building, causing the borrower to increase the limits to $950M. Additional insurance was effected April 2006. Now, upon the 2006 renewal $1.1B is required by the lender, which we are having great difficulty getting. Even achieving $950M is a problem. We may only be able to get as

[2] Best Wire Services, 06/02/06 - Attached
[3] S&P Alter Approach to Gauging Insurers' Terrorism Exposure, 06/8/06 - Attached

much as $650M of terrorism, and might have to resort to the stand-alone policies which provide inadequate protection.

Another client renewed in July of this year. In 2004 we had terrorism limits of $1B, but in 2005 we were only able to obtain $850M. This year we were only able to secure $835M. Progressively (no change in the portfolio), the capacity is dropping.

Reinsures are not subject to TRIA and capacity in the reinsurance market is severely limited. This has caused insurers to lower their capacity as they lack the ability to lay off a portion of the risk.

By the end of this year, policyholders will encounter sunset clauses, as was the case in 2005. With fewer insurers providing lower insurance limits, combined with the inability to provide 12 month policies because of the sunset date, the situation is far grimmer even than last year.

TRIA does not cover CNBR (chemical, nuclear, biological, and radiological) except in very limited ways. There is extremely limited reinsurance available for CNBR, estimated at $1-2B – a fraction of what is needed. [4]

After 9/11 and before TRIA (11/26/02), there were major dislocations but the overall impacts were softened by several factors. 1) Many reinsurance treaties did not expire until 4/30/02 or 7/31/02. There were, therefore, only a few months between the treaty expirations and the enactment of TRIA. 2) We did not have the same capacity and aggregation issues before 9/11 that we face today. Unfortunately, there are only a few insurers today writing many buildings. Before 9/11 there were numerous insurers, which spread the risk. 3) Policies that were written in the latter part of 2001 still had their policies in effect for 12 months (with terrorism). Therefore, there were a limited number of buyers with serious problems before TRIA was in effect. 4) The ratings agencies weren't dictating to the insurers what they could write and what they could not. For these reasons, renewals at the end of this year and the beginning of next will be far more difficult that ever before.

Clearly, a long-term permanent solution is needed, and any workable solution will require government involvement. The insurance industry cannot predict terrorism losses, nor can it survive a significant event without a meaningful backstop. The European model of pooling risk is an alternative; the concept of a voluntary mutual reinsurance entity capitalized by insurer premiums is certainly worth exploring. Either model would provide a mechanism and an incentive for the development of a private capital pool. Gradually some of the federal backstop could be replaced by this layer of private capital. However, some sort of federal backstop is essential to maintain our economy on an even keel and to insure against the risk of terrorism. Private markets alone won't and can't do it.

Thank you for the opportunity to testify.

[4] Big "I" Asks Policy Makers to Look Ahead on Terrorism Risk, dated 04/21/06 - Attached

PR Newswire

United Business Media

Actuaries Disclose Potential Terrorism Costs

WASHINGTON, March 31 /PRNewswire/ -- The American Academy of Actuaries disclosed on Wednesday that a future large terrorist attack in New York City could result in $778 billion in insured losses. Speaking at the National Association of Insurance Commissioners (NAIC) public hearing on "Terrorism Insurance Matters," Michael McCarter, chairperson of the Academy Terrorism Risk Insurance Subgroup, provided potential property and casualty, and group life insurance losses as a result of various types of terrorist attacks. His group estimated potential insured losses from a conventional truck bomb terrorist attack, as well as medium and large chemical, nuclear, biological or radiological (CNBR) events caused by terrorism.

"The largest CNBR event we modeled caused $696 billion in property and casualty losses and $82 billion in group life insurance losses," said McCarter, whose subgroup used catastrophe risk models by AIR Worldwide to generate insurance cost figures. The subgroup was created by the Academy after receiving requests from Congress for actuarial analyses as it considered the reauthorization of the Terrorism Risk Insurance Act of 2002 (TRIA) last year.

