POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE ACT (TRIA)

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

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POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE ACT (TRIA)

Tuesday, April 24, 2007

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 1:36 p.m., in room 2128, Rayburn House Office Building, Hon. Paul E. Kanjorski [chairman of the subcommittee] presiding.

Present: Representatives Kanjorski, Ackerman, Meeks, Moore of Kansas, Capuano, Baca, Scott, Davis of Tennessee, Sires, Klein, Murphy, Donnelly; Pryce, Shays, Gillmor, Feeney, Garrett, Bachmann, Roskam, and Marchant.

Also present: Chairman Frank and Ranking Member Bachus (ex officio) and Representative Maloney.

Chairman KANJORSKI. This hearing of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises will come to order. Without objection, we are going to limit opening statements to 15 minutes on each side. Mr. Ackerman, I understand you have an opening statement. Is that correct?

Mr. ACKERMAN. Yes.

We meet this afternoon to review the policy options for extending the Terrorism Risk Insurance Act, or TRIA. In the wake of September 11th, Congress designed TRIA as a temporary program with the expectation that the insurance industry could eventually model and price for terrorism risk. The private marketplace, however, did not recover as quickly as initially hoped. As a result, we extended TRIA for 2 years in 2005.

While TRIA has increased the availability and affordability of terrorism risk insurance, the marketplace is still tenuous. Insurers still have limited capital to cover terrorism losses alone and without Federal assistance. Property/casualty firms had only $164 billion available to cover terrorism losses in 2005, according to the Insurance Information Institute, but some models have predicted terrorism losses of more than double this number.

TRIA as amended will, of course, expire at the end of this year. Because insurers remain uncomfortable with their ability to reliably price coverage for traditional terrorism, we need to extend this law once again in order to protect our Nation's economic security. In considering these matters, we must also act both in a timely fashion and in a deliberate manner so as to prevent marketplace

disruptions, allow for careful consideration of the policy implications of our actions, and avoid unintended consequences.

We have many important decisions before us, and I look forward to a thoughtful and bipartisan dialogue both today and in the weeks ahead. To help guide us going forward, I also want to outline five positions central to my thinking on these matters. First, we must make the extension of TRIA our primary goal and refrain from considering miscellaneous issues. A bill to further lengthen TRIA should not become a vehicle for moving non-related matters such as the surplus lines legislation and natural disaster reforms. Moreover, I have considerable skepticism about adding risk retention group reforms to this TRIA extension exercise. These separate issues need and deserve full, complete consideration on their own.

Second, the duration of the extension will require us to maintain a delicate balance. We must choose a length of time that is long enough to provide greater certainty to the marketplace and short enough to encourage the private sector to develop its own solutions to the problems posed by conventional terrorism. Such an extension should be neither permanent nor even semi-permanent. At this time, I believe that a 6- to 8-year timeframe provides the balance we need.

Third, we should use the TRIA extension debate to pursue needed and important reforms to the program. We should, for example, protect individuals, and not just the buildings they work in, by adding group life to TRIA. We should also eliminate the distinction between foreign and domestic terrorism events.

Fourth, we must explore how best to add nuclear, biological, chemical, and radioactive (NBCR) coverage to TRIA, and we will soon learn of a few different positions on this complex issue from today's witnesses. In the event of an NBCR attack, the marketplace already implicitly believes that the Federal Government will step in and respond. We therefore should explicitly address the government's role before an NBCR terrorism event occurs, rather than deal with such a significant problem during a time of great uncertainty and potential chaos.

Lastly, we should explore whether or not to continue to decrease or limit the government's financial exposure within TRIA. The creation of a trust fund in this regard is one idea worth examining. Under the proposal, policyholders and insurers would pay surcharges in advance of a terrorism event to the Federal Government and the collected monies would then help pay the Federal Government's costs in the event of a certified terrorism act.

In closing, I thank the witnesses for coming here today to share their perspectives on these five policy options and the many other important choices before us during these TRIA extension deliberations.

Thank you. Ms. Pryce?

Ms. PRYCE. Thank you, Mr. Chairman, I wanted to thank you very much for holding this hearing and for scheduling the previous hearing that we had in New York City. We welcome the chairman back to the subcommittee. We missed your leadership in New York and we're thankful for your speedy return, sir.

Ladies and gentlemen, our commitment to TRIA has never been stronger. We understand the importance of terrorism insurance to

American consumers, businesses, and to our economic security. In the aftermath of the brutal terrorist attacks of September 11th, this committee led efforts to help restore the recovery of a nation's market, especially the availability of commercial insurance.

According to reports by the Treasury Department, the Government Accountability Office, and others, our former TRIA efforts were a great success, providing American consumers with protection against terrorist attacks and the continued availability of insurance to protect our economy and job growth. Since TRIA's enactment, the insurance market has become healthier than ever before. Insurers have been able to restore lost surplus, diversify risk exposures, and develop increasingly sophisticated terrorism-loss modeling. Reinsurance availability for terrorism coverage has grown with TRIA's enactment with recent estimates of $8 billion of terrorism specific reinsurance available, growing by $1- to $2 billion per year.

The private insurance marketplace is able to manage an increasing level of exposure and with the right combination of TRIA reforms, such as tax reserving and regulatory reform, including the expansion of the Risk Retention Act, the terrorism insurance marketplace will continue to strengthen and expand. I feel that expanding the Liability Risk Retention Act to include property and casualty insurance would be an important step in the direction of ensuring that the market will eventually be able to carry this risk without a government backstop.

Risk retention groups often act as the insurer of last resort for unique or hard-to-insure risks, a category in which terrorism clearly belongs. I look forward to working with Chairman Kanjorski as we discuss the expansion of the Risk Retention Act, as well as other regulatory forms, such as streamlining surplus lines and nonadmitted insurance and enacting speed-to-market reforms.

Unfortunately, reforms in our bill of the last Congress were set aside as the Senate ran out of time to conference. Some specific reforms that were included in the bipartisan bill passed overwhelmingly here, and we look forward to reviewing those very important reforms as we proceed in this committee in this Congress. I want to thank Subcommittee Chairman Kanjorski for today's hearing and for all of his hard and thoughtful work. We hope to continue our committee's past bipartisan cooperation on insurance legislation. I look forward to working together on comprehensive, longer-term TRIA reform, and I'll reserve the balance of my time. Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you, Ms. Pryce. Mr. Ackerman?

Mr. ACKERMAN. Thank you, Mr. Chairman. It's good to have you back in the Chair again, rested and looking so robust. Mr. Chairman, at the subcommittee's field hearing that you scheduled in New York City on March 5th, we heard from developers, insurers, and reinsurers, and their assessment was unanimous. There is still not nearly enough supply in the terrorism risk insurance market to meet the huge demand, especially in higher risk urban areas. Indeed, if TRIA were to expire, it would certainly result in the destabilization of the insurance industry and, in all likelihood, the national economy.

Every type of large-scale enterprise would be at risk, and the threat to our national economic health would be immense. I believe a permanent extension would be best, but in my view, as large development projects take many years, an extension of less than 15 or 20 years would be insufficient to developers, insurers and reinsurers, whose efforts fuel our Nation's economy and build our cities' skylines.

If the House were to pass a 6- to 8-year extension, knowing that in conference with the Senate the extension period is sure to be compromised on a contentious issue, we will certainly find ourselves here again, Mr. Chairman, with TRIA set to expire yet again, but an entirely inadequate supply of terrorism insurance on the private market. I would also note that with the shorter extension period, there would be uncertainty as to when or if TRIA would eventually expire. Let's be clear.

Uncertainty is the enemy we're fighting, and as we heard in New York, this uncertainty would threaten the reconstruction efforts at Ground Zero, the site of the worst terrorist attack on American soil and the symbol of our Nation's resilience and recovery, as well as many other sites. As I noted at your field hearing in New York, the potential for terrorists to commit not just a heinous, but a catastrophic act, will continue to influence the market's assessment of risk for years. It matters not whether foreign or domestic terrorists is a distinction, or if it is impossible to make. In the new world we live in, nuclear, biological, chemical, and radioactive, NBCR, coverage must be included in the TRIA program. A government accountability report in September 2006 found that and I quote, "any purely market-driven expansion coverage for NBCR risk is highly unlikely in the foreseeable future." The study simultaneously undertaken by the President's Working Group came to the same conclusion. Without a significant market expansion for NBCR coverage, the Federal Government must step in and provide coverage.

Mr. Chairman, I cannot emphasize strongly enough how important TRIA is to our Nation's economy, as you very well know, and I look forward to hearing from our very distinguished panel this afternoon. Thank you.

Thank you.

Chairman KANJORSKI. Thank you, Mr. Ackerman. Mr. Bachus?

Mr. BACHUS. Thank you, Chairman Kanjorski. In the aftermath of the terrorist attacks on September 11th, this committee responded quickly and forcibly to stabilize the financial services marketplace and protect the economy. On the insurance front, within 2 months of the attacks, the committee passed by voice vote the original Terrorism Risk Insurance Act, or TRIA. This legislation has been a great success over the past 5 years. Since its enactment, consumers have been generally able to obtain terrorist coverage, and harm to our economy by the unavailability of insurance, particularly in the commercial real estate sector, has been avoided. Insurers have been able to restore lost surplus, diversified risk exposures, and develop increasingly sophisticated terrorist-loss modeling.

While the terrorist reinsurance marketplace has grown to nearly $8 billion, TRIA was intended to be a temporary program while the market recovered, and it was very carefully designed to require an-

nual increases in the private sector responsibility with the corresponding reduction and the exposure to taxpayers.

The private marketplace will always provide a more dynamic response than the Federal Government and we must continue to ensure that the Federal safety net of TRIA minimizes regulatory interference in the marketplace over time by government. When the original TRIA program was set to expire in 2005, our committee took the lead on legislation to extend the program, passing comprehensive TRIA reform by a bipartisan 64 to 3 vote in committee and 371 to 49 on the House Floor. This bill contained a number of critical reforms to TRIA to transform the safety net into a longer term program, which is essential.

While we ultimately accepted a very short-term TRIA extension from the Senate without most of our reforms, as Congresswoman Pryce has said, members on both sides of the aisle in the House predicted we'd be back in 2 years, still in need of a long-term TRIA. Still in need of reforms and not that much further along in creating long-term stability for consumers, it will be a test of our leadership whether we can advance these reforms further with strong bipartisanship that has characterized this committee's deliberation on TRIA for the past 6 years.

Most Republicans are committed to this effort, if the committee continues to focus on building capacity in the private marketplace while slowly reducing Federal displacement and regulatory interference over time. Taxpayers must be fully protected. Consumers should be able to obtain market price coverage without gaps, and the program should address not only pre-event stability, but also post-event stability to protect the ongoing functioning of our economy.

For example, last Congress's TRIA extension legislation approved by the committee included a very slow increase in private sector retention over time, but with a reset mechanism that would significantly lower the deductibles and trigger levels in the event of another major terrorist attack. The reset mechanism is needed to promote post-event stability. Without it, the marketplace would inevitably pull back in the wake of a large-scale terrorist attack, jeopardizing consumers and our economy. The bill also incorporated a number of regulatory reforms to make commercial insurance more available, such as streamlining speed to market and surplus lines of availability. Taxpayers were protected by full recoupment and consumers received new protection for their most vulnerable risk—nuclear, biological, chemical, and radiological coverage, the NBCR coverage. Insurers were able to set aside long-term terrorist reserves without tax penalties, again to promote post-event stability and those reserves could be barred as a temporary pool to reduce the Federal exposure over time.

In conclusion, TRIA has worked well for our country, but it is a short-term program according to its original design. In considering legislation a place to program on a long-term footing, I would hope we can build on prior bipartisan efforts and produce a bill to both promote private sector innovation and protect taxpayers while providing long-term predictability and stability.

Thank you, Mr. Chairman.

Chairman KANJORSKI. Thank you Mr. Bachus. Mr. Meeks, you are recognized for 3 minutes.

Mr. MEEKS. Thank you, Mr. Chairman. It is good to see you back in your seat, and I shouldn't need the full 3 minutes, but we really want to thank you.

We all know that the attacks of 9/11 brought about the need for the TRIA program, and since then, the city of New York has worked hard, very hard, to recover and rebuild not only the devastating loss of life that took place that day, but also from the catastrophic economic loss that New York City experienced. The amount of office and retail space lost on 9/11 in a relatively confined area of New York City exceeds that of some whole cities.

If you knew the area around the World Trade Center before 9/11 in the way that most New Yorkers did and then compared it to post 9/11, the post 9/11 neighborhood was practically a ghost town. Never had it been so clear what an economic engine that the World Trade Center had been, and we know that plans are currently in place to rebuild the World Trade Center site along with other continuous development efforts. However, those plans and efforts like it will be jeopardized if we let TRIA lapse, and uncertainty of insurance coverage makes debt- and equity investors "risk averse".

Not only do we need TRIA to be in place, but it needs to be in place for, I would say a minimum of 10 years; 15 years would be even better. The financial marketplace loves stability, and any permanent financing of facilities must be accompanied by a surety of insurance coverage. Ten years of financing, accompanied by 2 years of certainty in insurance coverage just won't work. And I hope that we do continue to work in this committee in a bipartisan manner so that we can show that we've gone to make sure that our businesses know that they will be able to obtain insurance. TRIA is tremendously important for New York City, but not only for New York City, I think for businesses throughout this country and this day and age that we live in. I look forward to hearing the testimony from the witnesses today and ultimately passing a bill that I believe will be truly bipartisan.

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

Chairman KANJORSKI. Thank you, Mr. Meeks. Mr. Shays of Connecticut?

Mr. SHAYS. Thank you. Just very briefly: this is a very important hearing, Mr. Chairman. Thank you for calling it. Thank you for being here today to call it, and I just want to say to you that I know all of our witnesses are very distinguished, but I have a personal friend, Lee Cotton, and I just want to thank him for being here. He is someone who knows this business through and through. So when you hear him speak, he speaks with a tremendous amount of experience, and he is very successful in his business, as well.

I am eager to see that we have a period of time, at least 10 years, where we don't have to keep coming back to this legislation. I think that foreign attacks should be dealt with. Obviously, they are, but domestic as well. I think it should include group life as well. I do think there should be higher deductibles and I'm hoping that we'll pay attention to all types of attacks: nuclear, biological, chemical, and radiological. I think these are issues that we need to address and I am going to apologize to the committee for giving a

statement and then leaving. It's not my usual practice, but we have the Tillman hearing and it's a very personal hearing that I think I need to be back at. But thank you again for having this hearing. I'll be eager to work with my colleagues to form a good bill.

Chairman KANJORSKI. Thank you, Mr. Shays. Mr. Scott of Georgia?

Mr. SCOTT. I want to join in welcoming you back, Mr. Chairman; it's good to have you back. Terrorism is the most significant risk facing our Nation's economic security today. The 9/11 attacks were a decapitation strike. They cut off the heads not only of our civilian and military leadership, but very significantly our financial leadership in the world. So a successful campaign against these radical ideologues requires a very definitive national strategy that includes plans to provide a backstop against possible massive insurance claims. And since terrorism is less predictable and possibly more severe than other catastrophes, it is necessary for the Federal Government to ensure that insurance remains available if the private market is not doing so. And if the private market cannot do so, Congress has passed a limited extension of TRIA through 2007 and I believe that Congress must work to provide a meaningful extension of TRIA while creating a long-term market-based solution to this problem. And I furthermore believe that the people inside the buildings, the lives of the people need to also be insured, and, therefore, I support the inclusion of group life insurance in TRIA.

Thank you, Mr. Chairman. I yield back.

Chairman KANJORSKI. Thank you, Mr. Scott. Mr. Garrett of New Jersey?

Mr. GARRETT. Thank you, Mr. Chairman. I also wish you continued good health as you come back with us.

I recently attended the TRIA field hearing the committee held in New York City. I thought it was a very productive hearing and focused on the issue that is important in New York and also the Fifth District. After the attack of 9/11, terrorism risk insurance either became unavailable or extremely expensive, and that was a problem not only for the insurance industry, but also for real estate, transportation, construction, energy, and utility sectors. So realizing this problem, Congress acted, and passed the first TRIA Act of 2002. And of course we then extended it for another 2 years, adding up the time additional reform to make it better.

Now, since September 11th, insurers and reinsurers have cautiously, and I'd say responsibly, re-entered the market, allocating more capacity year-to-year, and more commercial policyholders are becoming insured year-to-year as well. At the same time, on the up-side, the Federal role has scaled back year-to-year with higher deductibles, higher co-payments, higher triggers and fewer lines of insurance covered, and I view this private sector involvement in decreased government exposure to be a positive development. Now, I've read a number of comments and quotes in the media, and hear, as well, recently from individuals who want to see TRIA become a permanent program or extended up to 20 or 30 years.

If we do that, I have concerns that we will not revisit this important topic as we just don't and continue to try to make improvements, like we just recently did, after that long length of time. A short-term extension allows for periodic reassessment of the mar-

ket conditions to see if there is more room for private sector participation and also allows for a gradual scaling back of the program going forward as we observe how private insurers and reinsurers continue to respond to the market. Given that the private sector continues to increase its capacity, I do believe that a shorter term extension is more appropriate than creating a very long-term or permanent program.

I am really concerned that if we establish such a program, the private sector will lose some of the incentive that they have to look for the innovative things they've done, and new solutions. And the Congress also will lose our ability to step in and make the further reforms that we did, just a couple of years ago. So, again, I appreciate the focus of this hearing and the other hearings that we've had previously and I ask that we consider the possibility that Congress remain involved with this as the program goes forward. And with that, I yield back.

Chairman KANJORSKI. Thank you, Mr. Garrett.

Are there any other members who wish to make a statement? I see no response. We have an unusually good panel today, six members, and we are going to try and move through them. I just want to say that we are anticipating votes, so we are going to take the opening statements, and then as soon as the votes ring, we will go into recess and return to take the remaining statements.

And to all the members of the panel, now I say without objection, your written statements will be made part of the record. You will each be recognized for a 5-minute summary of your testimony, so, we would appreciate it if you would hold to that 5 minutes, or you can go on the light side.

Our first witness is Mr. Leonard Cotton, vice chairman of Centerline Capital Group, and a friend of Chris Shays.

STATEMENT OF LEONARD W. COTTON, VICE CHAIRMAN, CENTERLINE CAPITAL GROUP ON BEHALF OF THE COMMERCIAL MORTGAGE SECURITIES ASSOCIATION (CMSA)

Mr. COTTON. Yes, that is true. Thank you, Subcommittee Chairman Kanjorski and Ranking Member Pryce. I also see Chairman Frank and Ranking Member Bachus, from the full Financial Services Committee.

Thank you for having us here today. As stated, my name is Lee Cotton, and I am vice chairman of a company called Centerline Capital Group. Excuse me, we just changed our name. One of the Nation's leading real estate lenders and investors, I have been in the real estate business for about 35 years, and I am happy to have the opportunity to come and talk to you today. I am also the president-elect of the Commercial Mortgage Securities Association, otherwise known as CMSA, and it's in that capacity that I speak today.

CMSA is an international trade group representing the collective voice of the capital markets for real estate around the world, primarily in the United States most recently. Our membership has included 400 financial institutions and thousands of individual members. We are a very broad and diverse group. The thing that distinguishes us from most trade groups is that we are vertical in the sense that we have everybody involved in our business in one

group. We have the lenders, the people who securitize the loans, the people who service them, the people who are the trustees for them and the investors. So, everybody involved in commercial mortgage securities is part of our group. Our primary mission has been and continues to be to promote the ongoing strength and liquidity and viability of the commercial mortgage market.

As you may know, commercial mortgages are now securitized. Approximately 40 percent of those mortgages made last year were in fact securitized and almost all of them are available to be securitized or sold into the market. In essence, we have brought liquidity to the marketplace and broader expansion of capital available to the real estate industry. Last year, over $200 billion of mortgages were securitized, almost 40 percent of the mortgages made last year. The mortgages are in every county in the country.

Our own portfolio, I think, covers almost every county in the country, and the portfolios of the whole industry today exceed $750 billion. With an average loan size of around $8 million, and an average maturity between 7 and 12 years, we are the lenders in the room, so to speak, and we care about the viability and the sustainability of all of those assets. There are thousands and thousands of assets around the company.

We'd like to thank you for the hard work that this committee is doing on TRIA and its extension. We appreciate your efforts and we are here to support that extension, obviously. We had hoped that a private market would fill in. It hasn't. We don't think it's necessarily viable fully to be filled in, because it's an event that is unpredictable, unlike possibly even a hurricane. It's critical to the policyholders who are our clients. Remember, we're the lender, the policyholders are the borrowers. The borrowers own property and they borrow money from us. It's critical to them that they have this insurance, not only for the protection of their properties, but for the stability of the capital markets.

Think, if you will, of those $750 billion plus mortgages all being in technical default as a result of no insurance on their buildings. What would that do to the stability and the viability of the capital markets? That's the issue that we're here to talk to you about. An interesting statistic for you, the CMSA, or the CMBS business for which the CMSA represents, has grown steadily from about a $4 billion business to the aforementioned $750 billion plus. The only time we had a reduction in issuance and a reduction in mortgages made was in the year 2002. It was a very steady climb. It stalled, and then it has come back into business. I credit TRIA for a lot of that reestablishment of stability. Simply put, the real estate markets around the country impact the economy around the country. The ability to attract capital that is stable and is available is important to the entire economy, not just the people who own the properties or those of us who own the mortgages on those properties. To that extent, we would recommend a TRIA extension for as long as is practical. Permanent is fine, but for as long as is practical.

We would like to eliminate the distinction between foreign and domestic, as has already been stated, and we also believe that there should be an extension or an inclusion of radioactive and biological and nuclear as part of the coverage.

Thank you very much for the time today. We are looking forward to a timely extension of this Act. Thank you, very much.

[The prepared statement of Mr. Cotton can be found on page 54 of the appendix.]

Chairman KANJORSKI. Next witness, Brian Dowd, CEO, Insurance-North America, ACE Group.

Mr. Dowd.

STATEMENT OF BRIAN E. DOWD, CHIEF EXECUTIVE OFFICER, INSURANCE-NORTH AMERICA, ACE GROUP, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Mr. DOWD. Thank you, Chairman Kanjorski, Ranking Members Pryce and Bachus, and Chairman Frank. I appreciate the opportunity to be here today on behalf of both ACE and the American Insurance Association.

My name is Brian Dowd, and I am the CEO of ACE's operations in North America. ACE is one of the largest property and casualty insurers in the United States and we operate in virtually every State in the United States. I started in the industry as a property underwriter, and my first exposure to terrorism risk was really the bombings in the United Kingdom in the late 1980's and early 1990's. I remember thinking of risk for terrorism largely as a European and a Latin American event. You know, as time has gone by, the tragic events in Oklahoma City and both World Trade Center events, our perception of the risk as an industry has changed to encompass clearly the United States.

I have been involved with ACE's Management of Terrorism Risk as well as public policy discussions throughout our industry since 9/11. First, let me say that the original TRIA was in fact a tremendous success. The availability and affordability of terrorism insurance has grown each and every year and has helped the economy in many, many ways. With all the technical information that is being discussed regarding TRIA and extensions, I thought I would spend a few minutes just talking about some practical matters that insurance companies think about with how much risk to take on. And essentially, we have a three-step process in how much risk we are willing to take.

You know, essentially it starts with talking to our customers. What is the demand for a product? We design a product and we look at what the risks are. We try to decide how much capital we would risk based on what the profitability and the downside risks are. The second step is we generally look at can we measure in a mathematical way what those risks are? Can we accumulate the data and in some way control how much we underwrite?

And, third, we generally buy reinsurance to protect those risks so that we can operate and continue in a stable environment. Terrorism creates some challenges in our traditional three-step method. You know, first, clearly our customers have a desire to buy terrorism insurance and they have a willingness to pay. However, the amount of risks that insurers take on as regards to terrorism insurance isn't our choice, based on how much of our earnings, our capital we are willing to risk. It's actually mandated by the TRIA Act.

The original retention of the original Act was 7 percent. Generally, 7 percent of our direct-earned premium is basically within the underwriting guidelines and most appetites of most commercial insurers. Today, the retention is 20 percent and has an additional 15 percent coinsurance. For ACE, that translates into over $1 billion worth of deductible, as it is commonly referred to.

By comparison, the amount of deductible or retention I take for hurricane or earthquake is only $250 million. The second step is, you know, most insurers today are spending more time gathering information and in fact attempting to model the risk. And essentially, what we are doing is deterministic methodology of looking at it. We are looking at an event, but one of the core pieces of information that we look at and decide how much we are going to risk is what is the probability of that event occurring, and no one has developed the model today that brings that into impact.

And third, generally, reinsurance is available for most types of risk we take. I think as Ms. Pryce said, there is about $8 billion worth of reinsurance available, which has grown. But it's still far below the demand of what the insurers would like to buy to protect their deductible in the situation. With all that said, I think the P&C industry generally has found a comfort zone with conventional terrorism in the United States, and what they've done is essentially underwritten risk at below their full deductible level. Most companies aren't actually writing as much insurance to fill their deductible today.

Terrorism insurance as it relates to NBCR is an entirely different story.

Step 1, there is a clear customer need. Our customers are crying out for the cover. Today, only one product covers it—worker's compensation—and frankly that's because statutes require it. You actually have an unwilling seller. Most insurance companies don't want to sell NBCR for worker's comp; we are mandated to do so.

Step 1, our ability to determine and measure the size and probability of the loss, is severely limited when it comes to NBCR. We've seen estimates that range anywhere from hundreds of billions of dollars to trillions of dollars on what the impact of a loss can be, and both the magnitude and duration of the claims could last over 30 years, so it is very difficult for us to price for that risk.

Step 3. Virtually no reinsurance today exists for this risk. And when we think about these three items together and the current retention of 20 percent and the 15 percent co-insurance taken at NBCR, our risk is clearly an untenable situation for most insurers. We do believe that if the right provisions were mandated, NBCR could be available at a separate retention at a much lower level.

Finally, the last thing I'd like to mention is the $100 billion cap that's in the program. Currently, the statute provides that the financial responsibility ends once losses reach $100 billion. It's neither the Treasury's nor the insurer's responsibility. Congress will then decide how to deal with it. This is an impractical situation for the customer, for the Treasury, and in fact insurers, to leave that up in the air.

It puts us in an untenable position of saying, as claims have already incurred, to somebody who's bought a policy, that potentially they won't get a recovery because the cap has been reached, and

it really is uncertainty that we need to remove in the future on this program. We need to face the reality of that situation now so we can plan for it and be prepared. The Federal program should clearly pay the losses in the situations where the losses due to NBCR terrorism exceeds the cap.

I've tried to spend my time focusing on the practical aspects of managing terrorism from a public policy perspective. We believe TRIA has worked to address the availability and state-wide marketing economy. The program not only must continue, but it should also be modified to better address the daunting challenge of NBCR closest to the insurance system and the economy, et al. We appreciate the opportunity to testify, and we're happy to take any of your questions. Thank you.

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

Chairman KANJORSKI. Thank you very much, Mr. Dowd.

We are going to sneak you in Ms. Abraham, if that is all right. Can you hold to 5 minutes so we can make the vote?