According to the models, a truck bomb attack in New York City could cost $11.8 billion and a medium CNBR terrorist attack could cost $446.5 billion. Models for three additional U.S. cities also were generated. In Washington, D.C., a truck bomb attack could cost $5.5 billion, a medium CNBR event could cost $106.2 billion and a large CNBR could cost $196.8 billion. In San Francisco the costs for those events were estimated to be $8.8 billion, $92.2 billion, and $171.2 billion, respectively, while in Des Moines, Iowa, the costs could be $3 billion, $27.3 billion, and $42.3 billion.

McCarter says that much of the property and casualty insurance market could be financially incapacitated in the event of a large terrorist attack. "Our largest modeled CNBR loss is more than two-thirds higher than the entire property and casualty insurance industry surplus," he said. "In the absence of TRIA or some other national framework for dealing with terrorism insurance losses, many commercial lines insurers would be devastated."

In early December, the Academy subgroup released a public statement about extending or replacing TRIA. It is currently preparing a report for the President's Working Group on Financial Markets, which will submit a report about the long-term availability and affordability of terrorism insurance to Congress by Sept. 30, 2006.

For more information or to arrange an interview, please contact Andrew Simonelli, Media Relations Manager, at 202.785.7872. A copy of the statement of Michael McCarter before the NAIC public hearing, and the subgroup's statement about replacing or extending TRIA (Dec. 2005) can be found at http://www.actuary.org/.

The American Academy of Actuaries is a national organization formed in

1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.
SOURCE American Academy of Actuaries

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Aon: Five Years After 9/11, Little New Capacity Offered to Terror Risks

WASHINGTON June 02 (BestWire) — Per-risk capacity for stand-alone terrorism insurance would need to rise by 263% before insureds would be able to exercise any "pricing power," according to an analysis of the global terror risk market by U.S. broker Aon Corp.

Some stand-alone terrorism markets have increased their maximum lines in the nearly five years since the Sept. 11 attacks. However, per-risk capacity has remained relatively stable at about $500 million, excluding capacity offered by units of Berkshire Hathaway Inc., Aon found. Including Berkshire capacity, the stand-alone market offers maximum terrorism insurance capacity of roughly $1.52 billion, Aon said.

The report was offered in the form of written comments submitted to the President's Working Group on Financial Markets, which includes representatives of the U.S. Treasury Department, the Federal Reserve, the Securities and Exchange Commission and the Commodity Futures Trading Commission. The group currently is preparing a report on the long-term availability and affordability of terrorism insurance.

Under the Terrorism Risk Insurance Extension Act, the group must present its findings to Congress by Sept. 30. Passed late last December, the act extended the federal reinsurance backstop for terrorism risks through year end 2007.

Aon's report found that, in 2005, the global commercial property market offered maximum per-risk capacity to U.S. insureds of $8.12 billion, with a median limit of $300 million and average limit of $570 million.

However, 23% of that capacity was offered on the condition that terrorism would be excluded completely had the original Terrorism Risk Insurance Act expired at year end. An additional 49% of capacity relied on substantial sublimits for terrorism coverage, or the right to reprice coverage should TRIA either expire or be scaled back, Aon found.

Of the remaining $2.34 billion of full-term terrorism capacity, $1 billion either was offered by Berkshire Hathaway or was "duplicate" capacity offered by units of American International Group Inc., Aon found.

The broker said it generally chose to exclude from its analysis Berkshire capacity — most of it offered through the conglomerate's National Indemnity unit — because of the relatively high cost of the coverage and because the potentially large line size of Berkshire risks would tend to overstate the available overall capacity. Furthermore, should the federal terror backstop expire, Aon expects Berkshire to reallocate most of this capacity to higher-return terrorism reinsurance lines.

AIG offers full-term capacity for energy and chemical risks through its AIG Global Energy unit, as well as all-risk property coverage through AIU Insurance Co. and Lexington Insurance Co. But according to Aon, the capacity wouldn't be combined on a per-risk basis because of distinctions made in the underlying exposure.

Despite an attractive pricing environment, the report notes no insurers have entered the market since 2001 to offer monoline, stand-alone terrorism capacity. Instead, Aon found that risk capital has been allocated by existing multiline commercial insurers either on the basis of forced entry — such as TRIA's mandate that insurers offer coverage — or through specialist, stand-alone programs that remain part of an overall, multiline business plan.