Okay, well, Janice Abraham, president and CEO of United Educators.

STATEMENT OF JANICE M. ABRAHAM, PRESIDENT AND CEO, UNITED EDUCATORS INSURANCE, A RECIPROCAL RISK RETENTION GROUP

Ms. ABRAHAM. Thank you, very much, Chairman Kanjorski, and Ranking Members Pryce and Bachus. I appreciate very much, Chairman Frank, the opportunity to be here. My name is Janice Abraham and I am president of United Educators. Given your healthy skepticism on risk retention groups as part of this hearing, I appreciate—I am president of a risk retention group, and I speak to you today on a policy option to consider, as with the extension of TRIA.

I am representing United Educators, a risk retention group. We have 1,200 schools, colleges, and universities as members of United Educators. They range from MIT to Penn State, Stanford University, Purdue, Miami University, University of Scranton, public school districts in Ohio, California and New York, and hundreds of schools throughout the country.

I am also representing various associations and business interests that have an interest in the extension of TRIA and finding a strong public/private partnership going forward. We strongly support the extension of TRIA and suggest authorizing risk retention groups to issue property coverage in addition to the liability coverage that we currently offer. We think this will be a strong public/private opportunity for a solution going forward.

Over 20 years ago Congress, with great wisdom and foresight, passed amendments to the Risk Retention Act that allowed businesses and nonprofits with similar interests to join together to share liability risks. There was an insurance crisis in 1980 and Congress wanted to find a way to add capacity and competition to the liability insurance market. Risk retention groups now serve a wide range of businesses and nonprofits, including educational institutions, large and small law firms, churches, nonprofit agencies, healthcare providers, and manufacturers. As a risk retention

group, United Educators is owned by and governed by our 1,200 educational institutions. Our policyholders are our owners and they share their risks with each other and make significant investments in risk management and loss control, to try to keep their students and employees safe and their campuses safe.

As Congress explores policies options for extending the public private partnership in providing terrorism insurance, I think the successes of the Liability Risk Retention Act could be a model for you to consider that can add capacity and stability to this volatile market. Expanding the Liability Risk Retention Act to include property insurance with an extension of TRIA creating a long-term role for the government as a backstop or reinsuring our terrorist risks will allow businesses and nonprofits to pool our resources, to share our risks and our risk management lessons, to purchase reinsurance and with the long-term stability of TRIA be a reliable, committed source of capacity for both property and liability risks.

Now, I want to be careful today not to oversell this for risk retention groups. Risk retention groups only comprise approximately 3 percent of the liability commercial insurance market, but it's an important 3 percent. At United Educators, we cover the risks that most others are afraid to cover: sexual molestation; tenure disputes; dealing with students with severe mental health issues; and catastrophic athletic injuries. These are some very challenging risks, and the risks for educational institutions of potential terrorist targets are real.

Our schools and universities represent the very best of this country. Our campuses are open and accessible. Debate and free exchange of ideas are encouraged. A lot of people gather on our campuses for commencement, for football games, for Presidential debates. And some of the most important and dangerous research, that is very important to this country and supported by the Federal Government, is done on our campuses. In fact, the experts say that our campuses are "soft targets". A long term commitment from the Federal Government to be a partner with private industry in providing the high limits that we need—our campuses need—for terrorism insurance and extending the Liability Risk Retention Act so that we are able to offer property insurance is a creative and sound option to allow businesses and nonprofits the chance to help themselves. These two actions will add capacity and increase competition.

That's a good thing. These mega risks require long-term commitments and extensive planning and investments. Risk retention groups are ideally suited to filling this void for select groups. They are owned and governed by their members. The interests are in mind and it's matching the long-term horizon that this kind of risk calls upon us.

Thank you very much for the opportunity to speak with you today.

[The prepared statement of Ms. Abraham can be found on page 45 of the appendix.]

Chairman KANJORSKI. Thank you very much, Ms. Abraham.

Members of the committee, we have five votes pending now. We anticipate that votes will run until 3 p.m., so I am going to put the committee in recess until then, but I urge the members to return

as soon as possible, because we do have time constraints and we are limited on the hearing until 4 p.m. As you have noticed, we have some powerful members of the panel, and we certainly want to extract from them their best information.

So, with no further adieu, we will recess until 3 p.m.

[Recess]

Chairman KANJORSKI. Our next witness is Joseph P. Ditchman, Jr., Partner, Colliers Ostendorff-Morris.

Welcome to the subcommittee.

STATEMENT OF JOSEPH P. DITCHMAN, JR., SENIOR VICE PRESIDENT, COLLIERS OSTENDORFF-MORRIS, ON BEHALF OF THE NATIONAL ASSOCIATION OF REALTORS, AND THE COALITION TO INSURE AGAINST TERRORISM (CIAT)

Mr. DITCHMAN. Thank you, Mr. Chairman, and Ranking Members Pryce and Bachus. Mr. Chairman, I'd like to extend my personal best wishes on your health and my hope that you recover soon.

My name is Joseph P. Ditchman, Jr., and I am a partner in the commercial real estate brokerage firm of Colliers Ostendorff-Morris located in Cleveland. I am a member of the National Association of Realtors and am appearing today on behalf of the Coalition to Insure Against Terrorism, more formally known as CIAT. This coalition is represented by the National Association of REITs, the national chambers of commerces, and many other organizations. This coalition represents 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.

NAR commercial members are involved in all aspects of commercial real estate. Our members broker commercial transaction, identify tenants, manage properties, and advise property owners. The availability of terrorism insurance touches every aspect of our industry. Terrorism insurance is often categorized as only an insurance institute. With respect to that, we believe terrorism insurance is vital to the national economic security of this country. It insures the businesses of individuals who own and manage real estate in which we live, work, and play—vital pieces of coverage that are so important to their survival. It is also an issue of protecting the investment of those pensioners, the shareholders, the bond holders, and individuals across the country who are the owners of that real estate.

Since Congress worked hard to find the solution to the economic risk associated with terrorism, terrorism insurance laws is a solid step forward and we cannot lose it. But TRIA, as you know, is set to expire in less than 8 months. Consumers now in the marketplace are being told that they may not be able to get terrorism insurance for next year or that they will be repriced out of the market. This hearing recognizes the essential facts that have not changed from the congressional enactment of TRIA in 2000.

Terrorism continues to be, at best, an unpredictable threat. But, at worst, as we all know, is a catastrophic event and staggering losses. The insurers continue to say that terrorism risk is uninsurable, yet, our economy depends on the helping hand of terrorism

insurance to maintain the critical services that safeguard our Nation in the event of a terrorist act. That is why our support is market-oriented. But absent the current Federal program, there has never been a true market for terrorist risk insurance. There is no evidence a market will develop to provide the capacity that the American economy needs. Because of this, Congress must act soon.

We believe our Nation is best served with a viable long-term solution. In fact, we believe it should be permanent. While TRIA has been successful, there are some availability problems. For example, New York, a high-risk, major market in an urban area with "fire following" laws combines the aggregation of risk, high retention rates for the insurers, and rating agencies' pressures on the insurance companies. This causes capacity problems for the conventional terrorism coverage.

In other words, some market businesses still cannot buy necessary levels of terrorism insurance. Even in my home City of Cleveland, I have seen significant increases in terrorism insurance in the office buildings that I personally own. However, the Government Accountability Office and the President's Working Group on Capital Markets have issued reports confirming that no meaningful amount of insurance against loss from nuclear, biological, chemical or radiological events, known as the NBCRs, is available in the property market today. Notwithstanding that TRIA backstops this insurance, we stand ready to work with this committee and Congress to find the proper long-term solution to the problem.

To that end, CIAT has jointly developed, with the American Insurance Association, a set of joint principals that we believe should be part of any TRIA modernization. For conventional terrorism attacks, we recommend leaving in place the TRIA backstop. With the insurer's deductibility, industry retention levels, and the program triggers at the 2007 level, we would also leave the current make-available provisions as it is for the conventional terrorist coverage.

The NBCR terrorism risk is a different matter. To make sure that businesses have access to this important coverage, we urge that NBCR perils be added to the make-available requirements under TRIA and to recognize that insurers cannot model this risk or price it either. We support a separate and lower insurer's deductibility and a lower co-pay with respect to the NBCR's risk. This legislation should clarify that the Federal Government is "solely liable" for the NBCR terrorism losses above the insurer's individual NBCR retentions, thus encouraging insurers to provide more capacity.

Finally, we support removing the distinction between foreign and domestic terrorism in the current definition of the act of terrorism. As the London bombings demonstrate, there are serious difficulties distinguishing between foreign and domestic terrorism and the distinction makes no difference to the victims.

In conclusion, we believe that the proper long-term solution should focus on a private market, having been unwilling or unable to do so. The ideal solution must enable businesses to purchase insurance for the most catastrophic, conventional terrorism risk. It must provide adequate insurance capacity in high risk urban areas. It must provide meaningful insurance against the so-called NBCR risk. An ideal program would seek, over time, to reduce the Federal

role in the conventional terrorism risk market while maximizing the long-term, private capacity by facilitating entry of new, private capital.

I'd like to thank you on behalf of our group, and I appreciate the opportunity to have spoken today.

[The prepared statement of Mr. Ditchman can be found on page 67 of the appendix.

Chairman KANJORSKI. Thank you, very much, Mr. Ditchman.

Mr. DITCHMAN. Thank you.

Chairman KANJORSKI. Our next witness will be Tom Watjen, president and CEO of Unum Group.

STATEMENT OF THOMAS R. WATJEN, PRESIDENT AND CEO, UNUM GROUP, ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

Mr. WATJEN. Thank you, Chairman Kanjorski, Ranking Member Pryce, and members of the subcommittee. My name is Tom Watjen and I am president and chief executive officer of Unum Group.

Unum is, among other things, the fourth largest writer of group life insurance, including accidental death and dismemberment, in the United States. We insure approximately 8 million lives and provide over $800 billion of group life and AD&D coverage.

I am here today on behalf of the American Council of Life Insurers. The ACLI is the primary trade association of the life insurance industry, representing 373 member companies that account for 93 percent of the industry's total assets in the United States. I would like to thank the committee for holding this hearing. Your committee has had a proven track record of supporting group life insurance coverage within TRIA, and we remain grateful for your sincere efforts and consideration of this issue.

While much of the ongoing discussion on extending the TRIA program has focused on property casualty insurance, it is also important to discuss how this issue affects the life insurance industry, particularly with regard to group life insurance. We believe that the individuals who work or reside inside our Nation's buildings should be adequately covered as well.

Group life insurance is a critical component of a standard employee benefit package. For millions of Americans, especially lower income workers, it is the only life insurance that their families have. In 2005, there were about 167 million group certificate holders with an average coverage amount of $49,500. Due to the nature of the coverage, group life policies have a very high concentration of risk. Members of an insured group are often gathered in single locations and live near their work places. A single catastrophic event can cause many or all of them to die at one time.

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, those insurers that receive an unexpectedly high number of claims could be forced into insolvency. Such insolvencies would impact payments to beneficiaries at their time of need. They would also impact the payment of benefits to all the policyholders of insolvent companies, not just the group life insurance policyholders.

Group life policies are designed to provide simple, affordable protection for average Americans. They are not designed or priced to account for the immediate deaths of thousands of people from a terrorist attack. Group life insurers could protect themselves from the terrorist risk exposure, either by excluding coverage for deaths due to terrorism, or by purchasing catastrophic reinsurance protection. However, neither Unum nor the ACLI are aware of any States, except for Kansas and North Carolina under very limited circumstances, that allow the use of terrorism exclusions by life insurers.

Furthermore, we do not believe it is good business or good public policy, frankly, to exclude the coverage for deaths due to catastrophic events such as terrorism. Since exclusions are therefore not a viable solution, insurers must turn to catastrophic reinsurance for protection. While such reinsurance has become more available since 9/11, it comes with higher deductibles, various exclusions and most importantly with overall coverage limits that are lower than were available prior to 9/11.

Without adequate catastrophic reinsurance, many life insurers risk financial ruin from a significant terrorist attack. We believe that catastrophic reinsurance would become more available if group life were included in the TRIA extension. This additional reinsurance capacity would significantly reduce the risk of insolvency that many group insurers face in the event of a large-scale terrorist attack.

If TRIA is extended again, and group life is included, we urge that a separate recoupment mechanism be created for property casualty and group life insurers. Recoupments of amounts paid by the Treasury for losses relating to P&C insurance should only be made by P&C insurers. Similarly, recoupment for losses relating to group life insurance should be only made by group life insurers.

We look forward to working with your committee and others in Congress, at the Treasury, and in the Administration, to ensure that group life remains available to millions of Americans who depend on it and that this vital protection is there when it is needed most.

Thank you for providing the opportunity to share our views now and we certainly look forward to having a chance to answer your questions at the appropriate time.

[The prepared statement of Mr. Watjen can be found on page 96 of the appendix.]

Chairman KANJORSKI. Thank you very much, Mr. Watjen.

Our final panelist is Vincent Donnelly, president and CEO, PMA Insurance Group.

STATEMENT OF VINCENT T. DONNELLY, PRESIDENT AND CEO, PMA INSURANCE GROUP, ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI)

Mr. DONNELLY. Thank you, Chairman Kanjorski, Ranking Member Pryce, and members of the subcommittee. Thank you for the opportunity to testify before you today regarding the terrorism risk insurance program.

My name is Vincent Donnelly and I am the president and CEO of the PMA Insurance Group, which is a member company of the

Property Casualty Insurers Association of America, PCI, representing more than 1,000 member companies. I am testifying today on behalf of PMA and PCI.

I am pleased to be here this afternoon to share my perspective on the uniqueness of the risk that terrorism presents to our economy, resulting in the need for the Federal Government to continue to play a major partnership role with the property and casualty insurance industry. Furthermore, the partnership role needs to be sensitive to the unique characteristics of small- and medium-size insurers when considering the key elements of the continuation of TRIA.

The PMA Insurance Group is headquartered in Blue Bell, Pennsylvania, and has been underwriting commercial lines of insurance for over 90 years, with worker's compensation business producing about 84 percent of our premium. Our total 2006 written premiums was $430 million, placing PMA within the parameters which the insurance industry would consider to be a small- to medium-size insurer. In the nearly 5 years since its inception, TRIA has become an essential part of our Nation's preparedness for responding to acts of terrorism. As Congress debates its continuation, we ask that you will consider the importance of TRIA in making it possible for small- and medium-size insurance companies to play its role in protecting the American economy.

I believe there are several basic principles that most of us here today can agree upon. One, without this program, the randomness and catastrophic risk associated with terrorist attacks pushes terrorism outside the realm of insurability. It is not possible for the insurance industry to calculate the probability of loss, nor to determine a reasonable range of outcomes.

Secondly, participation in this effort by the Federal Government is necessary, especially when it's apparent that the threat of terrorism has not abated. In effect, the Federal Government is in the best position to be the ultimate risk manager for handling this exposure to loss of life and property.

Third, a response by insurers to terrorism losses resulting from an event that occurs in New York City, here in Washington, D.C., or near my company home town of Philadelphia has financial implications that are widespread and extend to all policyholders who are depending on an insurer's capital and surplus to respond to their everyday losses. All acts of terrorism should be covered by TRIA and the Federal Government's participation should not be limited to only foreign-motivated terrorist attacks or to certain types of attacks (i.e., NBCR).

Let me now address the specific concerns that are particularly important to small- and medium-size insurers, all of which are even more acute for worker's compensation insurers who are challenged to manage the uniqueness of terrorism risk. Many small- and mid-size insurers are regional in nature, serving both niche markets and tightly defined markets, as well as a broad spectrum of employers across the country in many of the States that are represented on this subcommittee. They insure a variety of businesses, some small and some large. Indeed, 94 percent of companies writing TRIA policies are small- and medium-sized (as defined by total

premiums less than a billion dollars) representing a quarter of the Nation's total TRIA lines.

So, as you consider the extension of TRIA, I believe it is important for you to consider the impact that two key elements have on the competitive landscape of the insurance industry. First, a higher program trigger (the point at which the program kicks in) increases the number of insurers whose capital is in jeopardy. Already, at today's trigger of $100 million, 75 percent of insurers—all of whom are small- and medium-size companies—have total capital below that level. In effect, TRIA provides no protection.

Just to give you an example, suppose there was a terrorist attack on a business resulting in 100 employee death claims in the State of Pennsylvania. That could result in $75 million in worker's compensation benefits that would have to be borne entirely by the insurer. Needless to say, no insurer can endure the risk of any single loss that can wipe out its entire capital base. In order to manage the risk of the magnitude on a going forward basis, small- and medium-size companies may be required to reconsider their risk appetite, an outcome that could potentially limit the access of businesses to a wider range of choices and a robust, competitive market.

The second aspect is the deductible. A high TRIA deductible means that a greater proportion of the terrorism loss is paid by the insurance company, putting more of its capital at risk. This threatens solvency for smaller and mid-size insurers to a greater degree. And while I cannot speak this afternoon for the rating agencies' position on this issue, I do believe that the impact of TRIA's deductible and trigger requirements upon future financial performance has become a greater focal point in their evaluation of individual insurers.

The characteristics that make terrorism a unique, and even more importantly an uninsurable risk, are as present today as they were after the events of September 11th. It is essential that the Federal Government continue to be a long-term partner with the insurance industry in addressing the potential economic effects of terrorism. In designing the program, the economic interest of all market participants needs to be balanced, yet with special recognition that the small- and medium-sized insurers are essential to the health of the insurance market and, as such, the economy as a whole.

The size of the program trigger and the deductible retained by insurers needs to promote a robust market for the consumers that it serves. I want to thank you for giving me the opportunity to share our perspective this afternoon.

[The prepared statement of Mr. Donnelly can be found on page 78 of the appendix.]

Chairman KANJORSKI. Thank you, very much, Mr. Donnelly.

And now for the record I ask for unanimous consent to have two statements, one by the American Bar Association and the other by the Risk and Insurance Management Society, entered into the record and made a part thereof.

It seems to me that we have almost unanimous agreement on the panel that we should continue TRIA, which is not surprising. But it is surprising in terms of the fact that there seems to be a strong indication that you prefer an extension for a longer period of time

rather than a shorter period of time and some permanency to the program.

Is that to indicate from your statements that you have concluded that the private market will never come back to fill this vacuum? Do you believe it its really a government program from now on and that we should treat it as such?

Mr. DITCHMAN. Mr. Chairman?

Chairman KANJORSKI. Yes.

Mr. DITCHMAN. Mr. Chairman, we believe strongly, CIAT believes strongly, that it is very difficult to handle that type of magnitude of issues and it really belongs in the hands of the Federal Government to handle, certainly, the NBCRs, but when one looks at business and handles when one buys a mortgage or gets a mortgage, they get 15 to 25 years, depending on what the terms are. Companies need surety; they need clarity; they need some safety level. And if—over some period of time they need to know how that process can fare, so I would say longer is better—15 to 25 years.

Chairman KANJORSKI. It does not create any fear on your part that this is the camel's nose under the tent, if you will, and that we can make the same argument about catastrophic insurance? Can you make the same argument about size of coverage, that maybe some companies and some markets just aren't capable. Certainly, you could make the argument, if you wanted to make workmen's compensation uniform among the 50 States, that it would be justified to turn that program into a totally Federal program.

What is stopping that effect?

Mr. DONNELLY. Mr. Chairman, if I could add my thoughts on that, I believe, as I said in my remarks, that this is a very unique exposure, and in my opinion uninsurable, and I believe probably forever it will be uninsurable. But I think when you balance the fact of that issue with also the need to have more stability in the market so that we're not looking at this issue every 2 or 3 years, there does need to be a fair amount of time for it to evolve and to see if there are changes and to look at some of the parameters of the program, to look at what does happen in the marketplace. The world does evolve.

So, I echo some of the other comments that were made, is that probably looking at something that is similar in the 10 to 15 years, so that there is some permanency in terms of the market being able to react in a stable fashion to dealing with this, both for worker's compensation and non-comp. The fact that this is unique is a very important point that I made today and, I want to emphasize again that terrorism is unlike any other risk that I can think of, that we deal with. It is the uninsurability of terrorism that puts this on sort of an island by itself when you evaluate this particular exposure.

Chairman KANJORSKI. So, you don't see the private market having the flexibility to find a way to solve that problem?

Mr. DONNELLY. I think I certainly don't see that in the short-term, and even when I look out further, sir, because when I think of insurability, I think of the need, the ability to predict loss, the frequency of loss, and the ability to measure that loss. I don't see either of those issues here.

And the third issue is, and I mentioned it in my comments, at the end of the day I believe the Federal Government is ultimately the risk manager. I'll give you an example: in worker's compensation, over the last 15 years, what we've seen is the frequency of loss change over time and decline. And it has declined because of the risk management techniques that have been brought to bear with respect to worker's compensation and potential injuries, by manufacturers, by insurance companies, by consultants, and so forth.

Those three elements, the ability not to predict loss, not to be able to measure loss, and the fact that the government is ultimately the risk manager, puts this in a unique, I think, in a very unique picture, and I don't foresee, as I look out in my crystal ball, the ability for any of those three things to change.

Chairman KANJORSKI. Yes?

Mr. WATJEN. Mr. Chairman, if I could just add the group life perspective a little bit, because this is certainly a new piece to the discussion around TRIA, not for this committee, but more broadly around the inclusion of group life.

Similar characteristics: it is very difficult to predict and price the terrorism act into your group life pricing; and, in fact, if you tried to do so, I had almost postured the fact that the employer may not actually offer that coverage to their employees, which very much is contradictory to good public policy right now. As I said in my comments, oftentimes the only place an individual employee can actually acquire group life or any life insurance coverage is in the work place, and what we don't want to do is to create an atmosphere where the employer is no longer incented to provide that coverage, because the cost is too high. So, again, it is very difficult to price that into the product, given the randomness of the events.

The second thing I'd point to is that actually since 9/11, we've really not seen a material amount of capital come back into the industry in the form of reinsurance coverage, because—again, for those very same reasons. So, even though there is a lot of capital out in the marketplace looking for a place to find a home, it's actually not migrating to the reinsurance business in terms of covering—group life coverage. And so again this is where I do believe there is a more active involvement of the government. It is very essential for us to have some stability, create some sense of comfort that encourages capital to come back into the business. Whether it needs to be a support mechanism that's in place for a long term, that remains to be seen, but at least in the short term, that's the force necessary to attract capital and restore confidence.

Chairman KANJORSKI. Are there any other free enterprises here?

[Laughter]

Mr. DOWD. I probably qualify.

The biggest thing for innovation, I think, is the challenge, because a lot of times the innovation comes from very private companies in the capital markets and the challenge for the capital markets who are innovating and adding more capacities is they are so quantitatively driven, right? You know, I use the capital markets for some of my other risks that I use, rather than traditional reinsurers.

And how do you get their interest is, when you can model and quantify the risk with the greater certainty, the more they are will-

ing to risk their money. They really want to be able to bucket, slice and dice and move the market. That is how credit cards, that is how mortgages, everything else, if they can repackage it and quantify it, they can sell it to different groups of investors. And, the real trick with terrorist insurance is that we don't have probabilities. Right? We don't know what the likelihood of loss is.

We can do estimations on the severity of loss, but the probability is missing, and so there is not a good way to repackage and slice and dice the product so that the average investor wants to buy it, and that really stifles the creativity in terms of more capital wanting to handle terrorism risk.

Mr. COTTON. Well, it stifles the capital market in the sense that it provides volatility with the uncertainty of whether or not an event would occur and whether or not it were covered. As I said in my remarks, the mortgages that are supporting the bonds that we own or sell or buy are 10 or 15 year mortgages, as was pointed out earlier, and all we have to gain back from our position is the mortgage to get paid back if something happens.

And it seems to me that if we are not going to have a volatile capital market, we need to have some certainty, and that's where I think long term is important, though I am a free marketer.

Chairman KANJORSKI. You know, the arguments that you are making could have been made regarding commercial mortgaging 30 years ago or 40 years ago, that there wasn't a secondary market. We found a vehicle to create a secondary market, which now the private market is coming in and saying, "Get Fannie Mae and Freddie Mac out of the picture and let the private market handle the whole proposition." It's interesting where 30, 40, or 50 years ago they said it was something that couldn't be done, could not be put together.

Let me pose a question that goes to why I would favor a limitation of time as opposed to a long extension. If we do a 15- or 20-year extension, for all intents and purposes, that is permanent for several reasons. One, the institutional memory of this committee will be gone when we reconsider. Now, that sounds stupid, but there are only about three of us who remember the S&L crisis. Other than the three of us who still remain, everybody else here are virgins to that; they never heard of that problem before. So, if we do this 15 or 20 years from now, there will really be no institutional memory left here at the committee level. That being the case, they won't really know the nuances or the reasons why certain things were done or not done.

The second proposition that bothers me is if we go too long a period of time. As I indicated in my opening remarks, I prefer a 6- to 8-year extension. I am not sure that the private market can handle all of these things. But I don't feel as guilty talking that way as a Democrat that you all, being Republicans, should feel.

[Laughter]

But, that being beside the point, if we reexamine this proposition in 6 or 8 years, will we have a crisis of catastrophic insurance? What is going to happen; how can it be done? What is going to be done on "all peril" insurance? Regarding disaster insurance, certainly in the coastal States of the United States, it is a catastrophe, a second catastrophe. What is happening there?

We will not face that issue unless we have something that requires us to reexamine it so that maybe, ultimately, this issue of terrorism may make us recognize and separate what becomes a public interest issue of insurance that may be covered. It will give us the requirement to come back and revisit the system, 6, 8, or 10 years down the road as opposed to making it permanent, or 15 or 20 years down the road, when, as I said, the institutional memory of all these issues will be gone.

Now, the last legislation was lacking one thing that I am sure my colleague, Ms. Pryce, is going to join me in supporting. We really have to get a commission to do a total in-depth study of this issue and have it returned to the Congress within 3 years or so. Not just a paper, but a real analysis, not only on this issue, but on catastrophic insurance and all these elements, how they fit together and how they could be attacked. The study should be returned to us so that we have enough time to really work on the issues and examine them.

Right now we're doing patch work, and that does disturb me, particularly 2 years to 2 years. And I think, didn't the last leader in Congress only want to do 6 months? You know, which reminds me, there is that famous picture of the President balancing the basketball, and he bounces it and it just doesn't return, because there is no air in it. Well, doing 6 months of catastrophic or terrorism insurance is about the same thing. It really does nothing. We are already getting to a danger point in time. I think we really have to make sure that we move this legislation as quickly as possible, and I am probably partially responsible for its delay and I hope to not be any more responsible for that in the future.

So, we are going to try to move this along in the next couple of months as quickly as possible.

Ms. ABRAHAM. Chairman Kanjorski, excuse me; one comment on this. Stability is one of the most important issues that we are looking for. We plan at educational institutions really for a generation and make very large investments. And your recommendation for a major study of this, I think, is spot on, because risk management issues are evolving. There are new technologies; there are new issues that are coming up that may in part reduce the risks longer term. But, currently, the probability issue is very real for us. What's the probability of an attack on Boston, Philadelphia, Seattle, or Chicago campuses on any given day? I don't know that and so I can't possibly underwrite for it, nor can our reinsurers.