The company cited the limited availability of reinsurance capacity as a major barrier to entry for insurers in the terror risk market. The report found total private reinsurance capacity for terrorism risks remains in the range of $6 billion to $8 billion, with an additional $2 billion to $3 billion in risk-transfer capacity made available by hedge funds. Should the $100 billion in capacity offered by the federal TRIA program expire, it would reduce the total available market capacity for terrorism risk by more than 35%, Aon concludes.

"Logic would appear to dictate that the potential loss of TRIA reinsurance capacity as of 1/1/08 would add further barriers to new capital entry as any new markets would have to rely on limited, private market reinsurance for risk transfer capacity. This significantly decreases the likelihood of substantial new capital entry into the market in the long-term," the company wrote.

S&P Alters Approach to Gauging Insurers' Terrorism Exposure

June 8, 2006

Standard & Poor's Ratings Services said it is changing its process for evaluating the terrorism exposure of insurers and reinsurers.

The updated process is partly a response to the increased insurance retentions under the two-year extension of the Terrorism Risk Insurance Act of 2002, and it is also to quantify further the exposure and risk-management capabilities of the insurance industry. The process change will affect insurance and reinsurance companies globally and is consistent across sectors, as Standard & Poor's said it will be using the same approach and questionnaire for all property/casualty companies.

Standard & Poor's said it expects minimal rating changes to occur as a result of this process change and data-collection enhancement. However, the new terrorism evaluation will highlight the companies that have better risk-management systems, capabilities, and controls for measuring terrorism risk, and this will be factored into the rating qualitatively, according to the organization.

Standard & Poor's also said it has been qualitatively evaluating terrorism risk for companies, so this risk has largely been factored into ratings already.

To help it better evaluate each company's terrorism exposure and risk-management capabilities, the firm has developed a new questionnaire that is specific to terrorism risk. The questionnaire will be distributed in the second quarter of 2006 to Standard & Poor's interactively rated insurance companies.

The questionnaire is designed to solicit the data necessary for an evaluation of gross and net terrorism exposure (by line of business), with specific questions regarding various types of events and within various ring distances (such as between an insured location and a potential target).

In the case of stand-alone terrorism policies, full limit detail is also requested as well as details on single-address exposure.

The questionnaire also requests premium data.

Lastly, the questionnaire has a number of qualitative questions focused on evaluating each company's risk profile and underwriting focus. However, Standard & Poor's says the questionnaire is flexible in that it allows companies to provide data that matches their particular risk profile and exposure set, and Standard & Poor's says it will work with each company's level of data to ease the completion of the questionnaire.

Currently, Standard & Poor's charges terrorism risk within the premium and reserve factors applied within the risk-based capital model, so terrorism risk is not separated out individually with stand-alone terrorism premium or reserve charges. At this point, this new questionnaire is only an update to the firm's data-collection process, but there are no changes to its capital model risk charges used to measure the capital adequacy ratio.

As part of the ongoing rating review process and surveillance, Standard & Poor's expects each company to provide it with this additional data and have detailed discussions regarding this process change.

Source: www.standardandpoors.com.

BIG "I" TESTIFIES NATURAL DISASTER LEGISLATION NEEDED
Association calls for "national solution to national problem"

WASHINGTON, D.C., Sept. 13, 2006—The Independent Insurance Agents & Brokers of America (the Big "I") testified today before a subcommittee of the House Financial Services Committee on the crucial need for natural disaster legislation.

J. David Daniel, president of Daniel & Eustis Insurance in Baton Rouge, La., and a member of the Big "I" Executive Committee, represented the association before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises. Daniel testified that there needs to be a federal role in natural disaster preparation, and that Congressional attention is needed for several pieces of legislation that have been introduced to deal with this issue.

"Put simply, insuring against natural disasters is a national problem that requires a national solution," Daniel testified. "Despite our longstanding position that the insurance market is best served by limited federal involvement, we believe that a federal solution is necessary to help provide capacity and fill a void that the private market cannot and will not service. However, it is important that the day-to-day regulation of insurance remain at the state level, where state insurance departments are best equipped to serve the special needs of local consumers in local markets."