We can pool. We can try to do some things, but that stability and lack of ability to judge when it will happen and what the probability may be is significant. But there are new things that we are looking at; the government is learning. Institutions are learning issues and learning new things. So I think we need stability; we need multiple years. Permanent, I think, is never say never; but, I think there is an opportunity for us to dig in. Look at the changing technology. Look at the changing issues that are evolving in this world of terrorism, and I think we'll be better prepared in 6 to 10 years, both for capital markets as well as loss control and risk management, which is an important part of this.

Chairman KANJORSKI. I hope from the academic world, there is some emphasis. Pay attention. One of the things that has always

disturbed me about insurance is that we failed to recognize its implications in regard to social and economic policy. When we under price insurance to make a sophisticated market like New York or Miami very attractive and very competitive, because we have been artificially subsidized by prices and other markets, we really have a tremendous impact on location of population investment policies in the future. Catastrophic insurance really points that out, but terrorism insurance also points that out.

On the other hand, with my good friend from New York here, terrorism insurance is one thing, probably, that I am not at all certain that we shouldn't underwrite on a national level. It is the importance of our financial centers of the world or our capital city that are much more highlighted and make them likely to be the subjects of those attacks because they are icons of the entire Nation and should be covered that way.

But as we get into catastrophic insurance and other forms of insurance, I think we have to be very careful not to further destabilize the natural supply and demand of the private marketplace to see how growth occurs, how population shifts occur, and how investments occur. Or we just may populate the first 10 miles of the shoreline of this country to the extent that we cause an earthquake in California.

Ms. ABRAHAM. Well, I couldn't agree with you more. In fact, I think you speak to why risk retention groups really make a lot of sense for some particularly tough risks, because we really know the risks of our institutions better than others and can really work both to price appropriately, give risks and rewards, give carrots and sticks in order to both encourage investments and risk management, and encourage changes and behaviors, both societal behaviors and campus behaviors. So, knowing the risks, giving the right kind of incentives is something that we do day in and day out, whether it is athletic injuries, date rape, discrimination, harassment training, or some of the emerging terrorism risks.

So, I absolutely agree with you that we have a role as insurance makers to help encourage societal behavior that's positive.

Chairman KANJORSKI. Thank you very much, Ms. Abraham. I have just been notified by my chief of staff here on the committee that I broke my first rule, and I have over spoken and misused my time. And, therefore, I am responsible for the further delay of this process. I will yield and change that.

[Laughter]

And now, if we can, we will move on to a charming ranking member, Ms. Pryce.

Ms. PRYCE. Thank you so much, Mr. Chairman. Ms. Abraham, while we are on the topic let's continue with, well, first of all, I know that you've been traveling and I appreciate the accommodations you made for the committee to be here today.

Ms. ABRAHAM. I am honored. Thank you.

Ms. PRYCE. We especially appreciate that. And you have testified that expanding the Liability Risk Retention Act would create more capacity and more stability and more competition and all the things we see as good in this picture. But, I know that this committee has been approached by consumer groups and others in the past to include this in TRIA or freestanding, so, there must be

some opposition. There must be some—are there policy considerations against what you are proposing, and who would come forward with arguments counter to yours?

Ms. ABRAHAM. A good question. I don't know who will come forward. I'll get to them soon though, if you let me know on our own side. But we clearly see this as an opportunity to be a small part, and I want to be clear on that, a small part of the solution. So we think that we have the ability to understand risk, to add capital. Because risk retention groups, all of the capital is owned by the policyholders.

So when a member joins, a new institution joins United Educators, they make a capital investment. So, we're a co-op, a mutual, a reciprocal, so it is an ability to add capital and to try to solve a problem. We rely on reinsurance as well, but the members have an investment. They make an investment. Our net income is their net income. I can't invest in United Educators. Only Penn State can invest, or another educational institution. So, it is an ability for like-minded, whether it is a hospital, real estate agents, shopping malls, to be able to join together, so it is adding capacity.

It's not going to solve personal lines problems. It's not going to solve every issue, but some of the toughest risks. And I would say MIT and Cal Tech would be some of the toughest risks out there to be able to join together and find a solution. Some, there may be some out there. They have not approached us, but I think it adds competition and is a part of your very complex solution, not the magic dust, but part of the solution.

Ms. PRYCE. Well, I welcome comments of the other witnesses and let's ask Mr. Ditchman since he's a fellow Ohio Buckeye, if you have any opinion, and if the others would like to weigh in on the pros or cons of this, attaching this to TRIA or a free-standing bill. Mr. Ditchman?

Mr. DITCHMAN. Thank you. Mr. Chairman, the CIAT is a wide ranging group of organizations. And when one asks who may come out in opposition to the positions held at this table, one only needs to look at the United States Chamber of Commerce, who is involved in our organization. The Real Estate Roundtable, the National Association of Manufacturers, the National Retail Federation are members; the Association of American Railroads, the General Aviation Manufacturers Association, Taxicab and Limousine Association, the American Association of Gas, the American Public Power Association, Edison Electric Institute, the National Rural Electric Cooperative Association, the American Bankers Association, and the American Community for Bankers, the Mortgage Bankers Association and the Commercial Mortgage Backers and Securities Organization. What more can I say? There are a lot of organizations that support under the CIAT position.

So, I think you are going to find it difficult to find a large group that's going to be in opposition to the positions held at this table. Thank you.

Ms. PRYCE. Anybody else care to comment? I mean, this has obviously been considered in the past and for some reason has not made it in, made the cut. And so I just wonder if there's something I'm overlooking.

Mr. DOWD. I think for the large insurance group, I don't think that there's any opposition to the risk retention groups being added. I think Ms. Abraham was correct that probably in her view it doesn't have a lot of the excess we've seen in the House, though don't add a meaningful amount of capacity when you consider the billions and billions and billions of dollars that we are talking about.

But from the fringe of the situation, if insureds are interested in taking more of their own risk, which essentially this is, you know, we have no opposition to that.

Ms. PRYCE. All right, thank you.

Mr. WATJEN. If I could just add, I represent, I know again, a different group, which is the life insurance industry. And again, I can't see where the opposition would come from. The national insurance agents, the commissioners have all supported legislation like this, as we said. Frankly, protecting the buildings is a part of the object of all of us, but also the individuals in the buildings as part of that. So I can't see where the opposition would come from.

Ms. PRYCE. And, Ms. Abraham, the proposal is to add property too, and, the liability experience has been a very positive one. Is that what I am to understand?

Ms. ABRAHAM. It's been a very positive one. The market has grown over the past 21 years. We, in fact, are 20 years overrated by A.M. Best. Our member retention rate would mean, year-after-year, is 95 to 96 percent. So across the board it's been very strong comparable to the commercial insurance market, but very strong loyalty. These are institutions that, or businesses or nurse-midwives, that invest in their company. They run their company. So, it's not for everyone. Not everybody should join a co-op. But for those who believe in long-term investments, a risk retention group is a very good alternative.

Ms. PRYCE. All right, thank you. My time has expired. Thank you, Mr. Chairman.

Ms. ABRAHAM. Thank you.

Chairman KANJORSKI. Thank you, Ms. Pryce. Our good friend from New York, Mr. Ackerman?

Mr. ACKERMAN. Thank you, very much, and just for the record I want to make sure it indicates that I, too, am charming.

Chairman KANJORSKI. You are.

[Laughter]

Mr. ACKERMAN. Thank you. To stipulate, all the members of the community are charming.

Chairman KANJORSKI. All the guys are charming, come on.

Mr. ACKERMAN. This issue gets more complicated the more we look at it and I think that's because of the changing dynamics of our times as individuals or groups tend to become more and more violent. I think we're going to have to possibly look at redefining some things, at least for the purpose of insurance, if not in other areas under other committees' jurisdictions as well.

If we take away, for insurance purposes, the difference between international and domestic terrorism, which as I indicated I am in favor of doing, how do you define each of these terms and how? And to consider it may be necessary not just to redefine the word domestic, but the word terrorism itself, I know there are distinc-

tions in the law for some purposes between massacres and mass murders and serial killings, and the like. And each one is a different kind of category. But how, what category would you put the incident at Virginia Tech, for example?

All of these horrific examples have a terrifying effect, but is it an act of terrorism that I think we're going to have to collectively think about and reason out? I do not know that there's any answer right now. Certainly, if I were an insurance company, I'd have one argument. If I were a victim or relative thereof, I'd have a different argument for Virginia Tech, and I'm sure somebody's going to make those arguments at one point in this or some other case.

Do we need to redefine these terms?

Mr. DONNELLY. Well, I think, sir, what I'd say with respect to the domestic and the foreign, I'm not a lawyer. And I think when you were commenting, I think of the example in London of the subway bombings, where it was caused by British citizens who were creating, what I would say terrorist attacks. And I think before when we said foreign, we would think about literally people from outside of this country coming upon American soil and creating an event.

So, when I think of domestic, saying all events should be covered is something that we need to consider. We need to sit down and make sure we take a look and define exactly what we mean. But I reference, I use the London example as something that I say was a terrorist, you know, whether it was a British citizen doing it or an American citizen doing that versus somebody from another country coming here, because they were attempting to basically attack the way of life that we have here in our economy.

You know, the Virginia Tech issue, I guess I view as an unfortunate event. You know, an individual person that obviously had a lot of personal issues to deal with and created a lot of tragedy for a lot of people for not only the victims themselves, but the families and all of the people at Virginia Tech and a lot of other people in the country.

I don't necessarily consider that a terrorist event in the way—that particular event anyway, and I know that we have to write some legislation that's broad enough so that it doesn't take into account—we get in a situation that we'd have to redefine it every time there's an event happen. But I do think we have to make it broader than what we have today.

Mr. ACKERMAN. Yeah, I'm not sure that we have to look at this from the perspective of checking somebody's passport to identify what they've done. I think we get into the sticky area, and I guess maybe we do have to get into it, of what the motivation is of the person who is making the attack. And it doesn't necessarily have to be that they have the passport of some country that gave them a passport, whether or not they really—there are a lot of countries for example in the Middle East and other places that give people passports, who are not of that country. They just carry passports of other countries. An international terrorist attack, I would presume, is one where somebody is attacking our country in what they view as the interests of another country.

And we're dealing with other societies as well as other countries right now. You know, somebody could carry the passport of one country and commit a terrorist attack on behalf of some beliefs of

another country. And something like Virginia State was more of an attack on our society or our culture, or you could make the argument that it was just the ramblings of a mad individual.

Do we have an obligation on the terrorism insurance to insure against acts, individual acts of individuals?

Mr. COTTON. I might add a comment. I think you used the word intent. The intent to disrupt society in the government, operation of the government, it seems to me as a way to look at it. But I think the marketplace as we see it, CMSA sees it, will not make a distinction between who the person is or where they came from.

But when you see an act like this you'll recognize it and we think the distinction should not be there.

Mr. ACKERMAN. Well, it's like pornography, then.

Mr. COTTON. That's what he said.

Mr. DITCHMAN. Mr. Chairman, may I?

Chairman KANJORSKI. Yes, Mr. Ditchman.

Mr. DITCHMAN. The National Association of Realtors recently did a study of voting Americans and determined that 64 percent believe that in the next few months there would be an attack on this country and 42 percent believe it's going to be in their neighborhood.

And, candidly, the whole process of terrorism is to create horror. The horror of it all is to influence governments to act differently. The Rand study clearly indicated that these fringe organizations rely on the violence against civilized people to make a political point.

And that Rand study, which you have available to you, but more importantly is the effect that it has on one personally, and how one lives with that after the person who is down the hall from the person at Virginia Tech; or what happens to the person on 9/11. All you have to do is to look into that huge crevice today and realize what happened to those 3,000 people who passed away. I mean, it's just so—they want to create the fear within the individual and they don't really care who they are. They just want to do an economic damage to this country and create the horrors.

Thank you.

Mr. ACKERMAN. Let me just be clear on that before I further abuse the time the chairman has allowed. Are you saying it should or should not go to motive for insurance purposes? We have a different standard because we struggle with this and hate crimes, whether, you know, you bury someone's head in it because of their color or religion. Or you bury someone's head in it because they kissed your girlfriend, there's a different penalty, sometimes. But that was the intent of the hate crimes thing. Should we go to intent for purposes of insurance? I would think the purpose of insurance is to figure out from an actuarial standpoint, which is continually a moving target and what we're talking about—do we figure out just what the risk is and insure everything?

Mr. COTTON. Is it possible to say that this whole debate is around the fact that the only gap that really exists in the insurance world is as it relates to terrorism, and that's why we're sitting here?

Mr. ACKERMAN. I think it's a new frontier—a terrible but new frontier. I yield back my time.

Chairman KANJORSKI. Let's see. I don't know who is going to remain or who is here, but because we have some time constraints, I ask unanimous consent that we move on with only the remaining members being justified to be heard. Mr. Bachus of Alabama, Mr. Scott of Georgia, Mr. Murphy of Connecticut, Mrs. Bachmann of Minnesota, Mr. Donnelly of Indiana, and Mrs. Maloney of New York, in that order. And now, I recognize the ranking member of the committee, my good friend Spencer Bachus from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman, and I appreciate your work on this issue over the years. I am going to try to ask really short questions, so I can get long answers. And my first question, and I'll just start with Mr. Dowd, because I read your testimony and you sort of touched on this; how would you rate our current program on a one-to-ten basis?

Mr. DOWD. You know, if we look at the goals of increasing availability and affordability of terrorism insurance as one of the main goals, I think we probably got about an eight. I think when it comes to conventional terrorism, for the most part, the customers who want to buy it at a reasonable price do today, I think.

When it comes to the non-conventional at the NBCR, I would probably rate it closer to a two. Really, the only available insurance today is worker's comp and it's only available because it's mandatory. So, I think we need improvements there if you wanted to move the total scope of the bill up to a ten. But the truth is, I think, that's the main area that I would focus on for improvement to move it up to that. Because generally the economy, clearly as a direct result of this bill, took off in leaps and bounds. In our own industry, you know, people think of this as an insurance bill. Frankly, we're like the tail on this thing. The rest of all the issues that were mentioned over here really are what took off, because this bill is high. I would rate it very, very high on its goals of availability and affordability.

Mr. BACHUS. In fact, you touched on something that absolutely, when you said workmen's comp was the only coverage that doesn't exclude nuclear, biological, chemical, or radiological. You know, after 9/11 when we were working on that bill, we didn't hear as much about that. Now, we are told pretty much in briefings which have been released to the public, so this is not confidential information. And most securities and analysts tell us that probably the next attack, if it's a large-scale attack, will be nuclear, biological, chemical, or radiological.

I mean, that's what, and you know, we don't have the coverage there, except workman's comp. Normally, it's excluded otherwise. So, I would give that part of the program a two also. Now, let me ask a follow-up question, then I'll let everybody else answer it, but I'm going to put him on the spot first. But then, everybody else knows the two questions, because I'll ask anybody else who wants to answer them.

How could my side and both sides I think—cost is always a concern on the Hill—how do we increase coverage and at the same time not expose government involvement or reduce the cost? Is there a way to both, you know, to increase capacity, while at the same time lessening government involvement?

Mr. DOWD. I think it's actually tricky. I think we've probably reached the tipping point where increased deductibles and co-insurance from the perspective of putting on insurance, is actually reducing capacity today. I said before that I don't think very many insurers today are selling enough insurance to actually fill their deductible, because their deductible is greater than their appetite for any other risk. So, you've actually probably, with the increases in the deductible, lowered the available capacity.

I would sell more and was selling more when I had a lower retention. You know, the truth is that today's deductible is greater than the World Trade Center. We would get no recovery on the World Trade Center and from a conventional point of view, we have difficulty finding any scenarios that we would get recovery under. So, I think it sounds counterintuitive, but I think to increase more capacity, the first thing I would do is think about the deductible and the co-insurance layers.

And, I think if you are interested in how then to keep the government's participation at the same place, then you do have to come to some sort of fund mechanism, whether it's a pre- or post-event surcharge of some kind. I think that's where you end up with if you want to leave the government where it's at in terms of attachment point, but yet encourage people to write more insurance, I think you are going to have to joust with "someone else has to pay for it".

Mr. BACHUS. Okay, Mr. Cotton?

Mr. COTTON. From the point of view of the consumer, and I think we represent that to a degree here, I don't think there is a seeking of a free ride. And, if there are recoupments appropriate that help to repay, that makes sense. I agree with Mr. Dowd. And I also think that the more that it gets done, the market picks up on what's happening. Again, to what Mr. Dowd just said, you have a better chance for the market to understand what it's doing.

Mr. BACHUS. Okay, Ms. Abraham, do you have any comment?

Ms. ABRAHAM. I do. In fact, I represented Mr. Donnelly's a small company, I mean a micro-nano kind of company. But I think you want that. You want small- and mid-sized companies in their adding capacity. And if you make the deductible too high, make the triggers too high, we're out of the game. But I think you want us in there. I want to be in there providing capacity, giving some capital, making more of a market. If he's frightened by those kind of deductibles as a percentage, you can imagine what it does to our institution. So, making it so high that there's a safety and a release for the Federal Government really saps capital out of the market, because we can't be players.

So, you want a lot, not just the big guys in there. You want the small, midsize, and nanos in there as well.

Mr. BACHUS. Okay, anybody else? Mr. Ditchman?

Mr. DITCHMAN. Yes, sir. One thing that's very important is to understand that if we ratchet it up, it actually puts the insurance companies out of business and the reality is that this is an economic issue facing this country. You want more companies involved, so ratcheting down might be a more practical approach than that and we have always suggested that the event of the trigger should remain in the current level. You know, we believe that

a question of the domestic acts and so forth, so I think that deductibility issues, you know, if they can come down on some basis, I think that will only help the process.

Mr. BACHUS. Thank you. Mr. Watjen?

Mr. WATJEN. Yes, I'd like to just add to—back on your comment—about NBCR. Actually, group life insurance coverage does include that now. There are few exceptions. For the most part, that is not an exception. And again, in a couple of States there are limited exceptions. But again, we are very much contained to provide that coverage to our insureds, which actually raises the point that, you know, because we can actually price for the terrorism exposure, because those are such event-driven events and there is limited reinsurance out in the marketplace, I think our industry basically is taking on greater financial risk at this point.

So, one of the goals as we think about legislation and support going forward is to provide a little more of a safety net because our industry, frankly, is taking those risks on without the type of coverage and catastrophic reinsurance coverage that used to be available to it in the past.

Mr. BACHUS. Okay.

Mr. DONNELLY. I guess I would just echo Ms. Abraham's comment about what I believe is good for the economy, good for the consumer, is more competition. So the need to lower the trigger, lower the deductible, and deal with the co-insurance, is important to make sure that the playing field is level.

I will tell you that I did mention in my comments, I think, the rating agency is one of the things that's evolved over time. In reference to your question about how things have evolved is, I believe, the rating agencies will continue to play a greater role in evaluating the parameters of the key elements of TRIA or an extension of TRIA and what that means for the competitive landscape. And, I think not lowering and not addressing those needs is going to constrict competition, not expand it. The other thing; I am a free enterpriser, but I do believe, and I probably have said it too many times is this is unique exposure, including the fact—and I think the government has done a fabulous job being a risk manager since September 11th—we've not had an event.

And I certainly don't want the job of being the risk manager—I have enough trouble sleeping at night. I don't want to know about all of those things. But the fact is the government really is ultimately the deterrent here and the protector and this puts a lot of responsibility on the Federal Government to play a major role here today in going forward. And while that may evolve over time, I do see that continuing because of that very fact.

Mr. BACHUS. Can I just close with a statement? One thing that, Mr. Donnelly, you were sort of saying this, I think. Another thing that's happened since 9/11 that members ought to reassess, not doing everything we can do to create the private market insurance, and that's Katrina. Because, you know, one of the biggest lessons out of Katrina, the difference, Katrina was much larger than any other hurricane. But the other thing about it was there was so much uninsured loss, because they were in a floodplain or there was a wave and all that.

And it's costing the government just untold amounts, because they're not very good at compensating people. Insurance companies have done it for 200 years. They have a good claims process, and, so when I say cost, I mean the government cost. If we don't create private sector insurance, we are going to come in like Katrina, just like we did on 9/11, and there's going to be a public outcry, and they're going to say, make everybody whole. And it's going to cost the Federal Government and the taxpayers 3 or 4 times what private insurance companies could do it for.

So we're really not saving any money. If there's an event and there's not coverage, we just don't do it well. I mean, I can tell you. You know that; the public knows that. But government is just not in the business of running an insurance company and of compensating people for claims. It's not what we do well.

Mr. DONNELLY. And that's why I am not going to criticize the government, but I echo the need to look at TRIA, the extension of TRIA in a pretty orderly fashion, which this committee has done. And I also go back to Chairman Kanjorski, your suggestion about a study over the next few years probably addresses that too. So that we can look at collectively government and the insurance industry and business in general to look at the issues. So that if going forward, there needs to be adjustments, those adjustments can be done in an orderly fashion, not in a time of chaos.

Mr. BACHUS. Thank you.

Mr. COTTON. Might I add one thing? I wholeheartedly agree with you on the proactive nature of what you are talking about as opposed to the reactive nature. If you look at it from the CMSA's point of view in the capital market, the lenders need the insurance, because after all the skin in the game we have is a loan to get paid back. The rating agencies who rate the bonds demand it, because they are looking for stability, not volatility as it relates to the bonds that are sold.

And the investors who are buying these bonds can't withstand the thought of the loss of 100 percent of their investment, which is not an equity investment. It's a mortgage as a result of something like this. So from the capital market's point of view, the lack of insurance is untenable.

Mr. BACHUS. Thank you.

Chairman KANJORSKI. Thank you, very much, Mr. Bachus. Mr. Scott of Georgia?

Mr. SCOTT. Thank you. Mr. Chairman, this has been a very interesting hearing, and a very informative one. I have a couple of questions, but I first want to get a better understanding about the state of the discussion within the industry on the nuclear, biological, chemical, and radiological threats and how each of you feel about that, including an extension of the legislation. And I noticed here recently that there's been a split among the industry as to this. Could you just share a little bit on the status of that and sort of a summary of where we stand on that particular issue? Maybe the lady from—are you from Scranton?

Ms. ABRAHAM. No. I've been to Scranton. We insure the University of Scranton; they're a member of United Educators.

What I can tell you is from United Educators' perspective, we don't believe that it's an insurable risk. We insured some isotopes.

If there's an accident in the lab, we'll do some work at that level, but we have no idea how to underwrite the kinds of catastrophic risks that this would bring to one of our campuses. And, if it is included in a terrorism bill—a different deductible would be—a much, much lower deductible would be required for us to be able to have any role in taking part of this risk.

It's simply something that we don't know how to underwrite at the scale that the experts are talking about. So, my colleagues will have to speak to their own industry, but it's a level of risk that we can take a piece of, because we do that with a lot of other issues. But to take a major risk, the kind of deductibles you are thinking about for the rest of TRIA that are in place now, is something that would fall into the uninsurable level.

Mr. SCOTT. Okay. Yes?

Mr. DITCHMAN. CIAT clearly believes that the NBCRs are noninsurable and it just is not a possible way to cover it given the mechanisms that currently exist. And so, we stand, and all the organizations behind us clearly believe that's the case.

Mr. SCOTT. Thank you.

Mr. COTTON. CMSA would echo that and say that we are supportive of it: (1) because it's uninsurable; and (2) if it is included, it will provide a much more efficient mechanism by which to deal with it, as opposed to the government coming in after the fact and dealing with it.

Ms. ABRAHAM. Right.

Mr. DONNELLY. I would say that I think there's more fundamental agreement than there is disagreement. I echo comments made that I think it scares everybody in lots of ways. But as a CEO of an insurance company, and especially where it's mostly worker's compensation, it is clearly on the far spectrum of insurability. I think the range of possible outcomes is just staggering. And so, I'm sure there are some details as the legislation is worked out and recommendations are made from the industry that will require further study.

There are some nuances in terms of details, but I think we are fundamentally united on the fact that this is, if I could say, it's the scariest of when you think about the terrorists, of potential events, and therefore the outcomes.

Mr. WATJEN. Yes. I was just going to say, again, as I mentioned before; it's not excluded from a group life contract for the most part. That's mandated by the States that we all in our industry operate within. That doesn't mean, though, that we're not, as I said earlier, taking really significant risk as part of that. Which is why again it's created under some scenario, some solvency issues for some companies.

If they, in fact, found that there was a terrorist act where they had some unusual exposure, it could actually mean substantial solvency for some of our member companies.

Mr. DOWD. Truly, from the large insurer's point of view, I think it's probably the most troubling. Our customers uniformly want the coverage. And, generally speaking, when that's true, I want to find a product I can sell. The trouble is the quantification; we will have a very difficult time quantifying the size, magnitude of loss, and the probability of it occurring. And when you add that to the fact

that there's no capital markets or no reinsurance solution and the limited capital base is what makes it so difficult.

And those that would like to have it in the bill, I think the insurance industry is good at delivering the mechanism. Right? We can deliver the policies. We can deliver the claims handling service. We can deliver some services around that, but we do have difficulty with the financial side. So, to the extent that it is talked about from our perspective, the cap is very, very troubling, a $100 billion-event. All of us can come up with scenarios that are greater than that and the size of that would have to be either zero or very, very low before I think you'd get many people that want to put their capital at risk.

Mr. SCOTT. Well, I'd really appreciate those responses, because from all indications, and from information we get from Homeland Security, all of the experts are saying that if we do have another event of catastrophic nature, it's not going to be like the one we had because we're pretty well protected from that. It in all probability would come from a biological or chemical attack. And there's so much more work we need to do on that, but I appreciate those comments.

I would just like to ask, Mr. Chairman, some logistical questions. One, as we continue to pass short-term extensions of TRIA, is it not possible or plausible to extend the legislature for a longer period of time and if so, what would be the appropriate length for the extension. I would like to start with—I don't know. When I referred to Scranton, I just heard somebody at the very beginning say they were—

Ms. ABRAHAM. I'll be Scranton. That's all right.

Mr. SCOTT. Both the chairman and I went to elementary school there.

Ms. ABRAHAM. Actually, I'm Pittsburgh, but I'll do Scranton, so, that's all right.

Chairman KANJORSKI. You have to understand, Mr. Scott was born in Scranton, Pennsylvania.

Ms. ABRAHAM. I'm getting that.

Mr. SCOTT. Mr. Chairman, of course, will represent Scranton. We love Scranton and I just thought I heard Scranton mentioned up there. Go ahead.

Ms. ABRAHAM. We spoke before about the lack of stability and is that causing the real problem? A 2-year windows is really very difficult. Is this a forever kind of bill? I don't agree that it is a forever. I respect the institutional memory issues, but we need a long-term solution: (a) for the government to share with the industry the data, the underwriting for us to get better at it; and (b) for a study of new loss control and risk management issues. So, I see this as a 10-year kind of horizon that seems like a very long period of time. But I think it's going to be very difficult for the capital markets to develop, fill in the voids, and for the evolving nature of this risk to really come to a level that we will be able to underwrite it.

And, more importantly, the capital markets will step in and be able to, as Mr. Dowd said, develop a probability associated with it. So, anything less than that creates an instability in the market that I think is a real problem for us.