Daniel noted Big "I" support for H.R. 846, the Homeowners' Insurance Availability Act, introduced in 2005 by Rep. Ginny Brown-Waite (R-Fla.). Her bill would allow private insurers to purchase, at auction, reinsurance contracts directly from the U.S. Treasury to cover natural disasters that are equal to, or greater than, a 1-in-100-year event.

"We believe this is a strong proposal," Daniel testified, "because it will encourage more companies to enter at-risk markets, thus increasing availability and market stability, while limiting federal involvement to only the most devastating catastrophes."

Daniel also mentioned other pieces of pending natural-disaster legislation, including the following bills:

- **H.R. 2668, the Policyholder Disaster Protection Act,** introduced by Rep. Mark Foley (R-Fla). This bill would permit insurers to create tax-free reserve funds for natural disaster claims.
- **H.R. 4836, Catastrophic Savings Account Act,** introduced by Rep. Tom Feeney (R-Fla.). This bill would create tax-free, personal catastrophic savings accounts.
- **H.R. 4366, the Homeowners Insurance Protection Act of 2005,** introduced by Reps. Ginny Brown-Waite (R-Fla.) and Clay Shaw (R-Fla.). This bill would make state catastrophe funds eligible for federal reinsurance.
- **H.R. 4507, the Natural Catastrophe Insurance Act of 2005,** offered by Rep. Carolyn Maloney (D-N.Y.). This bill would establish a federal program to provide reinsurance for state natural disaster insurance programs.
- **H.R. 5891, the Catastrophic Risk and Insurance Commission Act,** introduced by Reps. Debbie Wasserman Schultz (D-Fla.), Mike Castle (R-Del.), Patrick McHenry (R-N.C.) and Charlie Melancon (D-La.). This bill would help Congress address ways to reduce the costs of disasters by establishing a national commission to examine proposals

and make recommendations to assist the federal government in preparing for and managing natural disasters.

"Our members support exploring ways to reduce the costs of disasters, such as mitigation efforts, Daniel said. "For instance, enhancing building codes and using financial incentives to mitigate risk are among proposals worth exploring in order to protect both consumers and taxpayers across the country."

Daniel stressed that, despite the Gulf coast hurricanes getting most of the attention in 2005, natural disasters affect all areas of the country, which means that national solutions are required for a national issue. And natural disasters affect every single taxpayer in the nation, no matter where they live.

"Our members live across the country, serving and living in a wide variety of communities—large and small—and so many of them have been impacted by natural disasters," Daniel testified. "Certainly, the most devastating natural disasters in recent years have resulted from hurricanes, which have had the greatest impact on the homeowners' insurance market. However, hurricanes are only one of the many catastrophic risks our nation faces. Whether it is tornadoes in the Midwest, earthquakes in California, or ice storms in the Northeast, we all face some risk of natural disaster, and it often takes only one or two events in a particular area for the homeowners' insurance market to be dramatically affected."

Founded in 1896, IIABA (the Big "I") is the nation's oldest and largest national association of independent insurance agents and brokers, representing a network of more than 300,000 agents, brokers and their employees nationally. Its members are businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents and brokers offer all lines of insurance—property, casualty, life, and health—as well as employee benefit plans and retirement products. Web address: www.independentagent.com.

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HEARING BEFORE THE

HOUSE FINANCIAL SERVICES COMMITTEE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

AND

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

ON

"Protecting Americans from Catastrophic Terrorism Risk"

Statement of the

NATIONAL ASSOCIATION OF REALTORS®
AND THE
INSTITUTE OF REAL ESTATE MANAGEMENT

SEPTEMBER 27, 2006

REALTOR® is a registered collective membership mark which may be used only by real estate professionals who are members of the NATIONAL ASSOCIATION OF REALTORS® and subscribe to its strict Code of Ethics.

EQUAL HOUSING OPPORTUNITY

The National Association of REALTORS® (NAR), and the Institute of Real Estate Management (IREM) are pleased to submit this statement for the record to the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises and the Subcommittee on Oversight and Investigations for their hearing on protecting Americans from catastrophic terrorism risk. We appreciate the time and effort that its members, including Subcommittee Chairs Kelly and Baker, have spent on this very important issue. IREM and NAR look forward to working with subcommittees to address to developing long term solutions to the challenges posed by creating a long term sustainable terrorism risk insurance program.

With over 1.3 million members, the National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association, including NAR's five commercial real estate institutes, societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS®. IREM is the only professional real estate management association serving both the multifamily and the commercial real estate sectors. With 81 U.S chapters and 8 international chapters, IREM is an international organization that serves as an advocate on issues facing the real estate management industry. Collectively, IREM members manage more than 6.5 billion square feet of commercial space and more than 13 million residential units totaling $848.2 billion in real estate assets. Because of the importance of terrorism coverage to the health of the commercial real estate markets, NAR and IREM urge Congress to pass a long term terrorism insurance program that ensures the long term sustainability and availability of coverage.

Nature of the Threat of Terrorism and the Real Estate Industry Response:

Despite the valiant efforts by the U.S. Department of Homeland Security, security firms and property owners since 9/11 to better secure our nation's private sector, we all realize that it is not possible to guarantee security at all locations all of the time due to our relatively free and open society. Last year's terrorist attacks in London, Madrid and Israel prove that it is very difficult to thwart well-prepared, well-funded and determined terrorists from doing harm. Many security analysts believe that it is only a matter of time before suicide bombers and other terrorists refocus their deadly agenda on U.S. targets.

A study conducted by the RAND Corporation's Center for Terrorism Risk Management Policy finds that "soft" targets, such as office buildings and retail centers are increasingly at risk from both Al Qaeda and domestic radical terrorist groups. This shift in emphasis comes from the realization that the "hard" targets, such as "iconic" office buildings (e.g., Empire State Building, Sears Tower), government centers and embassies have become more secure and harder to penetrate, and that attacking more vulnerable soft targets would still allow Al Qaeda to cause significant civilian casualties and economic disruption.

Because of the ever changing nature of terrorism threat, both IREM and NAR are members of the Real Estate Information Sharing and Analysis Center, a partnership created by the Department of Homeland Security and the real estate industry. The partnership facilitates information sharing on terrorist threats, warnings, incidents, vulnerabilities and response planning — to counter terrorism and protect buildings and the people who occupy and use them. This important partnership helps the real estate industry stay aware of all the emerging threats facing each real estate sector, and enables property managers and other real estate professionals to take appropriate measures to protect those who work live and play in the nation's buildings.

The Importance of Terrorism Insurance to Commercial Real Estate:

Affordable and available terrorism insurance is a vital component of most commercial real estate transactions. It is estimated that 84% of outstanding commercial mortgage balances require terrorism insurance. Thus, if TRIEA were to expire, and insurers subsequently dropped terrorism coverage, those loans would be in technical default. The pricing and availability of coverage is an important component to both the commercial real estate transaction and the ongoing management of the property. The inability to obtain terrorism insurance may either limit the financing options of a particular transaction, or may jeopardize the transaction entirely. If terrorism insurance costs rise significantly, it will negatively impact the price of commercial real estate. Furthermore, the rising costs of terrorism insurance can outweigh any potential income from a particular property creating a disincentive to property ownership, and potentially forcing the property managers and owners to pass on the costs of the additional costs of terrorism coverage to tenants. If a property owner is unable to pass those increased costs, as for example in the case where a property is triple net leased (tenant assumes all costs), or as in the case with multifamily units receiving a public subsidy, the owner may be forced to operate the property at a potential loss.

The Terrorism Insurance Risk Extension Act (TRIEA) has, by and large, kept insurance available and affordable, but at the end of next year we will again face the uncertainty associated as it is set to expire at the end of 2007. The debate on the future of TRIEA is set against the backdrop of ever increasing problems of either unavailable or unaffordable property and casualty insurance throughout many areas of the country. NAR and IREM urge Congress to limit the effects of economic uncertainty associated with the looming expiration of TRIEA by passing a permanent fix early next year. NAR supports the concept of creating a chartered mutual reinsurer that could be housed in the treasury department and that would eventually be sustained by fees paid by insurance firms.