Mr. COTTON. For those of us who finance these assets, 10 years sounds like a good number. Permanent also sounds good. The issue is sustainability and the ability for our borrowers and their customers, to have affordable and available insurance to conduct their businesses, and for our investors to be able to have a sustainable income stream that they can understand and see not be interrupted as a result of these 2-year exchanges like this.

Mr. DITCHMAN. To answer your question, Mr. Scott, the business certainty and stability are the key elements here and CIAT clearly believes it would be wonderful to have it indefinitely. But the reality is that 15 to 25 years is a reasonable time that any large corporation will study or have a plan for, so we hold to a 15 to 25-year time-line if not indefinitely.

Mr. DONNELLY. Mr. Scott, PMA Insurance Group provides workers compensation insurance to the University of Scranton.

Ms. ABRAHAM. I'd echo the comment about 10 years. I think that 10-plus years is in one way a long time, but I do think it is something that gives a lot of stability and allows, you know, the studies that Chairman Kanjorski mentioned before to take place and to be able to monitor, in fact, if there are innovations.

The world is going to change over the next 10 years, and it does make sense to have some point at which evaluations can take place in terms of the key parameters. But we do need something. I believe it's in the best interest of everybody to have more stability. Certainly something a lot longer than 2 years, because 2 years can go by very quickly and we're back debating the issue, and I don't think that's constructive for anybody.

Mr. SCOTT. Okay. Just a final question, if I may. Anyone agree on inclusion of group life insurance?

Mr. WATJEN. Certainly, speaking for myself, yes sir.

Ms. ABRAHAM. I can't think of a reason to exclude it.

Mr. COTTON. I don't have a dog in this hunt.

Mr. DITCHMAN. Nor do I.

Mr. DONNELLY. Nor do we.

Mr. SCOTT. Thank you very much. I yield back, sir.

Chairman KANJORSKI. Thank you, Mr. Scott. Mr. Murphy of Connecticut?

Mr. MURPHY. Well, thank you very much, Mr. Chairman, and that actually provides a fairly apt segue to my question and that is mainly directly to Mr. Watjen to help many of us make that case for the inclusion of group life. Explain to us why we've gotten to the point where the market has treated group life in a slightly different way, why both insurers and reinsurers to an extent have been able to price a group life product in a way that we have not been able to for property and casualty, and why there still is a major risk for either originators of products or reinsurers to pull out of that market.

I myself certainly share the view that this should be as comprehensive and long-term a solution as possible, and that certainly in my mind includes the composition of a program with group life. But, I think that there are some members who maybe need to understand why the market has treated them differently and still given that differentiation, why it makes sense to include group life as part of this package.

Mr. WATJEN. I'd be happy to answer that and again I do think this committee certainly has been very supportive of group life for some time. It just has never reached its way to a final bill. And some of the characteristics that I think we discussed a couple of years ago very much exist today and actually came out with some of the discussion here today from the property casualty program, which is that there's still a high certainty around the event of a terrorist act, which makes it very difficult to price and underwrite for this business. That characteristic has existed ever since 9/11 and has continued to exist actually for all companies in our industry. And as I said in my prepared comments, there has been no return in meaningful ways of reinsurance capacity to provide some catastrophic coverage to give all those group life insurers frankly to really have some degree of support to the extent there was a catastrophic event like that that they'd actually make good on.

And so, as I said earlier, we can't really fully pass the price law, because again, what would happen, if you think about the whole dynamic here is that our group life products are basically for the most part paid by an employer. In many cases, that's the only insurance that the employee actually has is actually the insurance provided at the employer. So it's a discretionary expense, if you will, by the employer.

So, we try to overload the cost with what could be a theoretical cost of a terrorist act. Employers may consider dropping that coverage, which actually is not good public policy, because in fact in many cases this is the only safety net the individual actually has is the coverage they receive at the employer. So, really our whole industry is taking on more risk right now, because in the past we used to have some level of catastrophic exposure that we could rely on.

Our own company, for example, on 9/11 had a fairly extensive catastrophic reinsurance program in place, which minimized the cost of the tragic events of 9/11. Those programs are no longer available. So, the private sector hasn't stepped back in to provide that capacity, to provide that safety net for insurance companies. And the reason it hasn't is because these are still events that are very random. How does the reinsurer actually price for those events?

And so we, as an industry, are frankly taking on more risk right now, more risk than we think is acceptable in the long term. We are still waiting for new capital to come in and accept some of this risk, but that capital has not been coming in for very obvious reasons.

Mr. MURPHY. Now, you mention in your written testimony, I don't know if you touched on it in your verbal testimony, about a limited number of reinsurers starting to creep back into the market but at a price apparently that's not terribly—could you talk a little bit about what's happening in the reinsurance market on life?

Mr. WATJEN. Very much so. And again, we were very fortunate. We, up until 9/11, were very active users of catastrophic reinsurance, even though we're a fairly large company, to protect our capital, to manage volatility. That was a very important part of our risk management. And again those programs for all intents and purposes have completely been eliminated.

What you can find is some limited amounts of coverage with more significant deductibles, with more limits of coverage, so again there are pieces of the marketplace that have returned. But in terms of having a more holistic market that provides that safety net if you will for small, medium and large companies that has not returned in anything close to the levels we saw pre-9/11.

Mr. MURPHY. Thank you. The second question I guess I'll direct to Mr. Ditchman, because you are on the real estate side of this, but open it up to the panel, is a question of geography. I guess I'd be interested in hearing to what extent on the property insurance side this is an issue that has been more of a problem in terms of our urban areas, metropolitan areas. To the extent that from a real estate perspective, you have lenders across the country, no matter of areas that may be at greater risk of terrorism, and other areas requiring this kind of coverage.

In some parts in the short time that I've spent in this building, it's been talked about as an issue really to one that relates to the east coast's more densely populated areas. But it certainly seems to be an issue that from a real estate investment side really has no discrimination as to geography.

Mr. DITCHMAN. The situation is not limited to the coast. As I indicated, we own an office building in Cleveland. One of the ones that we have, have a large number of telecommunication companies that reside in it. Our terrorism insurance—this is something that I own personally with a couple of partners—has just skyrocketed because of the types of uses. That's in Cleveland, Ohio, a 21-story office building.

Most people don't even know that it has telecommunication companies in it, but the insurance company knows, and so we do it. And, the same thing is true for other parts of Ohio, and, I know is certainly in the major cities it has affected. We do the real estate for Goodyear, Goodrich, Eaton Corporation, some of which are self-insured and some that rely on other companies to provide the insurance, all of which is a question that they ask and make a determination when they determine the location.

For example, Albuquerque, New Mexico: We are doing something for Goodrich in Albuquerque, New Mexico, right now. Goodyear got out of Paris. We sold an office building in Paris for them. The problem is they are trying to concentrate in areas where they believe they have the least number of risks. Does that answer your question?

Mr. MURPHY. Yes.

Ms. ABRAHAM. Mr. Murphy, I would say that I think of a Saturday afternoon and I think of the University of Michigan and Notre Dame and University of Nebraska, and those are not necessarily urban centers but they are certainly worldwide-known centers. Some of them might be streaming video, and so these risks are not simply New Haven, New York, Pasadena. These are truly "in heartland" issues that we face and I worry about every single day, that we have a large number of people at the big house or any other major establishment that are on our campuses in usually remote areas, very rural heartland areas.

Mr. MURPHY. Thank you very much.

Mr. WATJEN. Congressman, I can echo that too, again. In the group life world, again, it's the concentration of employees that are really the issue that we need to consider. And those—that can be a large plant, that can be an office park. That can be just large concentrations of people all in one position, which again could mean it's not just the metropolitan areas. It's all across the country and I would echo those comments.

Mr. DONNELLY. That's certainly true about workers compensation insurance as well.

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

Chairman KANJORSKI. Mr. Donnelly?

Mr. DONNELLY OF INDIANA. Thank you, and I'll try to keep it to 5 minutes so we can go vote.

I just want to tell you the extreme wisdom I thought that the gentleman at the far right of the panel, I think Mr. Donnelly—

Mr. DONNELLY. I appreciate that, cousin.

[Laughter]

This question is for Mr. Cotton, then maybe for the entire panel. And that is we are talking about a timeline of 2 years, 5 years, 10 years, indefinite, and you have to talk to investors. We were talking about a timeline. We were talking 2 years, 5 years, 10 years and you talk to investors. Is there a tipping point on this legislation where if this is renewed for an additional 2 years or something your investors will say, we're not real comfortable with that kind of horizon.

Mr. COTTON. I will tell you that I'm not sure I'm smart enough to know where the tipping point is. The issue is stability versus volatility and if the rating agencies or the investment grade buyers in our world smell volatility, they leave. If they leave, that's a liquidity issue. If there's a liquidity issue, it affects the real estate industry, which affects the entire U.S. economy, is the way we look at it.

So, I don't know that I could tell you 2 years versus 4 years. I think sustainability and permanence are really critical. I understand the free market desire to have free market fill it, and I think Mr. Dowd said it very well when he said, more availability, more people participating may in fact encourage more participation. It's sort of an ongoing cycle. I think that's the point he was trying to make and I echo that. But I don't think I could tell you what the tipping point is.

Mr. DONNELLY OF INDIANA. And that follows into my next question, which is if it's 5 years or 10 years, do you anticipate a time when the market itself can start to step up and fill this in, or do you see the government as being almost a permanent partner in this process?

Mr. COTTON. That's not a question for us, because we're not in the insurance business. I will tell you from the investor's perspective, if they keep seeing the volatility, it discourages them from investing.

Mr. DOWD. I'll take a shot at the last one. Right now, there's nothing that I see from talking. I spend a lot of time with capital markets reinsurers, our own investors. Right now, there's nothing on the 5-year time horizon that leads us to believe there is going to be another solution. I'm with Mr. Kanjorski. I would hate to say

in 15 to 20 years something else wouldn't develop. Things always develop over long periods of time.

Mr. DONNELLY OF INDIANA. And I guess that's where I was trying to go is in 5 years do we see anything developing?

Mr. DONNELLY. I would echo Mr. Dowd's comments about that. I don't see over the next, you know, four, five, six and maybe beyond, you know, a situation where the government doesn't play a partnership role with the industry. And as for the first question about if this were to be renewed for 2 years or 3 years, and I guess I'll go back to the insurance company perspective as I can't speak for the rating agencies.

But for smaller and mid-size companies, looking at the elements, looking at first of all whether or not TRIA is going to be renewed, and what the elements are going to be to that, it is my perception that they are becoming more important in terms of the evaluation of companies. And I think so, and they generally take a time horizon, looking out more than 1 year, more than 2 years. So, I think, and we probably would be back if this thing were renewed at the end of the year. You know, we'd probably be back in the middle of 2008, starting to talk about, you know, the same issues over.

So, I certainly believe that another rollover in 2 or 3 years again is not in anybody's best interest in terms of it. And I don't think it really solves what we are trying to get at and you folks are trying to do from a committee perspective. One of the gentlemen mentioned before, the issues; I sort of feel from what I am hearing is that, you know, the complexity of the issues. And you guys have been studying the issues and they are more complex than maybe what was thought 5 years ago.

Mr. DONNELLY OF INDIANA. So, we're probably, I mean, to provide comfort factors and comfort levels to everybody, we may be looking at 10 years.

Mr. COTTON. Yes.

Ms. ABRAHAM. That's what we see.

Mr. DITCHMAN. And the CIAT organizations that I referred to earlier clearly believe that this is not something that's going to be solved in the short term, and I concur with the other gentleman. But from an investment point of view, one who owns real estate, who buys real estate and sells real estate, we want security. You know, we want the ability to know that it is there, that we are protected and the tenant that we have in that real estate is protected.

So you need security. You need that certainty and stability that it's going to happen, which is why although we'd like to see it for a much longer period, the 15- to 25-year term, which is the standard term of a mortgage as Lee would indicate. I mean, you know, that's how people think.

Mr. DONNELLY OF INDIANA. Thank you.

Mr. DITCHMAN. Thank you.

Chairman KANJORSKI. Thank you, Mr. Donnelly. Ms. Maloney, you have patience beyond.

Mrs. MALONEY. This is an important issue, Mr. Chairman, and it's wonderful to see you back in the chairman's seat. And I want to add my voice in thanking you for your leadership on this and your statement to have a bill before us to consider by April and hopefully to move something forward. As a New Yorker who rep-

resents many people who suffered from 9/11, absolutely nothing that Congress did, and I thank all of my colleagues for their support, was more important than the creation of TRIA.

We couldn't even sell a building. No one was building. No one was doing anything. Our economy just moved to a grinding halt and what I am hearing now from New York and from business is that no one can get insurance now. The only insurance they can get goes up through the extension and then it dies, or there's no insurance unless there is an extension. And so it's absolutely critical for the economy in New York, and I would say in many areas of the country. I've talked to some people, some constituents, who say they've had to go to London to get insurance. They couldn't even get it in America.

So, it's a really, really important issue, and I think it's the most important really for our national security, because part of our national security is our economic security, and our economic security is not going to go forward without a TRIA extension in place. I want to take this time to really thank the chairman for organizing a hearing in New York City that many of us went to. And we were there with many representatives and we heard loud and clear from all the witnesses, as I've heard from most of you today, that we need a long term extension and that a long term extension gives a certain amount of stability to our economy and allows the developers, investors, and insurers the guidelines to properly prepare for the future.

Now, what we heard in this hearing, and it may be somewhat unique to New York, is that some of the investors and developers, they were saying to build a building takes 15 years. To get the bonding for some of these buildings they are trying to replace is a 15- to 16-year deal, and they are very concerned to be able to put the financial packages together. And when I asked the question that I'd like to ask the panelists now—we've been called to a vote so we'll have to move very quickly. We don't want to miss a vote. You know, I asked the question of how long at a minimum must we extend TRIA in New York, and what I heard at that hearing was 15 to 16 years. And then of course some wanted a permanent one. But I'd like to ask each panelist going down in your opinion, what is the minimum Congress should do to extend TRIA for the stability in our economy that all of you have been talking about.

And why don't we start with Mr. Donnelly and come down. And I'd like to hear what you think is the minimum for stability in our markets.

Mr. DONNELLY. I think 10 years is a minimum.

Mrs. MALONEY. Ten years is a minimum.

Mr. DONNELLY. So, my first priority is to get us included in TRIA, but with that, then 10 years would certainly be—

Mr. DITCHMAN. Mr. Chairman, Congresswoman, we believe strongly in the longer the better. The 15- to 25-year timeline should be the absolute minimum.

Ms. ABRAHAM. The minimum should be 10 years.

Mr. DOWD. My customers want at least 10 to 25 years. It is more my customers' issue than it is mine, so I say 10 years.

Mr. COTTON. I would say an absolute minimum of 10 years and the inclusion of NBCR, for sure.

Mrs. MALONEY. Okay, that's my second question. NBCR—do you think NBCR should be included? And, also, do you think we should mesh together domestic and international and just go down the line again?

Mr. DONNELLY. I believe that the bill should cover all, both domestic and foreign terrorism, and certainly including NBCR, absolutely.

Mr. WATJEN. It should be inclusive of both domestic and foreign, and again in our particular case, group life is mandated and covered and already covers NBCR.

Mr. DITCHMAN. We also conclude or agree that it should be both domestic and foreign. We also believe that the NBCRs should absolutely, positively be covered.

Ms. ABRAHAM. Both included but a very different structure, very low deductible for the NBCR, very low deductible or first dollar. It's just not something that we can have a high deductible on, but both international/domestic included.

Mr. DOWD. Domestic and international I think is unanimous. NBCR; different challenges and clearly the structure of the program as referred to deductible co-insurance and ultimately limit are going to be critical factors.

Mr. COTTON. NBCR, no question, and the market does not distinguish the passport that the person carries.

Mrs. MALONEY. Well, I want to thank everybody. And, we may miss our vote, but we've enjoyed your testimony. It's very important. It's very important to our economy and, I would say, to the security in general of our Nation.

Thank you for your work and for your leadership and thank you, Mr. Chairman. No one has been better on this issue than you. We thank you.

Chairman KANJORSKI. Thank you. First, some members may have additional questions for the panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

And, with that, I would like to thank the panel. It has been really quite an enjoyable session. We are going to try and run off and make that vote, and this hearing stands adjourned.

[Whereupon, at 4:45 p.m., the hearing was adjourned.]

A P P E N D I X

April 24, 2007

OPENING STATEMENT OF
CHAIRMAN PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING ON "POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE ACT"

TUESDAY, APRIL 24, 2007

We meet this afternoon to review the policy options for extending the Terrorism Risk Insurance Act, or TRIA. In the wake of September 11, Congress designed TRIA as a temporary program with the expectation that the insurance industry could eventually model and price for terrorism risk. The private marketplace, however, did not recover as quickly as initially hoped. As a result, we extended TRIA for two years in 2005.

While TRIA has increased the availability and affordability of terrorism risk insurance, the marketplace is still tenuous. Insurers still have limited capital to cover terrorism losses alone and without federal assistance. Property/casualty firms had only $164 billion available to cover terrorism losses in 2005 according to the Insurance Information Institute, but some models have predicted terrorism losses of more than double this number.

TRIA as amended will, of course, expire at the end of this year. Because insurers remain uncomfortable with their ability to reliably price coverage for traditional terrorism, we need to extend this law once again in order to protect our nation's economic security. In considering these matters, we must also act both in a timely fashion and in a deliberate manner so as to prevent marketplace disruptions, allow for the careful consideration of the policy implications of our actions, and avoid unintended consequences.

We have many important decisions before us, and I look forward to a thoughtful and bipartisan dialogue both today and in the weeks ahead. To help guide us going forward, I also want to outline five positions central to my thinking on these matters.

First, we must make the extension of TRIA our primary goal and refrain from considering miscellaneous issues. A bill to further lengthen TRIA should not become a vehicle for moving non-related matters such as the surplus lines legislation and natural disaster reforms. Moreover, I have considerable skepticism about adding risk retention group reforms to this TRIA-extension exercise. These separate issues need and deserve full, complete consideration on their own.

Second, the duration of the extension will require us to maintain a delicate balance. We must choose a length of time that is long enough to provide greater certainty to the marketplace and short enough to encourage the private sector to develop its own solutions to the problems posed by conventional terrorism. Such an extension should be neither permanent nor even semi-permanent. At this time, I believe that a 6- or 8-year timeframe provides the balance we need.

Third, we should use this TRIA-extension debate to pursue needed and important reforms to the program. We should, for example, protect individuals and not just the buildings they work in by adding group life to TRIA. We should also eliminate the distinction between foreign and domestic terrorism events.

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Statement for the Hearing "Policy Options for Extending the Terrorism Risk Insurance Act"

April 24, 2007

Submitted to the
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
United States House of Representatives

By

Janice M. Abraham
President and CEO
United Educators Insurance, a Reciprocal Risk Retention Group
Chevy Chase, Maryland

Chairman and Members of the Committee:

Thank you for the opportunity to participate in your "Policy Options for Extending the Terrorism Risk Insurance Act". I am the president and Chief Executive Officer of United Educators Insurance. Created in 1987, United Educators is a risk retention group that has added much needed capacity, coverage and competitiveness to liability insurance market serving educational institutions. I believe, United Educators and other risk retention groups may be a model to consider as a part of the solution to strengthening the public private partnership needed to supply adequate capacity and coverage for terrorism insurance.

I would like, first, to provide a brief description of our company and its history. I will review what I understand to have been the Congressional purposes behind the 1986 Liability Risk Retention Act Amendments, and then I will explain why an expansion of the Risk Retention Act to include property insurance can be part of an important public-private partnership to encourage more private sector coverage for terrorism events in the long term.

Over twenty years ago Congress, with great wisdom and foresight passed legislation that supported non-profits and businesses, both large and small, to join together to share risk management resources and risk. Since that time risk retention groups have grown to $2.7 billion in premium, according to a 2006 report by the Risk Retention Reporter. Although this is estimated to be less than three percent of the total US liability insurance premiums, RRGs offer coverage to some of the most challenging risks where the traditional insurance markets are reluctant to provide stable and consistent coverage. The Liability Risk Retention Act permits RRGs to offer only liability insurance; property insurance is not permitted under current legislation.

A. About United Educators

United Educators Insurance, a Reciprocal Risk Retention Group, serves schools, colleges, universities, and related educational associations and groups. We are owned and governed by the educational institutions that are our policy holders. The institutions that are members of United Educators are committed to sharing risks, investing in risk management programs, taking an active role in reducing risks on their campuses and running United Educators.

We cover all levels of education from pre-K, including Head Start programs, to post graduate, providing liability insurance to public, private, nonprofit, and for-profit education-related entities. Our main policies are Educators Legal Liability, which cover employment practices liability such as directors & officers and failure to educate, and general liability--both "first-dollar" primary general liability and excess general liability--at high limits. Our members include Penn State, University of Scranton, University of Missouri, Washburn University, Johnson County Community College, Cornell University, public school districts in New York State, Ohio, California and many others.

Our company owes its existence to the federal Risk Retention Act Amendments of 1986. Those amendments opened new options for entities that were struggling with then-skyrocketing liability insurance rates and limited capacity. A group of educational institutions, collaborating through a task force of the National Association of College and University Business Officers, decided to form their own insurance carrier.

Throughout this history our mission has been to:

- Meet the specific liability insurance needs of educational institutions on a long-term basis.
- Price coverage predictably and rationally based on education's own losses, avoiding the high-risk exposures of commercial insurance.
- Identify emerging liability issues and assist administrators in formulating sound policies and practices to manage risk and reduce loss.
- Handle claims fairly, quickly and proactively to support the cost-effective resolution of disputes.
- Partner with institutions and brokers to manage risk and catastrophic losses.

Today we are strong in terms of member loyalty and involvement, financial position, and, most importantly, expertise in the risks facing educational institutions.

B. The Need for the Federal Government to partner with private industry to provide adequate terrorism insurance

You have heard 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. 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. I also believe without the federal government's role as reinsurer of insurance companies, many small to mid-sized insurance companies would not be able to offer the terrorism insurance needed by businesses and non-profits.

However, I also want to use this time to tell you about my company and why this issue is so important to us. 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 California Institute of Technology, MIT, University of Michigan, Notre Dame, Tulane and school districts throughout the country. Our company exists solely for the purpose of assisting these institutions manage the risks they face.

To the casual observer, the idea that 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. Athletic 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 "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."

In each of these cases, our member institutions face the possibility of workers compensation, significant property damage and liability losses 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 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.

Securing long term, affordable property insurance for terrorist risks is a significant problem for universities. We have been successful, because of TRIA, to have our reinsures continue to support our high limits of liability insurance, providing stability and competition to the liability insurance market. This option doesn't exist for property insurance, making appropriate coverage difficult to secure for universities.

When TRIA's extension was being considered almost two years ago, 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 more encouragement should be in place for the private sector to join with the public sector in creating long term solutions.

C. The Goals of the Risk Retention Act Amendments of 1986

Congress passed the 1986 Amendments to the Risk Retention Act to address the challenges that municipalities, universities, small businesses, and other entities were then facing in obtaining liability insurance. The House Committee on Energy and Commerce vividly described the bleak national landscape for insurance:

> "During the 99th Congress, the country has been shaken by a crisis in the availability and affordability of commercial liability insurance. Congress has been besieged with complaints regarding huge rate increases, mass cancellations of coverage, and entire lines of insurance virtually unavailable at any price. Crucial activities and services have been hard hit. Such activities include, among others, those of municipalities, universities, child daycare centers, health care providers, corporate directors and officers, hazardous waste disposal firms, small businesses generally, and many others."

House Report 99-8655, page 7.

The 1986 Amendments built upon the 1981 legislation that permitted risk retention groups, which are groups of similarly situated entities in a common line of endeavor, to offer product liability insurance. The 1986 amendments were designed to allow such groups to offer all lines of liability insurance other than workers' compensation. It expanded the opportunity for groups of schools, businesses, professionals, and others to shape their own destinies in the insurance marketplace.

Supporters of the 1986 Amendments expressed the belief that allowing risk retention groups to provide all types of liability insurance would foster rational underwriting and insurance pricing. They anticipated a positive, overall increase in the nation's insurance capacity and some moderation of the painful cycles in the availability of insurance from commercial carriers.

The House Committee report explained the expected benefits of the proposed amendments:

> "Since a risk retention group is simply a group of businesses or others who join together to set up their own insurance company only to issue insurance policies to themselves, it was believed that by encouraging such groups, the subjective element in underwriting could be reduced. The risk retention group would know its own loss experience and could adhere closely to it in setting rates. It was also believed that the 1981 Act, by providing alternatives to traditional insurance, would promote greater competition among insurers to "encourage private insurers to set rates to reflect experience as accurately as possible."

House Report 97-190, page 4.

> "...the Committee believes that creation of self-insurance groups can provide much-needed new capacity. Additionally, according to the Department of Commerce, "[t]he knowledge that substantial insurance buyers can create their own alternative insurance mechanisms will be an incentive to commercial insurers to avoid sharp peaks and valleys in their costs."

July 17, 1986, Congressional Record, pages S9229-S9230, letter of Douglas A. Riggs, General Counsel, Department of Commerce, dated June 25, 1986.

D. A new crisis

Now is the time for Congress to take the next step and help to solve a current insurance capacity and stability problem by expanding the Risk Retention Act again to include property insurance and creating a long term extension of the Terrorist Risk Insurance Act.

The federal Liability Risk Retention Act currently limits Risk Retention Groups (RRGs) to providing only liability insurance to its members. The ability to expand into property insurance, using the principles of member owned and controlled risk management, broad coverage, stable pricing and coordinated claims services would help fill a significant need of educational institutions.

The Present

Today, through UE, liability coverage works for educational institutions. UE emphasizes stable pricing and risk management, and coverage aimed to members' needs. UE covers risks often unavailable through other insurers but are basic to educational institutions, such as sexual harassment, sexual molestation, international study and athletic injuries.

UE works with institutions to minimize risks through workshops, roundtable discussions, computer-based learning tools, and other types of training. UE's risk management and education address campus topics including fire safety, sexual harassment training, dealing with students with severe mental health problems, disaster planning, athletics, discrimination prevention, bullying prevention, and substance abuse.

The Future

An expansion of the Risk Retention Act that enables United Educators to provide property insurance to educational institutions would add additional capacity and make that coverage more affordable, available, and as we are owned by and committed to only serving the educational market, more responsive to their needs. With an annual member renewal rate of 95%, United Educators' members clearly value the existing products and services.

Advantages of the expansion into property would include:

Coordinated training and claims management: Liability risks are closely linked to property risks. One insurance company could provide coordinated in-depth training and coverage for all risks that encompass liability and property claims.

Pricing: Educational institutions would be judged on their own experience, so costs would not reflect extraneous factors. An RRG offering property coverage including a terrorist event will support sharing the risks across institutions throughout the country.

Loss control: United Educators would provide guidance specific to institutions regarding, for example, helping colleges establish mutual aid agreements to help each re-open and serve students as quickly as possible following a terrorist event.

Commitment: United Educators makes a long-term commitment to its members. It works with them to reduce their losses and doesn't drop them simply because there has been a major loss. As a member-owned company, UE is committed to helping educational institutions and the members are committed to supporting their investment in the RRG.

Combined knowledge: UE members benefit from one another's experience. The company serves as an information clearinghouse so one institution's experience can help another prevent a loss.

E. Support for the expansion of the Risk Retention Act

A wide range of consumer groups, insurance brokers, state insurance commissioners, real estate investment trusts (REITs), and RRGs representing public

housing authorities, non profit organizations and businesses support the expansion of the RRA. It is also a bipartisan effort.

F. Government Accountability Office Report on Risk Retention Groups

The Government Accountability Office ("GAO") issued a report in August, 2005 entitled *Risk Retention Groups: Common Regulatory Standards and Greater Member Protections Are Needed.* The GAO found that while "RRGs have had a small but important effect in increasing the availability and affordability of commercial liability insurance for certain groups," "widely varying state standards" and limited governance protections against potential conflicts of interest created the potential for problems in the industry.

Prompted by the GAO Report, the National Association of Insurance Commissioners ("NAIC") has undertaken a two-year process that has resulted in creation of corporate governance standards and requirements for the accreditation of the RRG states of domicile. While United Educators has none of the problems reflected in the GAO's concerns, we heartily endorse these proactive actions by the NAIC and, further, believe that any amendment to the LRRA expanding the scope of permissible insurance should include similar provisions or an affirmation of actions that have been taken at the state level.

Conclusion

We believe a long-term program should replace TRIA when it expires this year. We believe insurance policyholders and insurance markets will benefit significantly from the predictability and structure a long-term program would provide. We also believe that the expansion of the Risk Retention Act to include property insurance will allow businesses and non-profits with a federal government terrorism backstop to add much needed capacity and competitiveness to the terrorism insurance market for many years into the future.

The genius of Congress' enactment of the Liability Risk Retention Act in 1986 is vividly demonstrated by the successes of United Educators and other risk retention groups, including the Housing Authority Risk Retention Group, ALPS and Nonprofit's Insurance Alliance of California. They have succeeded because Congress recognized that commercial insurance purchasers know better than anyone else their own risks and needs. In requiring that Risk Retention Groups be owned and controlled by their policyholders, Congress also assured that the operation of the groups would consistently be in the best interests of their members.

Risk Retention Groups can not solve all of the problems that exist in the terrorism insurance market in America today. It is not a solution for homeowners and will not instantaneously provide all the capacity needed to provide coverage for the thousands of this country's schools, colleges and universities. If the federal government's role, under TRIEA, as reinsurer of risk retention groups and commercial insurance companies

diminishes significantly, the needed capacity for terrorism insurance will evaporate. Nevertheless, expansion of the Liability Risk Retention Act to include property insurance will have an important and significant role in adding capacity and stability as part of a comprehensive solution.

Having successfully addressed the hazards of a hard liability market, risk retention groups, if given the opportunity, can be part of a strong public private partnership to meet on of the greatest risk sharing challenges of 2007 and beyond.

Thank you very much for the opportunity to address the committee on this important issue.

Commercial Mortgage Securities Association (CMSA)

Statement of Leonard Cotton
Vice Chairman, Centerline Capital Group

on behalf of

The Commercial Mortgage Securities Association (CMSA)

Before a Hearing of the House Financial Services Committee

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

"Policy Considerations for Extending the Terrorism Risk Insurance Act"

April 24, 2007

Chairman Kanjorski, Ranking Member Pryce, members of the Subcommittee, thank you for holding this important hearing and for the opportunity to testify before you today regarding the terrorism risk insurance program. My name is Lee Cotton. I am Vice Chairman of Centerline Capital Group (Centerline) and serve as president-elect of the Board of Governors of the Commercial Mortgage Securities Association (CMSA). My testimony today is on behalf of my firm, as well as the member firms of CMSA.

Centerline is one of the nation's leading real estate finance and investment companies. A subsidiary of Centerline Holding Company (NYSE:CHC), Centerline Capital Group matches the users of capital with the providers of capital, with a strong focus on the real estate industry.

The Commercial Mortgage Securities Association is the international trade organization for the commercial real estate capital market finance industry. The CMBS market is an important source of capital for the commercial real estate industry, and its liquidity provides reliable debt financing to commercial real estate borrowers. The organization's primary mission is to promote the ongoing strength, liquidity, and viability of commercial real estate capital market finance worldwide. Based in New York, and with a strong presence in Canada, Europe, and Japan, CMSA is the voice for the entire industry, representing a diverse global membership of over 400 financial services companies represented by more than 5,000 individuals who actively engage in commercial real estate finance activities. Unlike many trade associations that

represent a single group of competitors, CMSA is the collective voice the entire commercial real estate capital finance marketplace. CMSA's membership includes the leaders from each sector of that marketplace:

- the lenders who make the initial loans;
- the investment banks that purchase the loans and package them into bonds and other securitized vehicles;
- the trustees that hold the loans which collateralize the bonds;
- the rating agencies that rate the bonds;
- the investors who buy the bonds; and
- the loan servicers who service the loans on behalf of the investors.

CMSA is a member of the Coalition to Insure Against Terrorism (CIAT). CIAT is a broad coalition of major trade and professional associations and businesses, representing the Nation's major consumers of commercial insurance lines.

Centerline and the members of CMSA share your belief that terrorism risk protection is an issue of utmost importance and a critical element in our nation's efforts to confront the threat of terrorism and its impact on our economic, as well as physical, welfare. Since 2001, the members of this Committee have been leaders in this effort with the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the Terrorism Risk Insurance Extension Act (TRIEA) in 2005. We commend you all for your hard and thoughtful work.

Introduction

It has been more than 5 ½ years since thousands of our fellow citizens, friends, colleagues and family members were killed in the September 11, 2001, terrorist attacks. Since that day, 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 risks essential to the functioning of our economy, constraining that ability would be economically devastating. TRIA has prevented that from happening at virtually no cost to the federal government. Indeed, not only have federal funds provided by the TRIA "backstop" never been tapped, the program has proved to be an unqualified success in stabilizing the insurance markets, and ensuring that coverage is available and more affordable. TRIA is not about protecting the balance sheets of insurers – it is about protecting commercial policyholders, protecting the exposure of taxpayers, and creating and sustaining a national economy that encourages investment and development. That is what I am here to talk about today.

The Importance of Terrorism Insurance to the CMBS Industry

Commercial mortgage-backed securities (CMBS) are bonds collateralized by a pool of commercial mortgage loans. All the principal and interest paid on the underlying mortgages flows to investors, the purchasers of the bonds. To create these investment vehicles, mortgage loans of varying dollar amounts, property types, and locations — and containing a myriad of individualized terms and conditions — are pooled and transferred to a trust. Bonds are then issued, backed by the pool of assets held in the trust. Those bonds vary in yield (the amount of return on the bonds), duration (the length of time before the bond is expected to be paid off), and payment priority (the order in which investors are paid a return on their investment).

The CMBS industry plays a vital role in the functioning of the commercial real estate market. The liquidity provided by CMBS enables mortgage borrowers to have access both to larger pools of capital than would otherwise be available in traditional lending markets and to lower interest rates. Mortgage lenders benefit from CMBS as well, because securitization enables them to access the capital markets with their loan products and to obtain new capital to make new loans. Investors also benefit from the creation of potentially attractive and credit-worthy investment vehicles that may cater to an investor's desired risk profile, investment term, and yield.

The importance of the CMBS industry to the U.S. economy cannot be overstated. The $770 billion U.S. CMBS market is the second largest source of commercial real estate credit in the U.S. and accounts for 26 percent of the $2.95 trillion U.S. commercial real estate debt market. In 2006 alone, CMBS provided more than $207 billion in debt capital to the U.S. commercial real estate industry, including 40% of all new commercial loans. In addition, as much as 80% of commercial mortgages are believed to be securitization eligible.

The functioning of the CMBS market, in turn, is dependent upon the availability of insurance coverage, including terrorism insurance which is critical to this ever-growing market. In fact, since 2000, 2002 is the only year in which the CMBS business experienced negative growth when new CMBS issuance dropped almost 25% from 2001. This decline is largely attributed to the lack of reliable terrorism insurance coverage between 9/11 (actually, the point in time when the reinsurers withdrew from the market) and the passage of TRIA 14 months later.

It has been our experience that the ability of insurers to provide terror coverage will be limited without TRIA. Consequently, commercial real estate mortgage borrowers will be in technical default under their loan agreements without the appropriate insurance coverage, rendering their loans unacceptable for pooling in CMBS. This has a tremendous impact on both new loans and the more than $770 billion in outstanding loans, as well, bringing unwelcome price volatility to the bonds backed by those loans. Virtually every single Congressional district includes commercial projects financed through the liquidity provided by CMBS. Therefore, the impact of a potential market disruption would be felt nationwide.

Specifically, investors presume a certain stability of income and ratings. When ratings become volatile reserves must be adjusted to reflect the rating changes. This volatility can cause bonds backed by existing loans to lose their attractiveness as an investment, and bonds already held by investors to lose value. The resulting decline in investors and increase in capital reserve requirements would limit cash flow for everything from capital for new commercial real estate developments to funds for pension benefits whose portfolios are heavily invested in commercial mortgage-backed securities. This oversimplifies the matter, of course, but the threat is real. The loss of terrorism coverage resulting from the demise of TRIA would damage not only the real

estate market and related industries, including CMBS, but it will cause a huge economic hit that will ripple across the Nation's economy.

The Success of TRIA and TRIEA

When TRIA was originally adopted in 2002, the assumption of many was that the private sector would be able to create a market for terror insurance coverage and the federal program would 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, the capital markets and rating agencies – have a very limited ability to insure and rate terrorism risks that are only questionably quantifiable, totally unpredictable and, essentially, impossible to underwrite. This is further exacerbated with respect to coverage for nuclear, biological, chemical and radiological risks (NBCR), the most catastrophic types of attacks for which coverage is essentially nonexistent even with TRIA in place.

Given these realities, Centerline and the members of CMSA believe a sustainable solution to the terrorism insurance crisis is essential and that the federal government must play an important role in terrorism risk coverage for the foreseeable future. In order to function properly, the insurance market needs some level of stability and predictability. The prospect of TRIA's demise – or the uncertainty that would come with periodic renewal or extension of the program every few years – is not viable for the long term. Failure to implement a long term or, ideally, a permanent fix before TRIA expires at the end of the 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. Of course, the impact on CMBS is critical to us, but the potential ramifications for all sectors of the economy are even more significant.

In our view, the issue before Congress, then, is not whether the government will be the insurer of last resort in the event of such an attack, but how to develop a plan before an attack to maximize private sector coverage of the massive damages that will result from a terror strike, rather than reacting in crisis mode after an attack occurs. CMSA believes that such a plan must

also protect policyholders and taxpayers from NBCR risks that today are almost completely uninsured.

We do not have to look far to see what can happen in the aftermath of a catastrophe in the absence of proper financial preparation. New Orleans has not recovered nearly two years after Katrina struck despite billions of dollars in assistance from the federal government. In addition, serious questions have been raised about the efficiency and effectiveness of the post-disaster funding. If history serves us, it would seem that the federal government would step in to provide assistance after a terrorist attack, particularly if there is insufficient private sector relief. But without TRIA or some sort of federal involvement enabling the private insurance market to be involved in providing terror coverage, you lose all that the insurance industry has to offer: direct contribution through upfront premium payments, relief delivery through established claims processes, and a repayment mechanism through policyholder surcharges after the event. So it is not a question of whether the federal government will pay, but rather whether the federal government will work with the insurance industry to ensure that the preparation and response to a terrorist attack is handled in the most efficient way possible. Put simply, better TRIA than FEMA.

Since its inception in 2002, TRIA has been successful in providing the commercial property and casualty market, and insurance buyers, with increased terrorism capacity and in decreased prices at virtually no cost to the federal government. In addition to providing readily available and more affordable terrorism capacity for U.S. based risks, the program has also allowed the private market to progressively increase its role in coverage terrorism risks through retained terrorism exposures under TRIA.

Coverage that is both available and more 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, terrorism risk was considered minimal and coverage for terrorism was generally included at no additional cost in most property and casualty policies.

- After September 11 and prior to the enactment of TRIA, terrorism insurance became almost entirely unavailable, and the small amount that was available was prohibitively expensive. The lack of coverage for terrorism risk at a time when the perceived risk was enormous resulted in uncertainties whose effects rippled far beyond the insurance industry.

- In the months after enactment of TRIA, the initial pricing for terror coverage was high and the take-up was low.

- Since that time, the purchase of terrorism insurance has been steadily increasing, according to the major insurance brokerages.

- The increase in take-up rates reflects the increasing demand by America's business community for terrorism coverage at commercially viable prices. Affordable terrorism coverage has allowed numerous business transactions that would otherwise have been stalled 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 extremely high — and volatile — terrorism insurance costs and have been able to budget for their business plans.

- Purchase of terrorism risk coverage has not been limited to urban, coastal areas and is not limited to particular industries. Insurance industry reports indicate that the take-up rates are high across the country and across industries, and policyholders are generally willing to purchase terrorism coverage when it is available at an affordable price. For companies with a higher perceived risk, whether due to size, location, industry or other factors, the take-up rates are even higher. 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. These take-up

rates illustrate not only the demand for coverage, but that we are making progress toward the public policy goal of encouraging coverage in affected areas and industries. By comparison, take-up rates for terrorism insurance show a higher percentage of commercial buyers across the country purchasing such coverage than the percentage of eligible purchasers in most of the other areas where the federal or state governments have provided capacity – areas such as earthquake, flood, crop and wind.

Where We Stand Now

Unfortunately, despite the success of TRIA and TRIEA in stabilizing the terrorism insurance market, the basic facts that prompted the enactment of TRIA and TRIEA in the first place – including the threat and nature of terrorist attacks – have not changed and still call for federal involvement in providing terrorism insurance after the expiration of TRIEA. Although the particular ways of federal involvement are open to discussion, some sort of federal involvement must be preserved in order to avoid the potentially devastating effects caused by the expiration of TRIEA. CMSA comes to this conclusion after considering the following facts:

First, the threat of terrorism remains unabated and unpredictable. More than five years after September 11th, we have been fortunate to not have had another terrorism attack on the American soil. Nonetheless, terrorism attacks elsewhere in the world since September 11 — including the bombings in Madrid and London — remind us that terrorists could strike any time, at any place. The continuing conflicts in Iraq and Afghanistan make the security situation even more fragile. Given this continued threat, the underwriting process is inhibited by the ability to predict the location, timing and scope of any terrorist attacks.

Second, without the federal involvement, reinsurers would be unable to quantify the risk and would have to effectively withdraw from the terrorism reinsurance market. This conclusion was true when TRIA and TRIEA were first enacted, and remains true today. The private reinsurance industry paid about two-thirds of the roughly $33 billion insured losses related to 9/11 claims. After September 11th and prior to TRIA, the reinsurance industry withdrew from the terrorism reinsurance market due to the huge and unpredictable terrorism risk. Today,

despite the success of TRIA and TRIEA over the past several years, the reinsurance industry estimates that there is only about $6 billion to $8 billion in global terrorism reinsurance capacity available, and only $1 billion to $2 billion in capacity available for nuclear, biological, chemical and radiological (NBCR) coverage. This current capacity is nowhere near the level needed to adequately insure our economy against terrorism risk without the TRIA backstop. It is estimated that terrorism losses could reach $100 billion and that losses from a large NBCR attack in New York City alone could reach $778 billion. Without the TRIA backstop, private reinsurers would want as little exposure to terrorism risk as possible. Indeed, even with TRIA backstop now, reinsurers are not meeting the capacity demand of primary insurers for their deductible and coinsurance layers.

Finally, without TRIA backstop or adequate reinsurance coverage from reinsurers, primary insurers are reluctant to expose themselves to potentially unlimited terrorism risks. We saw this quite clearly the last time when Congress was debating whether to enact TRIEA and extend TRIA, in 2005. Back then, primary insurers were including exclusions that would have voided terrorism coverage beginning January 1, 2006, had TRIEA not been enacted. A Moody's report indicates that 50-75% of all policies written prior to TRIEA's enactment included such exclusions. Now, with the possible expiration of TRIEA at the end of 2007, primary insurers may once again ask policyholders in the market shopping for policies that run past the end of 2007 to accept those exclusions in their insurance policies. It is obvious that if TRIA were allowed to expire after 2007, a large percentage of those policyholders would have no choice but to accept those exclusions, and therefore would see their terrorism risks uninsured—and their business plans disrupted or even halted as a result.

Going Forward

From our perspective, the goal of the federal government should be to create a mechanism that would result in a stable insurance market in which terrorism coverage is available and more affordable. The specific approach taken is most relevant to the insurance industry and the federal government, provided it meets the market demands that our industry and other policyholders face. We want to emphasize that the path forward should be carefully chosen based on considerations of economic realities, and whatever we choose to do should be

done with input from all relevant players, such as the commercial real estate capital market finance industry – which includes lenders, issuers, servicers, rating agencies, and investors, among other marker participants represented by CMSA.

We believe there are essentially three options going forward: (1) take no further action and let TRIEA expire; (2) modify and extend the current TRIEA program; or (3) take a new approach aimed at creating a permanent private market solution that allows TRIEA to sunset.

Because the insurance industry clearly cannot to handle terrorism risk on its own, we believe that the first option is not feasible for the reasons mentioned earlier. Simply letting TRIA expire would return our economy back to the post – September 11th and pre-TRIA era, and would undo the progress we have made in the past five years under TRIA and TRIEA.

The second option, or the first "real" option, is to modify and extend the current TRIEA program. Extending the life of TRIEA, improving the program to better encompass NBCR exposures and readjusting its terms to address the changed parameters will keep terrorism coverage available and the market and economy stable, continuing the positive trends mentioned earlier.

A third option is to create an alternative permanent private market solution. We are aware of a number of proposals circulating that envision a private sector pooling arrangement. Such a mechanism could allow the insurance industry to essentially "backstop" itself, by growing the capacity to handle a catastrophic terrorism attack like those of September 11th. The existence of a terrorism insurance pool and backstop may provide insurers with a reinsurance vehicle that will allow them to further expand capacity. Growth in capacity could stabilize prices and decrease the need for the federal backstop over time as the government's potential liability phased out. CMSA is open to considering proposals designed to create shielded pools of dedicated capital that can be applied to these exposures.

Finally, there are several issues that we wish to raise and hope that Congress will consider in order to better protect policyholders and taxpayers.

The first issue relates to the length of any extension or any federal mechanism for terrorism insurance. While CMSA would like to see a permanent solution, we support a sustainable solution to ensure that coverage is available and more affordable. We believe that any program should last for a minimum of 10 years. If the program is going to be for such a limited time, we think that it should provide for some transition period and that mechanisms should to be built to address long term coverage needs (such as pooling or dedicated tax credits).

Second, CMSA asks Congress to consider addressing the distinction between "domestic" and "foreign" acts of terrorism in the current program. The market does not distinguish between "domestic" and "foreign" acts of terrorism, and such a change may be needed primarily to address confusion issues and to eliminate an unnecessary and potentially unworkable distinction. Any act designed to destabilize the government and our economy should be encompassed by the program. Under the current structure, the Secretary of the Treasury Department ultimately will determine what is and is not covered by the Act. In the meantime, it is important that policyholders have access to complete coverage without gaps or carve-outs in coverage.

Third, CMSA, along with CIAT of which we are a member, has been concerned about the lack of availability for NBCR coverage where it is not statutorily mandated. We believe that it is important to consider any provisions that will encourage an expansion of private sector coverage for NBCR. Mechanisms to help achieve that could include lowering deductibles for NBCR exposures and lowering insurer co-payments for such exposures. CMSA would also support a "mandatory offer" regime that permitted different policyholder attachment points for NBCR coverage than primary coverage. We believe that mechanisms like those discussed above could help lead to greater take-up rates that protect policyholders and taxpayers, while also spreading risk and building capacity.

Conclusion

We have come a long way since TRIA was first enacted. With the help of TRIA and TRIEA, the terrorism insurance market has been largely stabilized, coverage has been steadily expanding, and the price of coverage has become more affordable. TRIA and TRIEA have

provided relief that is essential to the smooth functioning of our economy, all without paying a penny in claims.

Accordingly, TRIA and TRIEA have clearly made a difference for the insurance industry, policyholders and the Nation's economy as a whole. However, federal government involvement is still necessary to ensure a stable terrorism insurance market because: terrorism threats facing our country remain significant and unpredictable; our reinsurance industry still lacks sufficient capacity to address terrorism risks on its own; and primary insurers remain unwilling to expose themselves to enormous terrorism risks without charging prohibitively high prices. Allowing TRIEA to expire at this time would have devastating affects across the economy, and would particularly disrupt the commercial real estate capital market finance industry.

CMSA urges Congress to enact a sustainable solution to ensure that terrorism insurance continues to be available and more affordable. We also ask Congress to consider strengthening the program with regard to "domestic" acts of terrorism and NBCR coverage in order to protect policyholders and taxpayers.

Again, thank you for holding this important hearing today and for the opportunity to present the views of the members of CMSA.

# # #

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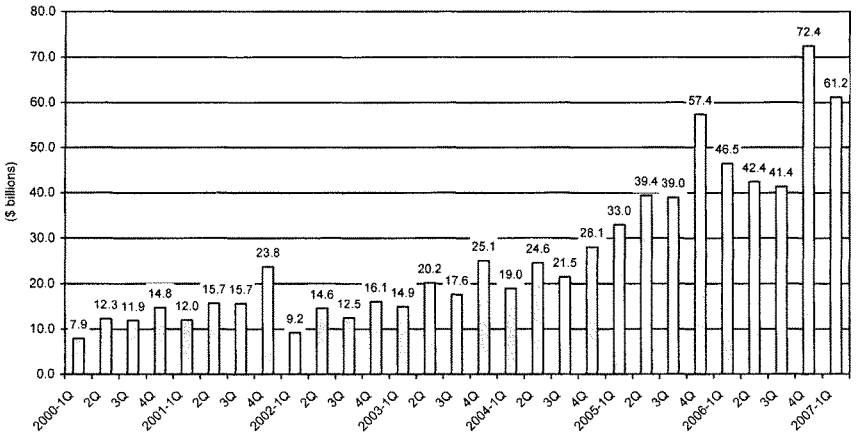
2000-2007 Q1



Source: Commercial Mortgage Alert, CMSA.

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

STATEMENT

OF

JOSEPH P. DITCHMAN, JR.

SENIOR VICE PRESIDENT, COLLIERS OSTENDORF-MORRIS

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

AND

THE COALITION TO INSURE AGAINST TERRORISM

BEFORE A HEARING OF

THE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

REGARDING

POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE ACT

APRIL 24, 2007

Thank you Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee for inviting me to testify today on policy options for extending the Terrorism Risk Insurance Act. My name is Joseph P. Ditchman, Jr. I am a past president of the Ohio Association of REALTORS®, past liaison to NAR's leadership for commercial REALTORS® and am currently a partner at Colliers Ostendorf Morris in Cleveland Ohio. I am pleased to testify on behalf of the National Association of REALTORS® which, through the REALTORS® Commercial Alliance includes the Institute for Real Estate Management IREM, CCIM Institute, the Society of Industrial and Office Real Estate (SIOR) the REALTORS® Land Institute (RLI) and the Counselors of Real Estate (CRE). Together, members of the REALTORS® Commercial Alliance are involved in all aspects of commercial real estate – from real estate brokerage to property management.

I am also testifying today on behalf of the Coalition to Insure Against Terrorism (CIAT), of which NAR is a member. CIAT is a broad coalition of commercial insurance consumers formed immediately after 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. CIAT joined Congress and the Administration in recognizing 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 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 Real Estate Roundtable, 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, Commercial Mortgage-Backed Securities Association), 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., Major League Baseball, NFL, NBA, NHL, and the NCAA).

We still live in a world of uncertainty. We are still fighting the war on terror. Though we have been safe at home since September 2001, we only need to look to London and Madrid for terrorism's devastating potential. We cannot pretend to know what motivates terrorists and how and in what form they may act to severely disrupt our economy and shake our sense of security. It is in the interest of America's economic security to ensure that as much of our commercial real estate sector is covered by terrorism insurance as possible.

Through my experience working on some of Cleveland's most significant commercial real estate developments over the past several years, I personally understand the vital importance of terrorism insurance to accomplishing Cleveland's economic development goals. I have been fortunate to work on the Cleveland Browns stadium, Jacobs Field, the Rock and Roll Hall of Fame and the Cleveland convention center. I can tell you that if the terrorism insurance program were to expire, projects like these that transform neighborhoods and communities could not go forward.

Our firm also owns and manages several office buildings. The real estate we own is home to thousands of office workers and also provides a critical hub for our information technology infrastructure – in fact we own the real estate that houses switching stations for a large telecommunications firm. Over the years we have seen our terrorism insurance premiums fluctuate and rise – in part due to the concern that TRIA may have expired at the end of 2005, and in part due to the greater burden the private sector has to bear under the Terrorism Risk Insurance Extension Act. The uncertainty of insurance pricing impacts our net operating income, and the value of our properties. The potential unavailability of this coverage at the end of this year impacts our financing agreements, and potentially hurts the commercial real estate market.

Though we are significant players in the Cleveland market, we do not have the market diversity of some of the larger REITS and developers. We cannot leverage the high operating expenses of one building in one market, with the lower expenses of another building in a different market. The basic real estate fundamentals matter to us. NAR's members are in every major and secondary commercial real estate market in the country. They are property managers, they are real estate brokers, they are real estate counselors and they are property owners. They may not own or manage the trophy office building downtown, but chances are they brokered the lease that brought the building its major tenant. Chances are they manage the retail center nearby. And chances are they own the office park on the outside of town. We are the engine of commercial real estate. I understand that 80% of commercial real estate debt requires terrorism coverage. If the terrorism insurance program were allowed to expire, coverage would become largely unavailable and unaffordable – the gears of commercial real estate could grind to a halt.

We are encouraged that this subcommittee and Chairman Frank and Ranking Member Bachus have made this issue such a clear priority, and we hope that the Committee will act soon to advance legislation to the full House. Frankly, we believe there is no need for delay in action by Congress. The facts are in – terrorism is clearly a risk that the private insurance industry alone cannot and will not underwrite. As we saw before in 2005 when the Terrorism Risk Insurance Act (TRIA) was set to expire, problems associated with the availability of terrorism risk insurance will increasingly get worse as the year wears on.

Moreover, the Government Accountability Office (GAO) and the President's Working Group on Capital Markets (PWG) have recently issued reports that confirm that, other than for workers' compensation insurance mandated by state law, no meaningful amount of insurance against loss from weapons of mass destruction (nuclear, biological, chemical and radiological or "NBCR") is available in the market today – notwithstanding the fact that TRIA backstops such insurance.

To avert disruption in the "conventional" terrorism risk insurance market and to address the gap in coverage against NBCR terrorism-related risk, we encourage the

Committee to follow this hearing promptly with the introduction and passage of a bill that will extend TRIA permanently and improve it to keep the economy running smoothly in the face of the ongoing threat of terrorist attacks.

In conjunction with the American Insurance Association (AIA), CIAT has developed a set of Joint Principles that we believe should be made a part of any TRIA modernization effort. I will discuss these principles in the last portion of my testimony.