The Success of TRIA and TRIEA, and the Uncertainty of Insurance Availability After 2007

The passage of the Terrorism Risk Insurance Act of 2002 helped stabilize the commercial real estate markets following the disruptions of the September 11, 2001 terrorist attacks by making terrorism coverage available and, over time, more affordable. Commercial property owners, brokers, managers, leasing agents and lenders throughout the country have all benefited from having sufficient affordable terrorism insurance in place. Development projects and related loans are no longer held up due to inadequate coverage; leasing of office, industrial and multi-family properties has gone uninterrupted; and lenders no longer have to "force-place" coverage for their clients in order to satisfy loan agreements.

Yet, while TRIA has been effective in stabilizing the insurance markets in recent years, a private reinsurance market had not demonstrated the capacity to fill the breach if TRIA's federal backstop had expired. Initially driven by a concern that the private insurers would not be able to provide terrorism coverage on their own, in June 2004 the Treasury Secretary extended the make available requirement of TRIA ensuring that insurers would continue to offer terrorism coverage in the final year of TRIA's three year program.[1] During 2005, it became evident that private insurers would be reluctant to provide terrorism coverage should TRIA sunset and the reinsurance market had not yet become strong enough to cover insured losses. In June 2005 the RAND Corporation released a study which suggested that if TRIA were permitted to expire, premiums would likely rise and "take up rates", i.e. the number of businesses purchasing coverage would decline.[2] Yet, this decline in coverage would come at a time of continued uncertainty about the specter of terrorist attacks in the United States. At the same time, a Treasury Department report recommended that TRIA be allowed to sunset to enable the market to develop without the interference of a federal backstop.[3]

The Terrorism Risk Insurance Extension Act of 2005 (TRIEA) strikes a balance between the two views. TRIEA extends the federal backstop program for an additional two years and increases reliance on the private sector. TRIEA specifically increases the trigger point at which the federal government will provide assistance from $5 million in 2005, to $50 million in 2006, and $100 million in 2007; while also raising insurer deductibles to 20% by the end of 2007.

NAR and IREM are concerned that reinsurance market has not yet developed the capacity to handle losses associated with a terrorist attack without a federal backstop in place. It is estimated that the reinsurance capacity is between $6 and $8 billion, which given the potential magnitude of a coordinated terrorist attack seems fairly small. Because of this continued weakness in the reinsurance market, and the importance of terrorism insurance to the continued health of the commercial real estate markets, NAR and IREM fear that the expiration of TRIEA at the end of 2007 will again cause uncertainty in the insurance markets and make terrorism coverage either unavailable or unaffordable. For these reasons, NAR and IREM support the concept of creating a mutual reinsurance pool within the department of Treasury.

The Challenges of Terrorism Insurance:

Long-Term Availability and Affordability of Terrorism Risk Insurance

The development of private reinsurance capacity to spread catastrophic risk is necessary to adequately insure against terrorism risks. Although Treasury's June 2005 study acknowledges the role of reinsurance in an insurer's capacity to absorb losses, the study did not adequately address the issue of developing long-term private reinsurance capacity. Nevertheless, the study

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[1] The Treasury Secretary extended the "make available" provision of TRIA through 2005 on June 18, 2004. http://www.treas.gov/press/releases/js1734.htm

[2] RAND Center for Terrorism and Risk Management Policy, "Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act."

[3] United States Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002."

seemed to assume that private market capacity would grow in the absence of a federal backstop. Insurance industry experts believe that the federal reinsurance backstop provided under TRIA is responsible for the existing private market capacity. There has been no evidence to suggest that private market capacity will increase following the expiration of TRIA. In fact, the American Insurance Association noted that "[g]iven the continued grave uncertainty and potentially catastrophic levels of loss, insurers simply lack the tools to underwrite and price this risk without a new mechanism to provide capacity." [4] The federal government possesses substantially more expertise concerning terrorism risks than the insurance industry. Accordingly, federal participation in a long-term solution is appropriate. In the continued absence of such evidence, we urge Congress, as we have urged the Presidential Working Group on Financial Markets, to consider long-term solutions to the availability and affordability of terrorism risk insurance which involves a combination of the private insurance industry, the private sector and federal participation.