TRIA HAS BEEN A POST-9/11 SUCCESS BUT MUST BE IMPROVED

There is no question that the Terrorism Risk Insurance Act (TRIA) accomplished its main objectives, which were to help stabilize the US economy following 9/11, to provide for the availability of terrorism insurance for commercial policyholders in the face of the ongoing threat of terrorism, and to also provide a system for the efficient recovery of the economy in the case of another severe attack. The situation was dire: in the 14-month period between 9/11 and the enactment of TRIA, over $15 billion in real estate related transactions were stalled or even cancelled because of a lack of terrorism insurance, according to a Real Estate Roundtable study. Furthermore, the White House Council of Economic Advisors indicated that approximately 300,000 jobs were lost over that period. Congress and the President worked together to enact TRIA, which required insurers to make terrorism coverage available in commercial lines, and in return provided a Federal backstop that allows the economy to recover quickly from a terrorist attack. Without it, not only was the economy slowed and at risk, but economic recovery following any further attack would have been retarded. The same is still true today.

TRIA, and its extension in 2005, the Terrorism Risk Insurance Extension Act (TRIEA), were part of a series of measures Congress passed to protect the US economy from terrorism threats, and continue today to be an integral part of our homeland security strategy. For instance, U.S. airlines are directly insured by the Department of Transportation (DOT) for both terrorism and war risk. The Federal Government, through the Overseas Private Investment Corporation (OPIC), also directly insures U.S. investors overseas for both terrorism and political risk outside the United States. It would be ironic and senseless if TRIA, which is the only similar protection of the domestic economy and

which, unlike the DOT and OPIC programs, is not a direct liability of the Federal Government, were allowed to expire or even linger in limbo through the remainder of this year.

Terrorism is the major threat facing our nation today. We hear about it on daily basis from the Administration, our national security team and from almost every corner of Capitol Hill. Whatever one's view of the wars in Iraq and Afghanistan, the threat of attack to our country does not now seem to be diminishing. The threat of "enemy attack" is part of our daily lives and shows no sign of going away.

Terrorism risk remains an evolving picture that insurers and reinsurers have a difficult (if not impossible) time modeling. Primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses without adequate reinsurance, and the current private reinsurance market provides only a fraction of the capacity needed. This problem is evident in the fact that, as we once again approach the sunset of the TRIA program, many policies again are being issued with "pop-up" and "springing" exclusions that void terrorism coverage after termination of the Federal backstop. We witnessed the same sort of exclusions in 2005 before TRIA was extended for two years.

Quite simply, economic security is central to an effective homeland security strategy. American businesses must have adequate terrorism risk coverage. Without terrorism insurance, the nation's economic infrastructure is totally exposed to large-scale business disruptions after an attack, and to a retarded recovery from the damage that is caused by the attack. As our economic interests continue to be targeted by terrorists, it is appropriate, necessary and vital that the Federal Government play a role in maintaining the security of our insurance system which helps provide for recovery of the economy.

LONG TERM SOLUTION NEEDED

The conditions that necessitated TRIA and TRIEA – insurers that are not willing or able to quantify man-made risks which are potentially catastrophic and a withdrawal of all significant reinsurance capacity – have not gone away. We believe that the time has

come for Congress to enact a long-term solution for insuring against terror – one that is either permanent or at least guaranteed to be in place until Congress declares that terrorism is no longer a risk. At least fourteen other major industrial nations have recognized that the private markets are unable to effectively manage terrorism risk and have adopted permanent national programs. The US market is no different. Terrorism risk is a national problem that requires a Federal solution.

We believe that the Federal role should focus most heavily on what the private markets have been unwilling or unable to do: enabling policyholders to purchase insurance for the most catastrophic conventional terrorism risks; ensuring adequate capacity in high risk, urban areas; and providing meaningful insurance for NBCR risks. A permanent program should also seek over time to reduce the Federal role in conventional terrorism markets and maximize long-term private capacity by facilitating entry of new capital. We believe that over time the private market may be able to develop enough capacity to address many terrorism risks, but the risk of truly catastrophic events – involving both conventional attacks in urban areas as well as NBCR terrorism everywhere– will continue to be virtually uninsurable without some sort of Federal program in place.

We also believe that the program should seek to encourage greater take up rates among commercial property holders – particularly in markets that do not have the most high-profile targets. The Rand study indicated that al Qaeda, sensing that the traditional marquee property-type targets may be too well fortified, may opt to strike at softer targets that can cause more psychological damage than economic – such as striking a suburban retail center. Congress should direct the Treasury Department to affirmatively seek advice on how to encourage greater take-up rates to better spread and finance the risks, which are societal in nature.

CIAT and AIA have developed a set of Joint Principles for a long-term solution, and I will devote the remainder of my testimony to describing this plan.

JOINT PRINCIPLES FOR TRIA MODERNIZATION

The Joint Principles seek to make sure there is adequate terrorism insurance capacity in the market in the future, particularly for high risk areas; to ensure that NBCR risks will be covered; and to ensure that the Federal government will have an insurance mechanism in place so that the nation can more easily and efficiently recover from a truly catastrophic attack—whether due to conventional or unconventional terrorism. At the same time, we hope that these principles will allow for the minimization over time of the Federal government's exposure for conventional terrorism losses.

DURATION

In order to enhance the stability of our financial markets, the modernized program should be made permanent – or should be in place at least until Congress declares that terrorism is no longer a risk. Simply put, the uncertainty of having to renew this program every few years can be harmful to the economy.

FOREIGN V. DOMESTIC ACTS

The Joint Principles urge removal of the distinction between foreign and domestic terrorism in the statute's definition of "act of terrorism." This distinction may force the Treasury Secretary to make determinations that may not serve our national security needs, and it serves no sound policy goal. As the London bombings demonstrated all too well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims. We commend this Subcommittee and the House as a whole for adopting that change in 2005 in H.R. 4314, although the feature did not survive in the final legislation.

PROGRAM STRUCTURE

The Joint Principles urge that the covered lines in a modernized TRIA be no narrower than those included in the current TRIEA program, and that the program trigger be raised no higher than the current $100 million level – with a possible special provision within the trigger for smaller insurers. As for the program structure itself, the Joint

Principles envision a two-part structure that would finance both conventional terrorism risks and NBCR risks.

Conventional Terrorism Risk. For risk of conventional (*i.e.*, non-NBCR) terrorism attacks, the Joint Principles would leave in place the TRIA backstop, with the insurer deductibles, industry retention, and program trigger all maintained at no higher than their 2007 levels. This ensures that policyholders will continue to have access to coverage through the "make available" provision.

While TRIA has been largely successful in making available private direct insurance coverage against conventional terrorism attacks, it has not been without some continuing problems of availability and affordability. There are major markets today, particularly high-risk urban areas with prescribed fire-following policy forms, where the combination of aggregation of risk, high retention rates and rating agency pressure are causing capacity problems for conventional terrorism coverage. Thus, Congress and the Federal government need to continue the statutory framework that is known as TRIA for conventional terrorism exposure, but this framework needs to be modernized to reflect the continuing market realities of capacity shortfalls in some areas.

NBCR Terrorism Risk. NBCR terrorism risk is a different matter. Even if the Federal backstop exposure to conventional terrorism can be reduced over time to all but the most catastrophic attacks, the challenges are different for NBCR, according to all of the expert actuarial estimates. As it presently stands, although TRIA covers NBCR perils, we have not seen any evidence that such coverage is being written except where mandated for workers compensation. Because TRIA only requires that terrorism coverage be made available on the same terms, amounts and limitations as non-terrorism perils, insurers are not required to make NBCR terrorism coverage available if NBCR coverage for non-terror events is not offered.

The GAO, the Treasury Department, and the President's Working Group have all recognized that markets simply cannot price the risks associated with NBCR perils.

Accordingly, we believe that this is a crucial area that the long-term solution should address.

The Joint Principles would embrace several features from the 2005 House-passed extension bill, H.R. 4314 including lower insurer deductibles and co-pays with respect to NBCR risks and creating a separate formula to determine the industry retentions. The proposal would also clarify that the Federal government is solely liable for NBCR terrorism losses above insurers' individual NBCR retentions, thus encouraging insurers to provide more capacity. Finally, it would add NBCR perils to the "make available" requirement under TRIA so that policyholders would have an optional endorsement giving them coverage for NBCR terrorism that would otherwise be excluded by the nuclear hazard or pollution exclusion contained in certain commercial lines policies.

In all, we believe that the Joint Principles for TRIA modernization will ensure economic security by keeping a backstop in place for the most extreme and catastrophic attacks, whether conventional or NBCR. We think it is a fair measure and we urge the Committee and Congress to incorporate these features into the measure to be adopted this year.

OTHER REFORMS COULD ALSO HELP COMMERCIAL POLICYHOLDERS

Extending and reforming TRIA, in our view, should be Congress' top priority in the commercial property-casualty insurance arena. However, there are at least two other measures that would help America's businesses cope with the terrorism risk insurance problem, although both also have value beyond terrorism risks.

First, CIAT urges Congress to pass the Nonadmitted and Reinsurance Reform Act (NRRA), now H.R. 1065, which would facilitate access to surplus lines capacity for commercial policyholders as well as simplify some of the patchwork of conflicting State rules which inhibit the reinsurance market. The same bill was approved by the House last September by a unanimous roll-call vote of 417 to 0 but the session ended before the Senate could act of the bill. We recommend the Committee take up the NRRA measure after you have completed work on TRIA extension.

Second, NAR and CIAT believe you should consider expanding the Liability Risk Retention Act of 1986 (LRRA) to include commercial property insurance lines of business. LRRA helps private companies and non-profits organizations in a common sector of the economy to organize and finance group solutions to the lack of affordable insurance; it does this chiefly by providing that qualifying "risk retention groups" will need to be licensed as an insurer in only one State rather than having to apply for and maintain a separate insurance license in every State where it has member, requirements which can otherwise make a group project unfeasible. Unfortunately, LRRA is currently limited to liability insurance lines – because it was originally conceived to address the so-called liability insurance crisis of the mid-1980s. However, since 9/11 – and exacerbated by natural catastrophes such as Hurricanes Katrina and Rita – commercial property insurance is now probably the sector which is most consistently challenging to corporate risk managers and insurance purchasers. Expanding LRRA to allow sophisticated businesses to form multi-state groups to pool and finance similar kinds of property risks – and such State-licensed risk retention groups would be eligible for the backstop under TRIA --could be an additional part of the solution to address some of the remaining short-comings in the terrorism risk market, and would also empower the business community to more efficiently finance other natural and man-made property hazards. Again, we urge the committee to give attention to this issue after it has completed the urgent task of passing TRIA extension legislation.

CONCLUSION

Again, we applaud you for making long-term renewal of TRIA solution a priority early in the year, and we thank you for the opportunity to testify at this important hearing. We urge you to incorporate the Joint Principles in your renewal legislation. As always, CIAT is committed to working with you, the insurance community, and other stakeholders in crafting a meaningful long-term solution as swiftly as possible.

Testimony of the Property Casualty Insurers Association of America (PCI) Before the U.S. House Financial Services Subcommittee On Capital Markets, Insurance, and Government Sponsored Enterprises Policy Options for Extending the Terrorism Risk Insurance Act

Vincent T. Donnelly
PMA Insurance Group

April 24, 2007

Chairman Kanjorski and members of the Subcommittee, thank you for this opportunity to testify before you today regarding the terrorism risk insurance program. My name is Vincent Donnelly and I am the President and CEO of The PMA Insurance Group (PMA) which is a member company of the Property Casualty Insurers Association of America (PCI). I am testifying today on behalf of PMA and the PCI.

The PMA Insurance Group is a group of property casualty insurance companies domiciled and headquartered in Pennsylvania that underwrites commercial lines business on a national basis, with workers compensation insurance producing about 84% of its written premium. Since its inception over 90 years ago, PMA has specialized in the writing of workers compensation insurance and has done so with a regional focus. Written premiums for PMA in 2006 were $430 million, placing it within the parameters of what the insurance industry considers to be small to medium-sized insurer. PMA markets its insurance products and services to a diverse cross section of our economy. Contractors, manufacturers, health care providers, nursing homes, retailers, schools and universities are representative of the type of accounts for which PMA has provided workers compensation insurance. PMA routinely competes in the same marketplace as many other small to medium-sized workers compensation insurers, as well as most of the larger commercial lines insurers.

The Property Casualty Insurers Association of America (PCI) is the nation's premier property/casualty trade association, representing more than 1,000 member companies. PCI member companies include large national insurance companies, mid-size regional writers, insurers doing business in a single state, and specialty companies that serve specific niche markets. PCI members write $173.6 billion in annual premium, nearly 40 percent of all the property/casualty insurance written in the United States. PCI members write 31.5 percent of the business insurance policies and 40.2 percent of the private workers compensation insurance market.

PMA and the PCI believe that small to mid-sized insurers and particularly those that are engaged in the underwriting of workers compensation have a meaningful, if not, somewhat unique perspective on terrorism insurance issues that we would like to share with you today.

Basic Principles

TRIA continues to be an essential part of our national security response to the threat of terrorism.

By protecting our businesses, our employees and making them more resilient against terrorist attacks, TRIA makes all of us more secure. PMA and PCI share the belief that participation in this effort is a fundamental obligation of the Federal government, especially when it is apparent that the threat of terrorism has not abated in the United States or elsewhere in the world.

TRIA has been critical to stabilizing the insurance market and the national economy by making it possible for insurers to provide affordable terrorism insurance to businesses.

According to Marsh, Inc., *MarketWatch: Terrorism Insurance, 2006,* terrorism insurance purchase rates have increased from 27 percent to nearly 60 percent in the last three years because of TRIA, and the cost of terrorism insurance has steadily declined, especially for smaller companies, providing a critical layer of stability and protection to America's businesses and their workers. This could not have taken place without TRIA.

The focus of TRIA has generally been one of concern for the insurance industry's ability to withstand future terrorism events, when it should be much broader than that. It is the entire national economy that could be disrupted if access to terrorism insurance is constrained or eliminated. The continuation of TRIA is about more than protecting the financial welfare of insurance companies; it is about protecting commercial policyholders and providing them with the ability to sustain risk and contribute to the maintenance of a healthy national economy. It is with that primary concern for all commercial policyholders in mind, regardless of their size, location or the type of product or service that they provide, that serious consideration needs to be given to the fact that payments that are made by insurers for terrorism losses are not limited by geography in their financial impact. When insurers respond to terrorism losses resulting from an event that occurs in Philadelphia or New York, the financial implications of this response are widespread and extend to policyholders throughout the nation who are depending on an insurer's surplus to be used to also respond to their losses.

Absent a Federal backstop the market for terrorism insurance would be virtually nonexistent.

Many experts from the insurance industry, academia and government agree that without a Federal backstop, the stand-alone market for terrorism insurance would be virtually nonexistent. Because of the insurance industry's limited ability to underwrite and rate terrorism risks, that are characterized as being essentially uninsurable due to the inability to predict when, where or how the next terrorist event will occur, it has become apparent that a stand alone, private sector solution is not a realistic possibility; this has become even more apparent with respect to nuclear, biological, chemical and radiological (NBCR) risks, for which coverage is generally non-existent. The potential magnitude of a terrorist event is likewise unpredictable, and it is difficult, if not impossible, for the industry to credibly estimate the amount or type of damages that could result from a future terrorist event.

A strong Federal role in terrorism insurance protection must continue, even as we work to reduce the Federal responsibility gradually over time.

Proposals that would suddenly and severely curtail the Federal government's participation in the terrorism re-insurance market in the immediate future would likely result in a drastic reduction in the availability of affordable terrorism insurance and seriously harm the economy. The federal government participation is even more important to workers compensation, where terrorism coverage is statutorily mandated and workers compensation insurers do not have the same opportunity as other commercial lines insurers to avoid or mitigate this exposure. Insurance coverage for work related injuries that arise out and in the course of employment cannot be excluded, which

differentiates it from the other types of insurance coverages that are typically purchased by business owners. Without a federal "backstop," workers compensation insurers, who find themselves with limited realistic options for responding to their exposure to terrorism risk, may seriously consider their position in the insurance marketplace and conclude that a continued presence in certain segments of the marketplace is not in their best interests.

Ensure that all potential victims of terrorist attacks, regardless of geographic location or the source of an attack, have access to terrorism insurance protection.

Just as all Americans mourned the losses of the terrorist attacks of September 11, 2001, we should share in the responsibility of securing the nation's economy in the event of another attack. Terrorism is not a problem only for America's urban centers and access to insurers who are willing and able to provide terrorism coverage is critical for businesses regardless of their size or location. TRIA has been instrumental in providing market support to ordinary employers, not just owners of potential target buildings located in major metropolitan areas. Steps which limit the protection provided by this program would reduce the nation's economic preparedness and limit the ability of our businesses to purchase terrorism insurance as an important component of a comprehensive risk management program.

Of even more significance in the area of workers compensation insurance is the fact that, given the mandatory nature of the coverage, insurers that do provide the coverage may find themselves so economically constrained without a federal backstop that they become limited in their ability to compete, a problem that is an especially intense one for small and medium-sized insurers.

Ensure that all acts of terrorism are covered.

Proposals that would limit a government role to only "foreign-inspired" terrorist attack or to a few types of attacks (i.e., NBCR) would curtail the essential protection afforded to American businesses and their workers, and ignore the significant threat from other forms of terrorism on American soil. The inability of workers compensation insurers to exclude coverage for any type of terrorist acts makes it even more critical that any federally supported program be "all inclusive" as to the type of terrorism risks it responds to.

Ensure that robust competition in the marketplace for terrorism insurance continues without disruption.

America's small, medium, and large insurance companies provide terrorism insurance to our nation's businesses and their workers every day. TRIA policy should maintain full and relatively equivalent access to the program to ensure that insurance consumers have available to them a competitive range of options for coverage and prices. Without a TRIA program, many entities may be forced to self-insure due to a lack of available or affordable coverage, leaving their balance sheets and their workers exposed to a catastrophic event that could bankrupt the company.

Moreover, without the involvement of the federal government in providing reinsurance capacity, there is a strong likelihood that insurers will no longer be able to obtain private reinsurance protection, a situation which occurred during the period following 9/11 until the enactment of TRIA. Indeed, even with the current TRIA backstop, reinsurers cannot meet the capacity demand of primary insurers for reinsurance coverage of their TRIA deductible and coinsurance obligations. Without the TRIA "backstop," private reinsurers will want to limit their exposure to terrorism risk, particularly NBCR, as much as possible.

As a result of this type of private reinsurance constriction, insurers may decide to withdraw from the terrorism insurance market entirely or make the coverage available only on a very limited basis at significantly higher prices. As for workers compensation insurers who will be required to offer the terrorism coverage, the loss of reinsurance protection from the private market and the federal government will be even more economically devastating; requiring them to redeploy capital in way that could potentially threaten their financial solvency.

Impact of TRIA on small and medium-sized insurers

The design of the terrorism risk protection program going forward has implications for smaller and medium-sized providers of commercial (or, more precisely, TRIA-covered) property/casualty insurance coverage. In order to fully appreciate the significance of these implications it is important to recognize the marketplace contributions of smaller and medium-sized insurers which include the following:

- Ninety-four percent (94%) of companies writing TRIA lines of insurance are small or medium-sized. These 964 small and medium-sized insurers write almost one-quarter (22%) of the TRIA-covered lines of business in the nation (approximately $38 billion).* Given the number of small and medium-sized insurers, if these companies' profitability and survival means no longer writing TRIA-covered lines, the detrimental result for policyholders and consumers is a more limited availability of certain product offerings and at potentially higher cost.

- Small and medium-sized insurers that write TRIA-covered lines of insurance are significant employers, estimated to employ some 220,000 people nationwide, with a payroll exceeding $11.6 billion (PCI estimate). The "downstream" annual economic impact of the payroll provided by these insurers is estimated to be over $17.5 billion (PCI estimate). Almost one-quarter (24%) of the property/casualty industry's federal income taxes are paid by small and medium-sized TRIA insurers.*

*Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

- Eighty-one (81) small and medium-sized TRIA insurers, writing almost $5 billion in TRIA lines of business, are located in the 11 most at-risk cities for terrorism, as identified by A.M. Best Company. These cities are New York; Chicago; San Francisco; Washington, D.C.; Boston; Seattle; Los Angeles; Houston; Philadelphia; Las Vegas; and Miami. A loss of insurers in these markets would make it that much more difficult for consumers to shop their business amongst competitors.

*Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

- Small and medium-sized insurers are more regional in nature, servicing tightly defined markets and consumer market segments. They are often highly specialized, possessing unique knowledge of their market niches. Given their size and the scale disadvantages they sometimes face in the market, most are highly focused on consumer service and risk knowledge, providing significant benefits to their policyholders. Their absence from these markets would be a loss of consumer choice and consumer products and services, a situation which is easily illustrated in PMA's case, where we have been one of the predominant providers of Pennsylvania workers compensation insurance products and services, with a marketplace presence that would appreciably impact Pennsylvania employers were it to cease to exist.

- Some niche businesses may experience a serious limitation upon their ability to operate effectively without the insurance provided by the niche carriers. Just a few examples of the niches filled by smaller insurers include providing insurance to jewelers; religious institutions; specialized workers compensation risks; ocean marine offshore energy, transport, cargo and fishing vessels; the mining industry; entertainment parks; small artisan contractors; and contractors in the Gulf coast states.

Aspects of TRIA program that negatively impact competitive position of small and medium-sized insurers

Three aspects of TRIA that adversely impact the competitive position of small and medium-sized insurers are a high program trigger, a high deductible and a high coinsurance percentage, all of which should be given serious consideration in designing a continuation of the TRIA program.

Program Trigger

- The level of the trigger, which has significantly increased since the inception of TRIA, determines when the program will be activated; that is, whether any of the loss will be paid by the program. A high program trigger is a greater solvency threat to small and medium-sized insurers, as 75% of insurers writing TRIA lines of business have less than $100 million dollars in policyholder surplus.* The current $100 million trigger means that no insurer will be reimbursed unless the total industry TRIA losses from a terrorist event exceed $100 million.

*Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

- A high trigger undermines small and medium-sized companies because it puts too high a fraction of a smaller company's capital at risk. To avoid this risk, small and medium-sized companies could decide to exit TRIA lines of insurance, which in turn limits the potential for consumers to enjoy the benefits of more choices, lower prices, and product innovation.

- A high program trigger increases the number of insurers whose capital is less than the trigger- that is, it increases the number of insurers who could face a loss that does not trigger the program but which exceeds their total capital. No insurer can endure the risk of any single loss that can wipe out its entire capital base.

- A terrorist attack on a business resulting in 100 employee death claims in the state of Pennsylvania, for example, could result in $75 million in workers compensation benefits. This size terrorist attack would be devastating to a small or medium-sized insurer, since the $75 million loss falls below the current $100 million trigger, and therefore would have to be borne entirely by the insurer.

Deductible

- A high TRIA deductible means a greater proportion of the terrorism loss is paid out of a company's surplus, putting more of its capital at risk. At the current high 20 percent deductible, a company must first absorb losses equal to 20 percent of its prior year's TRIA lines earned premium before receiving any reimbursement from the federal program.

- Because of their smaller capital base, small and medium-sized insurers have less financial ability to sustain catastrophic losses or in some cases, even large losses. For example, a company with $5 billion in surplus is better able to withstand a loss of $50 million than a company with $100 million in surplus. A high deductible threatens solvency for small and medium-sized insurers to a greater degree, resulting in potential financial rating downgrades, fewer insurers being active in the terrorism insurance market and insurer failures; this in turn results in less competition and the likelihood of higher prices for consumers.

- A high program deductible is a greater solvency threat to small and medium-sized insurers. Larger companies can better survive a greater "hit" to surplus than can small and medium-sized companies; large companies are generally considered to be stronger credit risks, have more established connections to capital markets and therefore can more readily access the necessary capital than can small and medium-sized companies.

- A 10% or greater "hit" to the surplus of a small or medium-sized company could result in a company-closing event; a 10% loss of surplus could lead to a rating downgrade(s) by A.M. Best, followed by the potential loss of major accounts (i.e., those with 'A' rated paper requirements) and the premium dollars associated with such accounts, that could eventually fatally impair the financial viability of the

company, a circumstance that would not be entirely unlikely for an insurer such as PMA.

- The current 20% TRIA deductible is greater than 10% of company surplus for 47 percent of all TRIA writers. That is, 478 companies (47%) are vulnerable to A.M. Best downgrades and precarious company stability due to the negative impact to their surplus at a 20% TRIA deductible. Small and medium-sized insurers are most at risk since they make up 447 of the 478 total companies (94%); a lower deductible would put them in a stronger position to continue writing and assist in market stabilization.*

*Source: PCI using NAIC 2005 Annual Statement Database via National Underwriter Insurance Data Services/Highline Data

Coinsurance

- The deductible is not the only stress to a company's surplus in the wake of a terrorist event. The impact on surplus is intensified by an insurer's TRIA retention (coinsurance share) of an additional 15% of losses (up from the 2006 coinsurance requirement of 10%) above its deductible.

- A high coinsurance amount is a greater solvency threat to small and medium-sized insurers. Because smaller companies have less capital to draw on than other writers, coinsurance places a more crushing financial burden on the small and medium-sized companies.

- A terrorist attack on a business resulting in 500 employee death claims in the state of Pennsylvania, for example, could result in the payment of $375 million in workers compensation benefits. A terrorist attack of this proportion would trigger coverage under TRIA, but under the current program, a company with premium writings similar to PMA would retain a deductible of $75 million plus be subject to the application of a $45 million coinsurance requirement.

Small and medium-sized insurers provide essential competition

Given that several TRIA program features have a disproportionate impact on small and medium-sized insurers, how important is this to insurance markets and consumers? Indeed, some have argued that public policy should not be concerned with the effects of a terrorist attack on any particular segment of the insurance industry, but only with the impact of an attack on the insurance market itself. This argument seems to suggest that concerns about the impact on small and medium-sized insurers is misplaced - that the only concern of policymakers should be whether a "market" exists; this argument is misguided.

Competition

The best public policy is one that balances the economic interests of all market participants and has as much concern for the continued viability of all of the companies that actually populate the market and keep it competitive, as it does for the existence of a "market". Second, it is one thing for unregulated markets to develop overtime in a way that makes some business models obsolete and allows others to thrive. That happens normally in a market economy and is one of the primary reasons for the success of market systems.

However, terrorism is fundamentally different from other risks that arise in a market economy and requires changes in business models. First, for all of the reasons insurers have argued that terrorism is different and uninsurable, allowing the structure of a government policy response to itself to make small and medium-sized insurers less competitive is inappropriate public policy. The issue at hand is the design of a government program. It is no more fair to establish program triggers and deductibles in a way that disadvantages small and medium-sized insurers than it would be to structure the program in a way that disadvantages the largest insurers. The program itself should be as neutral as possible to the competitive playing field.

Finally, government policy itself has a strong influence on the nature of the risks insurers' must respond to in regards to terrorism. Insurers have no control over the way in which the government chooses to respond to terrorism and, thus, are placed in the position of bearing a risk that they cannot effectively mitigate or manage.

Conclusion

The enactment of a federal terrorism reinsurance program with a term substantially long enough to maintain marketplace stability and the continued growth of our national economy is an issue of utmost importance. It is a critical component of our national agenda to strengthen each company's economic security and its ability to protect itself against the threat of a terroristic attack. It is imperative that we recognize that the terrorist threats that challenge our country remain significant and unpredictable, that the private reinsurance market still lacks sufficient capacity to respond to terrorism risks, and that there are primary insurers that continue to be unable or unwilling to expose themselves to the perceived enormity of terrorism risks. Characteristics that have made terrorism a unique and even more importantly, an uninsurable risk are as present today as they were after the events of September 11.

In designing a future program, a key principle should be that it not interfere with or disrupt the competitive playing field that otherwise exists in the market. In this instance, the provisions of an extended terrorism reinsurance program should not create barriers to the ability of smaller and medium-sized insurers to continue serving markets and consumers. It should also be sensitive to the unique characteristics of the small and medium-sized insurers when considering deductibles, triggers and co-pays. Insurance consumers will have more choices, prices will be lower, and product innovation will be greater when the greatest possible number of strong, viable competitors is able to actively

serve the insurance market place. The design of the federal terrorism reinsurance program must not disrupt that competitive landscape.

On behalf of PMA and PCI, I would like to thank the Chairman and the members of the Subcommittee for giving me this opportunity to share our perspective and to work together in developing a long-term, market responsive solution to the availability and affordability of terrorism insurance coverage for U.S. businesses. I also sincerely appreciate your interest in and leadership on this important issue and welcome any questions that you may have for me.

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The PMA Insurance Group

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UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING ON

"POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE ACT"

APRIL 24, 2007

WRITTEN STATEMENT OF

BRIAN DOWD

ACE GROUP

ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

My name is Brian Dowd, and I am Chief Executive Officer, Insurance-North America, for the ACE Group. I am appearing today on behalf of ACE and our national property-casualty insurance trade association, the American Insurance Association (AIA).

AIA represents approximately 350 major insurance companies that underwrite about one-third of the U.S. commercial insurance market covered by TRIA and TRIEA; the membership includes half of the top ten commercial lines writers in the United States. Terrorism insurance is among the highest priority public policy and marketplace issues for our members.

The ACE group of property-casualty insurance companies conducts business throughout the United States and in more than 50 other countries. We employ more than 4,000 employees here in the U.S., and trace our long, proud history in this country back to 1792, with the establishment of the Insurance Company of North America, the first investor-owned American insurance company. ACE is among the largest property and workers' compensation insurers for businesses and municipalities of all sizes. Our customers include a broad array of organizations that rely on a stable market for terrorism insurance. These customers include many financial institutions, energy companies, hotel chains and professional sports leagues.

The Terrorism Risk Insurance Act (TRIA), as modified and extended through the Terrorism Risk Insurance Extension Act (TRIEA or the TRIA Extension Act), provides a federal backstop for commercial property-casualty insurance in the event of a catastrophic terrorist attack on U.S. soil. Since its enactment in 2002, TRIA has achieved its goals of making terrorism risk insurance widely available to U.S. businesses and stabilizing the private marketplace for a risk that has many features that make it uninsurable. Unfortunately, despite the government's success since 9/11 in interdicting several terrorist plots and preventing another major strike in the U.S., most experts agree that it is not a matter of if, but when, another catastrophic attack will occur on U.S. soil. AIA has testified on numerous occasions before this Subcommittee and other committees in Congress in support of the critical need to maintain the public-private partnership necessary to manage our Nation's economic exposure to terrorist attacks. For the reasons cited in that testimony, the AIA continues to support a TRIA-like structure and has recently worked with the policyholder community and their Coalition to Insure Against Terrorism (CIAT) to produce a set of recommended joint principles, which we have attached to the testimony.

Terrorism Remains an Uninsurable Risk

The characteristics that make terrorism an uninsurable risk remain as strong today as they were immediately following September 11, 2001. These include: 1) the difficulty of predicting the likelihood of a major terrorist attack; 2) the concentration of insured lives and property values in business centers; 3) the magnitude of potential loss from an extreme terrorist attack, particularly those that involve the use of unconventional weapons; 4) the limits of mitigation in reducing terrorism losses; 5) the lack of available public information necessary to analyze the risk; and, 6) the legal, regulatory, and financial hurdles inherent in the current state-regulated insurance system. While TRIA and its extension do not erase any of these criteria that make the risk uninsurable, it puts a box around the volatility associated with terrorism risk and, therefore, facilitates both coverage availability and affordability.

In the past, AIA has testified about each of the aforementioned aspects of terrorism risk. They remain fundamentally unchanged because the nature of terrorism remains largely unchanged.

Is the Existence of TRIA "Crowding Out" the Development of Private Market Solutions?

TRIEA has not reduced the demand for private reinsurance. In fact, demand outstrips supply. For instance, the aggregate amount of all insurers' deductibles is over $35 billion and insurers are responsible for 15% co-pays in addition to their deductibles for every dollar of insured loss up to $100 billion. Private insurers could be liable for as much as $50 billion and yet the Reinsurance Association of America has testified that only $6-8 billion of reinsurance is available. Clearly there is room for the private market to participate if there was any appetite to do so. The characteristics that make terrorism uninsurable for primary insurers also hold for reinsurers. Like insurers, reinsurers lack sufficient confidence in the models and therefore are unwilling to put a substantial amount of their capital at risk. This is the reason that private reinsurance capacity has grown only incrementally since the September 11 attack, and not much additional improvement can be expected, according to reinsurance experts.

The limited private terrorism reinsurance that is available costs more than the amount of terrorism premium that primary insurers are able to obtain from policyholders, due to state regulatory restrictions on rates. As a result, insurers are buying as much reinsurance as they can afford and/or self-insuring their retentions and exposing more of their capital.

I now would like to focus on some of the open questions regarding design of a long-term federal terrorism risk insurance program.

Why hasn't the improved modeling translated to more coverage being available?

Despite the President's Working Group on Financial Markets (PWG) report's optimism, improvements in insurer modeling will not create significant new capacity for the foreseeable future. As the report notes, these improvements are helping insurers to estimate their aggregate loss accumulations at specific locations, based on assumed event scenarios, thus better understanding and more efficiently managing their terrorism risk. However, there is no logic to the implication that an insurer's ability to model losses from a hypothetical event increases capacity. Rather, improvements in modeling improve efficiency in the allocation of existing capacity, which could create availability problems in highly concentrated areas.

Why is there a need to incorporate coverage for domestic terrorism events into the Terrorism Risk Insurance Act?

Since TRIA was enacted, experience has shown that the distinction between foreign and domestic terrorism is artificial. Events such as the London Underground bombing have reinforced the practical difficulty of making this distinction and underscored that it is meaningless from an economic perspective, and impractical from an exposure management perspective. According to RAND, the threat of domestic terrorism is increasing and focusing on private sector targets. RAND also has identified the increasing "franchising" of terrorist attacks by al Qaeda to local affiliates and the added difficulty of attributing attacks to a particular group.

How should the Congress alter insurance company deductibles, event triggers, insurer co-payments, the cap on annual liability, or other elements of the existing program to encourage more capacity?

As a general matter, expanding TRIA by reducing per company retentions, event triggers, and insurer co-payments would reduce the uncertainty that insurers face in managing terrorism risk and their attendant financial exposure; as such, these changes would allow insurers to expand their ability to underwrite coverage, thus improving the affordability of coverage. That said, we believe the program is working relatively well for conventional terrorism risk (e.g., take-up rates have increased every year since the program was enacted).

Congress should also consider a program trigger that provides meaningful protection for small companies. Additionally, the state regulatory system poses significant challenges in managing this risk. We believe that state regulation of terrorism risk insurance rates and forms that can undermine the program's basic objectives should be preempted. We also believe that the changes we are advocating in the program as applied to chemical, nuclear, biological and radiological (CNBR) terrorism risk, which are discussed later in this testimony, not only will test whether a private market can develop, but could improve the market more generally for terrorism risk, for example, in the workers' compensation arena, where insurers have to take CNBR exposures into account when allocating capacity, because state laws do not allow for exclusions.

What are the particular challenges of insuring CNBR exposures?

As mandated by Congress, the PWG report looks specifically at the market for CNBR terrorism risk coverage and concludes that no private market for CNBR terrorism risk insurance existed prior to September 11, none exists today, and none is likely to exist in the foreseeable future. More specifically, the report finds that, unless mandated by state law, coverage for CNBR risk has not been generally available, and reinsurance capacity for CNBR terrorism has been virtually non-existent. Looking to the future, the report observes that "there may be little potential for future market development" in this area. These conclusions are entirely consistent with those of a contemporaneous report by the Government Accountability Office on CNBR terrorism risk.

This absence of CNBR coverage has led to calls from the policyholder community for insurers to be mandated to offer CNBR coverage. AIA has been working with the policyholders to consider whether there is a way that insurers could provide CNBR coverage without risking financial ruin. Before Congress considers mandating the offer of this coverage, the very unique nature of CNBR exposures must be carefully understood.

First, while the loss estimates are staggering—according to the American Academy of Actuaries, exceeding $700 billion in the case of a nuclear attack in New York City—questions remain about whether CNBR terrorist attacks can even be modeled, given the huge number of variables involved. Among the special difficulties in modeling CNBR terrorism risk are the timing of losses (the latency involved in bodily injury claims caused by CNBR exposures mean damages could take years, if not decades, to quantify) and their geographic range (the potential for widespread dispersal of contaminants makes it difficult to limit losses by managing aggregate exposures).

Second, insurers have almost no ability to spread CNBR terrorism risk to reinsurers or the capital markets. While reinsurance for conventional terrorism losses remains scarce, the situation is far worse for CNBR terrorism risk. Most of the available reinsurance coverage, as confirmed by the Reinsurance Association of America, specifically excludes coverage for CNBR losses. Similarly, the capital markets are not willing to take any position in CNBR terrorism risk. As a result, the insurance and financial market tools that help insurers manage their own exposures to other types of risk are simply not available for CNBR terrorism.

Third, CNBR terrorism losses threaten the solvency of insurers in the absence of a federal program. The lack of private reinsurance means that insurers must retain the virtually limitless costs of CNBR terrorism risk in the absence of a federal backstop. As the PWG report recognizes, a large-scale CNBR event could result in losses that would overwhelm an insurer's capital and surplus, and therefore its claims-paying ability. Moreover, a widespread CNBR event could paralyze the economy and shut down sources of outside capital that insurers might otherwise access to pay claims.

How can TRIA be changed to provide the CNBR coverage policyholders need without jeopardizing solvency of insurers?

The program would function most effectively if it provided an economic framework through which insurers are able to offer coverage enhancements without putting their solvency at risk, at rates that encourage policyholders to purchase coverage. This cannot be accomplished simply by imposing a CNBR "make available" mandate.

Rather, changes to TRIA must focus on the characteristics of CNBR risk that pose the greatest threat to a viable insurance system, reduce potential exposure and provide certainty with respect to the role of private insurers in managing CNBR terrorism risk. This can be accomplished by:

- Lowering or eliminating the insurer deductible and eliminating the insurer co-pay for CNBR to reflect that markets are not working in this area as cited by the PWG and GAO reports; and

- Clearly and affirmatively stating that the federal government is solely liable for CNBR terrorism losses above insurers' individual CNBR retentions, including the removal of the current $100 billion program cap.

Why doesn't the $100 billion annual cap work for CNBR?

Given the potential magnitude of CNBR losses, the $100 billion annual program cap poses real problems. While the current law provides that insurers and the federal government will not be liable for amounts in excess of $100 billion, there are very real practical problems with the implementation of this provision. For instance, individual insurers who are receiving claims will have no way of knowing what other insurers have paid or amounts the government has reimbursed. Since there is a lag between when the insurer pays and when it is reimbursed by the government, there is a real possibility that insurers will unknowingly pay claims that in the aggregate with other insurers' payments will exceed $100 billion. Alternatively, insurers may know that the $100 billion cap has been reached, and are then faced with a decision whether to

enforce their right to deny the claims of a policyholder who has purchased terrorism coverage and has suffered a loss. TRIEA is silent about what happens if this occurs.

Solutions

Since the days immediately following September 11, 2001, AIA and ACE have been working diligently with this Subcommittee and others in Congress, the Treasury Department and the White House, the policyholder community, and our colleagues in the insurance industry to develop the most operationally effective and fiscally efficient federal program for the public-private management of terrorism risk. Meaningful solutions must augment existing capacity and spread loss beyond current private sector parameters, while at the same time encouraging the growth of private sector capacity and protecting the taxpayer.

Recognizing that CNBR terrorism risk is uninsurable in the private market, we believe that Congress should consider recalibrating the current TRIEA backstop to provide increased federal financial participation in the event of a CNBR attack. With regard to conventional terrorism risk, we believe that the current backstop has worked and should remain in place. At the current levels (20 percent of subject premium in 2007), the TRIEA backstop would be accessed only in the event of a truly catastrophic conventional attack – most likely a "swarm" or other multiple venue attack – that exceeds the dimensions of the 9/11 strike.

Additionally, as I have mentioned previously, we believe that the distinction between foreign and domestic terrorism should be eliminated, and that the program trigger should be set at a level that provides meaningful protection for small companies. Additionally, state regulation of terrorism risk insurance rates and forms that can undermine the program's basic objectives should be preempted.

Finally, we strongly support the view that the program should be made permanent, or at least remain in place until the U.S. has won the war on terrorism—our ultimate goal.

Attached to this statement is a list of the principles for a new and revitalized program that AIA developed in close cooperation with the policyholder community, working through the Coalition to Insure Against Terrorism (CIAT). They represent changes that would continue TRIA's success in stabilizing the market for conventional terrorism insurance and build upon the program's foundations to create an economically viable way of providing protection against CNBR terrorism risk.

ACE and AIA look forward to working with you to address these important concepts. Thank you again for your unwavering commitment to a strong national economy through a strong TRIA program.

JOINT RECOMMENDED PRINCIPLES FOR 2007 MODERNIZATION OF TERRORISM RISK INSURANCE

This document represents a set of common principles that CIAT and AIA believe must be addressed as Congress renews and improves the existing TRIA program. It is not intended to be an exclusive list of concerns or items that may be supported by individual companies or segments of the industries represented on this joint statement.

Goals:

- Promote long-term availability of terrorism risk insurance for policyholders and provide stability for financial markets and recovery after terrorist attacks
- Spur greater capacity for those areas that are underserved even with the existing TRIA program, *e.g.*, perceived high-risk areas and attacks utilizing nuclear, biological, chemical and radiological means (NBCR)

Duration:

- The program should have no expiration date, and thereby end only when Congress determines terrorism is no longer a threat

Foreign vs. Domestic Acts:

- Remove the distinction found in statute's definition of "act of terrorism" that forces Treasury Secretary to make determination which may not serve national security needs

Program Design: Two-part structure for financing both conventional terrorism risks and NBCR

- Conventional Terrorism Risks:
  - TRIEA-like structure for conventional terrorism perils with continuation of (i) "make available" and (ii) retrospective policyholder surcharges
  - Continuation of current individual insurer retention at 20% of prior year direct earned premium and current individual insurer co-pay of 15% of every dollar of insured losses exceeding the retention up to the $100 billion annual cap.
- NBCR:
  - Reduce potential exposure and provide certainty with respect to the role of private insurers in managing NBCR terrorism risk by:

    (1) Lowering or eliminating insurer deductible and eliminating the insurer co-pay for NBCR to reflect consistent view of GAO, Treasury, and PWG that markets are not working in this area

(2) Clearly and affirmatively stating that the federal government is solely liable for NBCR terrorism losses above insurers' individual NBCR retentions, thus encouraging insurers to provide more capacity

- So long as the private insurer role with respect to NBCR terrorism is consistent with the above-referenced principles,, enhance "make available" provision to include availability to policyholders of an endorsement that provides coverage for NBCR terrorism that would otherwise be excluded by the nuclear hazard or pollution exclusion contained in certain commercial lines policies

- Covered lines no narrower than those included in TRIEA program
- Program trigger no higher than current $100 million, with possible special provision for small insurers

Statement of

Thomas R. Watjen
President and Chief Executive Officer
Unum Group

on behalf of the

American Council of Life Insurers

on

Policy Options for Extending the Terrorism Risk Insurance Act

before the

United States House of Representatives

Committee on Financial Services

Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

April 24, 2007

Introduction

Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee, my name is Thomas Watjen and I am President and Chief Executive Officer of Unum Group. I am responsible for the overall strategic direction of Unum and oversee the operations of each of its three business segments – Unum US, Colonial and Unum UK. Unum is the fourth largest writer of group life insurance, including accidental death (AD&D), in the United States. We insure approximately eight million lives and provide over $800 billion of group life and AD&D coverage.

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 373 member companies that account for 93% 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.

Overview

I would like to thank the Subcommittee for holding this hearing on the Terrorism Risk Insurance Program (TRIA).

We are all, unfortunately, well aware of the risks that our country continues to face from various domestic and international extremist and terrorist groups. 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 and reinsurance is a vital component of maintaining our robust economy.

While much of the ongoing discussion on extending the TRIA program has focused on 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 and beneficiaries, particularly with regard to group life insurance. While we certainly agree that there needs to be adequate terrorism insurance coverage for buildings, we also believe that the people who work or reside inside those buildings should be adequately covered for such events as well.

If Congress decides to extend TRIA, the ACLI and I urge you and your Committee to add group life insurance as a covered line (as the House did in the 109th Congress). The National Association of Insurance Commissioners (NAIC) has also adopted a resolution in support of the inclusion of group life insurance.

The Importance of Group Life Insurance

Group life insurance is a critical employee benefit and 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 September 11, 2001). 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. Almost $20 billion in death benefits were paid to group life beneficiaries in 2005 (which represented about 37% of all death payments).

Group life insurance represented about 45% of all life insurance in force - $8.26 trillion out of a total $18.4 trillion at the end of 2005. There were about 167 million certificate holders of group policies, with an average coverage amount of $49,500.

In addition, approximately 60% of ACLI member companies sell group life insurance. Group life insurers received about $29 billion in net group life insurance premiums in 2005 (which is a little more than 20% of the $142 billion of total net life insurance premiums received).

Potential Exposure to Group Life Death Claims

Unlike individual life policies where insured individuals are generally scattered throughout a particular area or region, group life policies usually have very high concentration risks. 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 $49,500, group life insurers could collectively be liable for almost $1 billion in death claims. If 100,000, 500,000, or one million people were to perish, potential claims would increase to almost $5 billion, $25 billion and $50 billion, respectively. In many urban locations, the average payout per life, including AD&D benefits, would exceed $49,500, exacerbating the losses.

While these death totals and claims amounts may sound exaggerated, unfortunately 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 type and timing of an attack, the concentration of lives in the effected area, and the amount of catastrophic reinsurance it has (if any).

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 expected mortality rates (such as those resulting from a major terrorist attack), payments come primarily from 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 solvent insurers according to certain formulas (e.g., premium volume).

Therefore, while the life insurance industry as a whole would be able to absorb tens of billions of dollars in death claims resulting from most terrorist attacks, those small to medium-sized insurers, and possibly some larger-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. Such insolvencies would also affect the payment of benefits to all of the policyholders of the insolvent companies, not just the group life policyholders.

However, in the case of a major, cataclysmic terrorist attack (e.g., NBCR event), several (or many) insurers, including medium to large-size carriers, may become insolvent, and the guaranty association system may not have the capacity to fund unpaid claims. It is this potential system collapse that concerns the group life industry and is why it urges that group life be included in any TRIA extension.

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.

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, homicides, and natural disasters, which have been tabulated and analyzed over dozens of years and incorporated into mortality tables (which help determine pricing of policies), there is insufficient historical data in this country relating to deaths from terrorism that can be factored into such tables. Terrorism is by its nature, unpredictable; it cannot be accurately or economically forecasted or priced. Similar to the P&C exposure for property losses, the extent of losses for any particular carrier would be highly dependent upon the specific location of an event, rendering loss prediction useless.

Second, neither Unum, nor the ACLI, are aware of any states (except for Kansas and North Carolina under very limited circumstances) that allow the use of terrorism exclusions (including those for NBCR events) by group (or individual) life insurers for group life coverage. Even if most states allowed such exclusions, unless the entire industry took the same approach, any group insurer that tried to manage its risk exposure by excluding terrorism coverage would be putting itself at a severe competitive disadvantage, particularly small to medium size insurers. Furthermore, we do not believe that it is good business, or sound public policy, to exclude coverage for deaths due to a catastrophic event. The importance of coverage would in fact be highlighted by the horrible nature of a terrorist attack, and families of victims would rely very heavily on these benefits for continued financial well being.

Third, catastrophic reinsurance is generally not available for group life insurance in sufficient amounts. Immediately after 9/11, group life insurers were generally unable to obtain catastrophic reinsurance, especially for terrorist events. While such catastrophic reinsurance has become somewhat more available since, it often comes with higher deductibles, various exclusions, and most importantly, with overall coverage limits that are substantially lower than were available prior to 9/11. Reinsurance is a fundamental risk spreading mechanism underpinning the insurance industry. Without adequate catastrophic reinsurance, many group life insurers risk financial ruin from a significant terrorist attack.

Group Life Should be Included in any TRIA Extension

While group life has been readily available to consumers, mainly for competitive reasons, if a major terrorist attack were to occur, it is very likely that some group insurers would be unable to fully pay their death claims. We also believe that group life insurance would not be widely available after such an event since many or most insurers would likely decide to exit the marketplace. It is for these reasons that we strongly urge Congress to include group life insurance in any TRIA extension.

Group life is very similar to workers compensation and most workers across the country are covered by both. The latter was included in the original TRIA legislation, as well as in its extension, and as a result, the industry experienced a significant increase in the availability of related reinsurance. As with workers compensation, we believe that catastrophic reinsurance would become more available and less expensive for group life if it were included in a TRIA extension. This additional reinsurance capacity would significantly reduce the risk of insolvency that many group insurers would face if a large-scale terrorist attack were to occur.

Separate Recoupment Mechanisms Should be Created

If TRIA is extended again and group life insurance is included, we urge that separate recoupment mechanisms be created for P&C and group life insurers. Recoupment of amounts paid by the Treasury for losses relating to P&C insurance should only be made

from P&C insurers. Similarly, recoupment for losses relating to group life insurance should only be made by group life insurers.

Group life insurers take on different types of risks than P&C insurers and the premium structures of the two industries are very different. In the event of a catastrophic terrorist attack that primarily results in P&C losses, and without separate recoupment mechanisms, group life insurers would have to reimburse the federal government for millions or billions of dollars for claims unrelated to their line of business and for which they received no prior premiums. The opposite would be true in the case of an event that killed thousands of people but spared properties. Given the various types of potential terrorism events, it is not possible to predict how an event would effect the distribution of losses between the two types of coverage.

All states (with the exception of Wisconsin) have created separate guaranty associations for the life and P&C insurance industries. The state guaranty association system was designed so that: (1) only life (and health) insurers would be responsible for contributing to the unpaid claims of another life (or health) insurer and (2) only property and casualty insurers would be responsible for contributing to the unpaid claims of another property and casualty insurer.

Conclusion

We look forward to working with your Committee, others in Congress and the Administration. Thank you for allowing me the opportunity to express our views on this very important matter. For the record, on April 13th, the ACLI also submitted written responses to various questions relating to TRIA that were posed to us by this Subcommittee. I will be glad to answer any questions that you may have.

AMERICAN BAR ASSOCIATION

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STATEMENT OF

PETER J. NEESON, CHAIR

SECTION OF TORT TRIAL AND INSURANCE PRACTICE

AND

FRANCINE L. SEMAYA, CHAIR

SECTION OF TORT TRIAL AND INSURANCE PRACTICE'S TASK FORCE
ON FEDERAL INVOLVEMENT IN INSURANCE REGULATION
MORDENIZATION

submitted on behalf of the

AMERICAN BAR ASSOCIATION

to the

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
COMMITTEE ON HOUSE FINANCIAL SERVICES

of the

U.S. HOUSE OF REPRESENTATIVES

on the subject of

"POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE
ACT"

April 24, 2007

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to submit to you the views of the American Bar Association (ABA) on reauthorizing the "Terrorism Risk Insurance Act of 2002" (P.L. 107-297) also known as "TRIA". We are Peter J. Neeson, Chair of the Section of Tort Trial and Insurance Practice, and Francine L. Semaya, Chair of the ABA Section of Tort Trial and Insurance Practice's Task Force on Federal Involvement in Insurance Regulation Modernization. We are submitting this statement on behalf of the ABA.

The ABA is pleased that the Subcommittee is holding hearings to discuss reauthorizing TRIA, which Congress passed in response to the September 11 terrorist attacks. The ABA believes it is very important to enact, in the near future, a permanent or long-term reauthorization of TRIA, an act which created a three-year program to help stabilize the commercial property and casualty insurance markets and ensure the continued availability of terrorism insurance for U.S. businesses. On December 22, 2005, President Bush signed legislation, P.L. 109-144, modifying and extending TRIA for an additional two years and increasing the aggregate loss trigger. It is very important that this Congress act much more quickly to reauthorize TRIA, rather than waiting until it is about to expire as happened at the end of 2005. Terrorism insurance is required by banks and financing institutions before they will make loans on commercial real estate projects and development. Insurance companies are reluctant to offer terrorism insurance without TRIA, which is set to expire at the end of December 2007. Thus, it is critical for Congress to act in a timely fashion so that new policies can be written by insurers and purchased by policyholders in time for 2008.

TRIA has helped stabilize the price of terrorism insurance by reducing the amount of risk to be borne by insurers. Without a federal backstop, many insurers would not have provided terrorism coverage – or would have provided insufficient terrorism insurance – and prices could have been even higher. By providing a backstop, TRIA improved the ability of the market to respond to this risk. The availability may have been even worse in compulsory lines like workers' compensation insurance, where insurers would have had to choose between providing workers' compensation coverage including terrorism, or not writing the coverage at all.

In February, 2007, the ABA adopted as policy the following resolution:

> RESOLVED, That the American Bar Association urges Congress and the Executive Branch to partner with the insurance industry to promote the availability of terrorism risk insurance through legislation that continues support for market mechanisms with federal government insurance backstop protection.

Attached is the report that the ABA policymakers, its House of Delegates, considered when adopting ABA policy. The report does not constitute ABA policy. It is for background purposes only. Only the resolution constitutes ABA policy.

The unpredictability of terrorism diminishes the ability of the private market to underwrite this risk. Terrorism is perpetrated by human actors who have the intention of causing harm. In order to generate greater fear and alarm, terrorists may act in ways that are unexpected. These characteristics make terrorism risk significantly more difficult to predict and model than other kinds of risks. The risk is so variable and difficult to predict that insurers and reinsurers are cautious and will only put limited amounts of capital at risk. The government backstop helps to consolidate the risk of catastrophic events so that

the consequences of modeling mistakes are shared collectively by the federal government and the private insurance industry rather than by individual insurers alone.

A role for government is especially needed in the area of coverage for nuclear, chemical, biological, and radiological attacks. At the present time, there is little insurance coverage available for such attacks apart from coverage mandated by state law, such as workers' compensation and "fire following" coverage in those jurisdictions with statutory fire policies.