The Challenge of Chemical, Nuclear, Biological, Radiological Coverage

There is currently little affordable coverage for CNBR events caused by terrorism. It appears most terrorism risk insurance coverage excludes CNBR events, except where such coverage is expressly required under state law (e.g., with respect to workers' compensation coverage). When NAR asked members whether CNBR was included in their terrorism coverage, most indicated that it was not.

Insurance industry representatives believe that CNBR events are not conducive to modeling, and likely to trigger greater losses than conventional terrorist acts. The AIA notes that "[i]nsurance models suggest that the potential loss is so enormous that accumulation management techniques—essential to managing conventional terrorism risk—are of little practical value." [5] In fact, the American Academy of Actuaries (AAA) noted that "after anthrax was sent through the U.S. mail in 2001, the cost of cleaning up the postal facilities alone exceeded the structural value of those facilities."[6] It is estimated that the reinsurance capacity for CNBR coverage lags behind that of terrorism at between $1 and $2 billion. Because the value of the insurance claims would exceed the value of the real estate affected, and due to the near impossibility to appropriately measure risk and price coverage, insurers are unlikely to offer coverage without federal assistance.

Support for a Public Private Partnership Solution

As noted above, NAR and IREM believe the solution to the long term challenges posed by terrorism coverage necessitates the continued presence of a federal backstop. However, we believe, consistent with TRIEA that the reinsurance and the insurance industries should

[4] Testimony of Debra T. Ballen, American Insurance Association at "NAIC Public Hearing on Terrorism Insurance Matters" March 29, 2006.
[5] Ibid.
[6] Statement of Michael G. McCarter, FCAS, MAAA Chairperson of the Terrorism Risk Insurance Subgroup, American Academy of Actuaries, before the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners.

gradually generate more capacity to provide terrorism coverage until a federal backstop is no longer necessary. It is clear at this time, a continued phasing out of a federal backstop program is necessary following the expiration of TRIEA at the end of 2007. We believe that, like we believed at the end of 2005, that the expiration of TRIEA will result in a dramatic run up in terrorism insurance premiums, and the complete lack of coverage in certain markets. This looming potential crisis will only compound the severe problems many commercial real estate practitioners already have in obtaining and affording property and casualty coverage.

The Real Estate Roundtable has taken an important first step in the debate on the future of terrorism insurance by proposing the creation of Homeland Security Mutual (HSM) a not-for-profit mutual reinsurance company to be housed in the Treasury Department. HSM would offer reinsurance coverage for the following lines of terrorism risk; 1)domestic and foreign based terrorism, 2) CNBR coverage, 3) group life, 4)workers compensation and 5) commercial property and casualty. HSM would be funded through initial assessments on insurers, private retrocessional insurance, pre-event alternative capital sources such as catastrophe bonds, and other policy surcharges. HSM would provide reinsurance for events over $100 million in losses – the same trigger as in TRIEA. The federal government would provide a retrocessional backstop until the capacity of HSM reached $30 billion dollars. NAR and IREM generally support this concept as it ensures the continued availability of terrorism coverage, while creating additional reinsurance capacity that will eventually replace the federal backstop program.

Conclusion

Affordable and available terrorism insurance is an integral part of the health of the commercial real estate markets. Given that the reinsurance industry has not yet been able to develop a long term solution that would eliminate the need for some form of federal assistance, IREM and NAR are concerned that the sunset of TRIEA will result in a spike in terrorism coverage premiums, and cause coverage to become unavailable in numerous markets. The concept of a mutual reinsurance pool, such as HSM proposed by the Real Estate Roundtable that could further phase out the federal government's backstop program, presents an important first step in the debate on the future of terrorism coverage, one that we hope that Congress and Treasury consider carefully.

Thank you for this opportunity for us to express our views on this very important matter.