The government-industry partnership benefits policyholders and the economy. Some critics of TRIA try to characterize it as an "industry bailout" bill. Such rhetoric is both overblown and misplaced. After September 11, and prior to TRIA's enactment, exclusions for terrorism risk were approved in 45 states and the District of Columbia. It is therefore reasonable to assume that without sufficient reinsurance or another financial loss-sharing mechanism such as the federal backstop, most insurers could simply exclude terrorism risk from their coverage.

The federal government, because of its massive national security apparatus and its superior access to information, is in the best position to partner with the insurance industry to provide terrorism insurance. The federal government also has access to very large amounts of capital and can use its broad powers to rebuild or repay the capital. Moreover, experience has shown that the government will likely provide assistance to victims of a major terrorist attack; it behooves the federal government to be involved prior to the attack in order to receive the benefits of advance planning, risk management, capital accumulation, and the opportunity to use the underwriting and claims expertise of the insurance industry.

Thank you for the opportunity to present the views of the American Bar Association. We would be happy to work with your Subcommittee on the legislation and to answer any questions you might have.

APPENDIX

Below is the report considered by the ABA House of Delegates when it adopted ABA policy in February 2007. This report does not constitute ABA policy; the resolution constitutes ABA policy.

Report

This Report supports the Resolution sought by Tort Trial and Insurance Practice Section regarding the need for a government-industry partnership for insuring terrorism risk. The Task Force on Federal Involvement in Insurance Regulation Modernization (the "Task Force"), which was first organized in 2005, has studied the Terrorism Risk Insurance Act of 2002 ("TRIA" or "the Act") and the Terrorism Risk Insurance Extension Act of 2005 ("TRIEA"). In March of 2006, the Task Force issued a White Paper exploring the various issues raised by the debate about extension of the Act, and concluded that the government-industry partnership represented by TRIA should be continued, although it made suggestions for possible improvement. This Report takes a slightly different approach than the White Paper, though it makes some of the same points. The purpose of this report is to outline the reasons the Task Force supports a permanent government-industry partnership for terrorism insurance. This Report does not consider any specific proposal regarding the nature of the government-industry partnership, though it discusses TRIA and TRIEA as relevant examples.

This Report outlines three main reasons for a permanent government-industry partnership regarding terrorism insurance: 1) the unpredictability of incidents of terrorism impedes the ability of the private insurance market to take on the financial risk without governmental support, 2) a government-industry partnership can support the use of the private insurance market to provide some terrorism insurance, and 3) a government-industry partnership to provide this protection is consistent with national interests.

I. The Unpredictability of Terrorism Diminishes the Ability of the Private Market to Underwrite This Risk.

A. In General

Although the Terrorism Risk Insurance Act of 2002 ("TRIA" or "the Act") and the Terrorism Risk Insurance Extension Act of 2005 ("TRIEA") have succeeded in providing greater access to terrorism insurance,[1] the ability of the private market to provide terrorism insurance absent government involvement is impeded by the unpredictable nature of terrorism. Its characteristics make terrorism risk significantly more difficult to predict and model than other kinds of risks. Terrorism is perpetrated by human actors who have the intention of causing harm.[2] In order to generate greater fear and alarm,[3]

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[1] According to a study conducted by Wharton Risk Management and Decision Processes Center at the University of Pennsylvania, "about 50% of commercial enterprises have purchased TRIA-line terrorism insurance." WHARTON RISK MANAGEMENT AND DECISION PROCESS CENTER, TRIA AND BEYOND, at 2 (2005) [hereinafter WHARTON]. The RAND study reached similar conclusions. *See* PETER CHALK, BRUCE HOFFMAN, ROBERT REVILLE, ANNA-BRITT KASUPSKI, TRENDS IN TERRORISM: THREATS TO THE UNITED STATES AND THE FUTURE OF THE TERRORISM RISK INSURANCE ACT at 7-8 (2005) (citing Congressional Budget Office and others) [hereinafter RAND]. The most recent study, conducted by the President's Working Group on Financial Markets, found take up rates of 58% in 2005. *See* TERRORISM RISK INSURANCE, REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS at 1 (2006) [hereinafter PWG REPORT].

[2] *See* WHARTON, *supra* note 1, at 13.

[3] *See* WHARTON, *supra* note 1, at 13.

terrorists may act in ways that are unexpected.[4] Although terrorists have sometimes attacked "hard" targets in the past because of their symbolic significance, terrorists are showing an increased willingness to attack "soft" targets with significant civilian exposures.[5] The religious or political fervor of some terrorists and their willingness to commit suicide in conjunction with terrorist acts is another consideration that makes it difficult to model or prevent terrorist behavior.[6]

The challenge of modeling terrorist behavior is compounded by a lack of information. The historical data available on terrorism are limited because of a relatively few number of incidents,[7] and the utility of the available data for those incidents is limited by the wide variety of cultural and operational contexts within which the events took place.[8] In addition, although much of the focus has been on al Qaeda after September 11, there are various terrorist organizations that have substantial differences in ideology, structure and methodology.[9]

Moreover, much of the information about terrorism risk has been collected by governmental agencies, which are understandably unwilling to share that information because of national security and law enforcement concerns.[10] Government policies also affect the nature and scope of the risk through anti-terrorism and other policies.[11] Government, the Federal government in particular, devotes substantial resources to combating terrorism, which may reduce or increase the risk of terrorism, or may have an impact on certain kinds of risks or risks in specific geographical areas.

Another characteristic of terrorism risk is the variability of its impact. While much progress has been made in modeling the consequences of a terrorist attack,[12] even with these models there are many different impact scenarios.[13] Although certain areas tend to present greater risk of terrorism, it is impossible to rule out any potential target. As some targets become more difficult to attack, it is possible that terrorists could switch to easier targets in less-protected locations. Nuclear, biological, chemical or radiological attacks could affect very large geographic areas and potentially millions of people,[14] while attacks with conventional weapons could be limited to a single business or individual.

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[4] This been described as the dynamic uncertainty problem. *See* WHARTON, *supra* note 1, at 52-53.
[5] *See* RAND, *supra* note 1, at 15-16; *see also See* WHARTON, *supra* note 1, at 13, 52, 56.
[6] *See* RAND, *supra* note 1, at 26-29 (describing use of suicide attacks by al Qaeda); *see also* WHARTON, *supra* note 1, at 55-56.
[7] *See* PWG REPORT, *supra* note 1, at 24.
[8] *See* WHARTON, *supra* note 1, at 58.
[9] The main threat to the U.S. is considered to be al Qaeda, but many terrorist events have been undertaken by other organizations that have largely limited their activities to local targets. *See* RAND, *supra* note 1, at 11 n.1. In addition, there is a growing risk of home-grown terrorism in the U.S. from both the left (the anti-globalization and radical environmental groups) and the far right. *See id* at 39-51.
[10] *See* WHARTON, *supra* note 1, at 53-54.
[11] *See* WHARTON, *supra* note 1, at 54.
[12] *See* WHARTON, *supra* note 1, at 59-61; *see also* PWG REPORT, *supra* note 1, at 20-23.
[13] *See* WHARTON, *supra* note 1, at 62, 65.
[14] Al Qaeda has an ongoing interest in acquiring and using such weapons. *See* RAND, *supra* note 1, at 30-31. The implications for the economy could be disastrous. *See id.* at 36-37. For a more general description of potential catastrophic scenarios, *see* WHARTON, *supra* note 1, at 50-51.

Some terrorist activity appears to be specifically aimed at the U.S. economy,[15] which presents the possibility of attacks in more remote areas.[16]

Taken together, these characteristics make terrorism very different from other kinds of risks and pose significant challenges for underwriting.[17] The risk is so variable and difficult to predict that insurers and reinsurers are cautious, and they will only put limited amounts of capital at risk.[18] In addition, because the size of the risk is so variable, it is hard to determine the amount of capital reserves that should be maintained for that risk.[19] Under the incentive of the mandatory availability requirements of TRIA, insurers are working to develop models to try to predict the probability of terrorist attacks, but most insurers recognize that the models are simply too imprecise to be of much help. The President's Working Group, after reviewing insurer behavior in the marketplace, noted:

> Skeptical of their reliability, insurers do not appear to be placing much weight on the probabilistic models at this time. A.M. Best reports that among surveyed insurers, only 19 percent reported using probabilistic modeling while 62 percent did not. As the NAIC pointed out during consultations, the ability to model frequency is uncertain and untested, and some regulators have even challenged advisory organization loss cost filings based on such models.[20]

The government-industry partnership represented by TRIA, aided substantially by the mandatory available provisions, has helped to facilitate the availability of terrorism coverage, notwithstanding this unpredictability. While government involvement does not change the nature of the risk, the government backstop helps to consolidate the risk of catastrophic events so that consequences of the modeling mistakes are shared collectively by the Federal government and the private insurance industry rather than by individual insurers alone.

B. Nuclear, Chemical, Biological & Radiological Risks

A role for government is especially needed in the area of nuclear, chemical, biological, and radiological ("NBCR") attacks. At the present, there is little insurance coverage available for such attacks apart from coverage mandated by state law, such as workers' compensation and "fire following" coverage in those jurisdictions with statutory fire policies ("SFPs").[21] Although TRIA requires that insurers offer terrorism insurance to

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[15] *See* RAND, *supra* note 1, at 21-23

[16] *See* RAND, *supra* note 1, at 22 (noting examples of oil installations, seaports and shipping).

[17] *See* WHARTON, *supra* note 1, Chapter 3.2.

[18] The PWG Report notes: "While insurers and reinsurers are willing to allocate some capacity to terrorism risk with untested probability models or by making their own internal probability assessments, given the degree of uncertainty associated with these modeling efforts, there may be limits in the confidence insurers may place on such models. Many commenters (*e.g.*, the Reinsurance Association of America) highlighted the fact that allocating additional capacity is tied to determining potential frequency and severity." PWG REPORT, *supra* note 1, at 24.

[19] *See* WHARTON, *supra* note 1, at 49.

[20] PWG REPORT, *supra* note 1, at 24 (citing A.M. Best, Special Report, "Terrorism: Too Risky Without TRIA?," December 2005).

[21] According to a 2005 Treasury study, less than 3% of policyholders reported purchasing NCBR coverage in their commercial property/casualty insurance policies. *See* GAO REPORT, TERRORISM INSURANCE: MEASURING AND PREDICTING LOSSES FROM UNCONVENTIONAL WEAPONS IS DIFFICULT, BUT SOME

their policyholders, they are only required to offer terrorism insurance on the same terms and conditions as property and casualty coverage for non-terrorism losses.[22] Because most property insurance policies in non-SFP jurisdictions have long excluded losses from nuclear and some chemical events, TRIA does not require terrorism insurance to cover such events.[23] Moreover, as the President's Working Group noted, "[t]here is virtually no CNBR [sic] reinsurance available."[24]

The absence of insurance coverage for NBCR attacks outside of state-mandated lines and the absence of available reinsurance for this type of terrorism exposure represent a significant gap. The use of NBCR materials for a terrorist attack is a serious risk. According to RAND, "al Qaeda has long expressed an interest in the offensive employment of NBCR materials."[25] Although al Qaeda has yet to demonstrate any such capability in an actual attack,[26] there is evidence of plans and efforts to develop it.[27] Models have shown that a large-scale biological attack, such as with anthrax, could generate as much as $90 billion in losses.[28] Nuclear or radiological attacks could have an even more severe impact.[29] The RAND study concluded that the "most profound risk" of uninsured losses is in the area of a NBCR attack.[30]

There is no evidence that the market will provide meaningful insurance coverage for NBCR risks.[31] Indeed, as the President's Working Group concluded, "there may be little

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INDUSTRY EXPOSURE EXISTS at 20 (September 2006) [hereinafter GAO REPORT ON UNCONVENTIONAL WEAPONS]. The GAO found that "property/casualty insurers generally have attempted to limit their exposure to NBCR risks by excluding nearly all NBCR events from coverage, both for commercial property/casualty and homeowners." *Id.* at 3.

[22] *See* Terrorism Risk Insurance Act § 103(C)(1), Public Law No. 107-297, 116 Stat. 2322.

[23] *See* RAND, *supra* note 1, at 6-7 (citing Marsh, Inc., *Marketwatch: Property Terrorism Insurance Update—3rd Quarter 2004*). *See also* WHARTON, *supra* note 1, at 86. It should be noted that workers compensation insurance is a notable exception to this because of the mandatory scope of coverage of workers compensation insurance. *See id.* at 81.

[24] PWG REPORT, *supra* note 1, at 5 and 78.

[25] *See* RAND, *supra* note 1, at 30. The RAND study cites a news interview of bin Laden in which he "specifically asserted that acquiring weapons of mass destruction (WMD) was a religious duty for all Muslims." *Id. See also* WHARTON, *supra* note 1, at 50 n. 68.

[26] *See* RAND, *supra* note 1, at 31.

[27] *See id.* at 31-32.

[28] *See* WHARTON, *supra* note 1, at 50.

[29] *See id.* The RAND study suggests that a "dirty bomb" could contaminate an area as large as ten square miles, and that demolition of contaminated buildings may be the only practical solution, resulting in huge losses. *See* RAND, *supra* note 1, at 33.

[30] *See id.* at xii.

[31] The number of insurers offering terrorism insurance for conventional attacks rose from 73% to 91% after the adoption of TRIA, but the percentage offering coverage for NBCR remained constant a constant 35% before and after TRIA (and offering a single policy with NBCR coverage was enough to count the company). GAO REPORT ON UNCONVENTIONAL WEAPONS, *supra* note 21, at 16. One reason that as many as 35% of insurers offer some NBCR coverage is that such coverage is mandatory for workers compensation insurance and "fire following" coverage in property policies in SFP jurisdictions, and too difficult to meaningfully exclude from life and health policies. *See id.* GAO at 4. The GAO found that "NBCR risks largely fail to meet most or all of the principles of an insurable risk," *id.* at 3, and that "insurance experts, representatives of insurers and reinsurers . . . agreed that difficulties in predicting NBCR events, as well as the prospects for catastrophic losses, make these risks difficult to insure," *id.* at 14.

potential for future market development" for NBCR terrorism risk.[32] As a consequence, if such risks are to be insured, the government must play a significant role.[33] It is true that the economy has survived for many years without such coverage, and that the government would likely provide post-disaster aid and assistance in the event of a major NBCR event. The purpose of insurance is to create incentives for risk management, and to establish mechanisms for the payment of claims in the event of covered losses. If government payment of NBCR claims is inevitable, which seems likely in the event of a NBCR terrorist attack, it would be more efficient and economical from a policy standpoint to use an insurance mechanism at least in part rather than to rely on an after-the-fact disaster relief approach.

II. A Government-Industry Partnership Can Support a Market Mechanism for Terrorism Insurance.

A. TRIA Supported a Market Mechanism for Terrorism Insurance

TRIA's backstop approach to terrorism risk actually supported the development of the terrorism insurance market. Because of the unpredictability of a terrorist attack and the amount of losses that might be caused by such an attack, insurers have an incentive to not insure terrorism events at all, or to charge a high premium to reflect the unpredictability, where they have the regulatory flexibility to do so.[34] TRIA, by reducing the amount of risk to be borne by insurers, has helped stabilize the price for terrorism insurance.[35] Without a federal backstop, many insurers would not have provided terrorism coverage and prices could have been even higher.[36] From a theoretical standpoint, larger and more uncertain risks generally have higher prices reflecting the greater risk, so it is not surprising that terrorism insurance would be expensive.[37] Competition, in theory, provides an incentive to lower prices, but even competitive pricing for risks with high levels of unpredictability are likely to reflect a higher premium for the high risk.[38]

By providing a backstop for catastrophic terrorism risk, TRIA improved the ability of the market to respond to this risk. One of TRIA's primary functions was to provide access to funds to pay claims in the event of a catastrophic loss. Under the extended version of TRIA individual insurer retentions (or "deductibles") were raised to 17.5% in 2006 and

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[32] PWG REPORT, *supra* note 1, at 78.

[33] This resolution and report does not take a position as to what kind of government involvement would be appropriate, only that if NCBR coverage is to be provided in any meaningful way, the government must show some leadership and play a major role.

[34] In more technical terms, an underwriter setting the price for insurance considers the "probable maximal loss." In light of the September 11th attack, the probable maximal loss for a terrorist attack can be billions of dollars. Insurers want to charge fairly high premiums to take on such a large risk. TRIA, by providing a reimbursement mechanism for large terrorism losses, reduces the probable maximal loss and thereby encourages a lower price.

[35] *See* RAND, *supra* note 1, at 7 (reporting that in the first 9 months of 2002 property insurance rates dropped by 50-75%, and have continued to fall by about one-half so that by third quarter 2004 the typical prices for terrorism insurance represented about 4% of the total premium for property coverage compared to 10% the year before). *See also* PWG REPORT, *supra* note 1, at 1 (noting that by 2005 the cost of terrorism insurance "had dropped to 3-5% of total property insurance costs").

[36] *See* RAND, *supra* note 1, at 9; WHARTON, *supra* note 1, Appendix 1A, at 28.

[37] *See* WHARTON, *supra* note 1, at 35-36.

[38] *See id.* at 87.

then to 20% in 2007, but it retained the backstop protection up to the $100 billion annual limit. While some of the payments made under TRIA could be recouped through discretionary post-event surcharges, the availability of federal funds reduces the catastrophic front-end risk to insurers. This allows the market to address the remaining risk. Because the catastrophic risk is backstopped by the Federal government and would be spread by the industry through the TRIA mechanism, insurers are more willing to put their capital at risk while still maintaining capital for other kinds of risks (such as natural disasters).[39] As a result, with TRIA, more capital presumably is available in the market for terrorism insurance.

TRIA also supported the affordability of terrorism insurance in the market. By reducing the amount of front-end capital at risk, TRIA gave insurers greater capacity to offer terrorism insurance at lower prices. In addition, while TRIA did not mandate the price for terrorism coverage, it required that participating insurers offer such coverage. The combination of a reduction in an insurer's capital at risk, the requirement of mandatory offering, and competition to satisfy policyholders who were purchasing property and other insurance products, encouraged lower prices for terrorism insurance. Studies show that prices for terrorism insurance decreased after the adoption of TRIA,[40] and a greater number of policyholders purchased terrorism coverage.[41] According to a several studies, the take up rates with TRIA in place have reached nearly 60% in 2006, from around 30% in 2002.[42]

By improving availability of terrorism insurance, TRIA encouraged pre-event planning rather than reliance on after-event ad hoc governmental assistance for victims. Insurance offered before an event creates an opportunity for risk assessment and management, and market forces create an incentive to take advantage of such opportunities. On the other hand, a mechanism that operates primarily after the event, such as government aid for victims of terrorism, may work against market incentives. If potential victims rely on the government to provide aid after the fact, they may not have incentives to assess and manage their risks. By encouraging availability and use of terrorism insurance, TRIA provided opportunities to use market incentives for assessing and managing terrorism risk.

B. Without Government Support, the Insurance Market Would Not Provide Sufficient Terrorism Insurance

Under the present market circumstances the availability of terrorism insurance likely would have decreased if TRIA had been permitted to expire.[43] The situation may have been even worse in compulsory lines like workers' compensation insurance, where insurers would have had to choose between providing workers' compensation coverage

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[39] For a historical summary of property losses from natural catastrophes and made-made disasters, including September 11th attack, see WHARTON, *supra* note 1, at 46-48.
[40] *See supra* note 31.
[41] *See supra* note 1.
[42] *See* PWG REPORT, *supra* note 1, at 42.
[43] *See* RAND, *supra* note 1, at 9; *see also* WHARTON, *supra* note 1, at 168 (noting that survey respondents from the National Association of Real Estate Investment Trusts reported "significant negative repercussions from non-renewal" of TRIA including loan defaults, difficulty in refinancing, and going without terrorism insurance).

including terrorism, or not writing the coverage at all. Although some reinsurers have re-entered the market for terrorism risk, reinsurers have indicated a willingness to provide only up to approximately $6-8 billion in coverage,[44] which is a fraction of the $25 billion industry aggregate for program year four and is only about one-fourth of the estimated $30 billion in individual insurer retentions. Survey data shows that reinsurers are not likely to significantly increase the coverage available for terrorism.[45] Without access to reinsurance or TRIA, if actions post-September 11 are any guide, many primary insurers would take actions to avoid underwriting terrorism risk or to ration existing capacity.[46]

C. Without Government Support, Some Insurers will be at Risk of Insolvency

While some insurers would voluntarily exclude terrorism risk from their policies if there is no government-industry partnership, in some states existing laws preclude insurers from excluding terrorism losses from coverage. Most workers' compensation insurance policies, for example, cannot exclude terrorism coverage.[47] As a result, a major attack could present a risk of insurer insolvency in certain markets, or, alternatively, reduced overall availability in certain insurance lines. The September 11th attack resulted in insured workers compensation losses of $1.8 billion.[48] That exposure could be as much as $90 billion in the event of a major nuclear, chemical, biological or radiological attack.[49] Even a conventional five-ton bomb used against a single building in New York could cause more than $7 billion in workers compensation losses.[50] Because there is only about $30 billion of capital available in workers compensation insurance,[51] a major attack could substantially deplete or even exceed the available capital.[52] Moreover, because only a few key insurers provide workers compensation coverage in states such as California and New York, "some insurers in these states are likely to be declared insolvent after a large terrorist attack."[53]

A second form of mandated coverage is for certain fires in states using the Standard Fire Insurance Policy. At the time of the September 11th attacks, 29 states required commercial property insurance to conform to the coverage of the so-called "standard fire

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[44] *See* PWG REPORT, *supra* note 1, at 26.
[45] *See* WHARTON, *supra* note 1, Appendix 1A, at 27-28.
[46] *See* U.S. DEPARTMENT OF TREASURY, ASSESSMENT: THE TERRORISM RISK INSURANCE ACT OF 2002, at 6 (2005) (nearly 50% of insurers responding to a treasury survey said that they do not plan to write terrorism coverage after TRIA expires; 25% of policyholders indicated that their current terrorist coverage excludes coverage after the expiration of TRIA) [Hereinafter TREASURY REPORT].
[47] *See* WHARTON, *supra* note 1, at 81 (noting that workers compensation insurance "is mandatory for a large majority of employers in all states except Texas where it is optional").
[48] *See* TREASURY REPORT, *supra* note 42, at 26, Figure 2.9 (relying on data from the Insurance Information Institute).
[49] *See* WHARTON, *supra* note 1, at 50; *see also* Towers Perrin, *Workers Compensation Terrorism Reinsurance Pool Feasibility Study: Summary of Study Findings and Conclusions* (March 2004) (available at http://www.towersperrin.com/tillinghast/publications/reports/WC_Terr_Pool/WC_Terr_Pool_Study_ES.pdf) [last visited Nov. 4, 2005].
[50] *See* WHARTON, *supra* note 1, at 99, Figure 6.4.
[51] *See* Towers Perrin, *supra* note 47.
[52] *See id.*
[53] *See* WHARTON, *supra* note 1, at 113.

insurance policy."[54] This requirement mandates that property insurance provide coverage for fires that ensue from a terrorist event even if other damages from the terrorist events are specifically excluded by the policy.[55] After TRIA was adopted, twelve states modified their statutes to exclude in various ways coverage for events of ensuing caused by acts of terrorism.[56] This leaves ensuing fire coverage for terrorism events mandated in 17 states. If reinsurance or some other kind of pooling mechanism like TRIA is unavailable for insurers in these states, a major terrorist attack may force some property/casualty insurers into bankruptcy.[57]

III. The Government-Industry Partnership is Consistent with National Interests

Because the government-industry partnership would help to reduce the risk of insolvency for insurers selling certain lines of insurance or issuing such coverages in certain states, some critics of TRIA try to characterize it as an "industry bailout" bill. Such rhetoric is both overblown and misplaced. After September 11, and prior to enactment of TRIA, in 45 states and the District of Columbia, regulators approved exclusions for terrorism risk.[58] It is therefore reasonable to assume that without sufficient reinsurance or another financial loss-sharing mechanism such as the Federal backstop, most insurers could simply exclude terrorism risk from their coverage.[59] This is exactly what happened prior to TRIA's adoption. Because of the unavailability of terrorism risk insurance, for example, banks were hesitant to lend on major construction projects, which created a "drag" on the U.S. economy.[60] As with the adoption of TRIA, a government-industry partnership to curtail the financial losses of another terrorism attack is there to benefit the economy rather than to benefit the insurance industry.

In addition, terrorism is a national threat that justifies a Federal response. As explained above, terrorists try to create fear and terror by undertaking surprise attacks. Thus, they could strike anywhere at virtually any time. Moreover, in addition to creating fear or terror, these attacks are increasingly aimed at the U.S. economy.[61] Thus, even though

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[54] *See* WHARTON, *supra* note 1, at 85.
[55] *See, e.g.*, Opinion Regarding Commercial Property Insurance Terrorism Limitation for Fire Following, General Counsel, New York State Insurance Department, June 26, 2003, available at http://www.ins.state.ny.us/rg030627.htm [last visited Nov. 4, 2005].
[56] *See* WHARTON, *supra* note 1, at 85. Amendments are under consideration in additional states. *Id.*
[57] *See* Insurance Information Institute, Updates and Releases, *Terrorism Coverage is a Taxpayer – Not Insurance Company – Responsibility, Industry Forum Told*, Jan. 23, 2002 (available at www.iii.org); *California, New York take Big Risks on Terrorism Policies*, National Underwriter – Property Casualty, Jan. 24, 2002, at 24. Richard J. Hillman, Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities, United States General Accounting Office Report, Testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives, February 27, 2002, at 7 (reporting that the NAIC found that a $25 million loss for a single primary property/casualty insurer would threaten the solvency of 886 companies, or 44% of the companies writing commercial property/casualty insurance) (available at www.gao.gov) .
[58] *See* Hillman, *supra* note 55, at 5.
[59] As noted above, Workers Compensation insurance and fire following property coverage is an exception.
[60] *See* Joint Economic Committee of the U.S. Congress, *Economic Perspectives on Terrorism Insurance* (2002) (available from the Government Printing Office); *see also* Robert P. Hartwig, *The Impact of the September 11 Attacks on the American Insurance Industry*, in INSURANCE AND SEPTEMBER 11 ONE YEAR AFTER: IMPACT, LESSONS AND UNRESOLVED ISSUES, at 28-29 (Patrick M. Liedtke & Christophe Courbage, eds., 2002); Hillman, *supra* note 55, at 9.
[61] *See* RAND, *supra* note 1, at 21-23.

owners of property that is damaged by a terrorist attack suffer more directly and significantly than those who don't own property, all property owners are at risk of a terrorist loss and all U.S. residents potentially suffer the economic consequences of an attack, which can be mitigated to some extent by the availability of insurance.[62]

Finally, the government, because of its massive national security apparatus, is in the best position to do something about terrorism risk. Because the Federal government has better access to information and can use the information to reduce the risk of attacks, the government provides meaningful benefits by partnering with the insurance industry to provide terrorism insurance. The Federal government also has access to very large amounts of capital, and can use its broad powers to rebuild or repay the capital. Moreover, experience has shown that the government will likely provide assistance to victims of a major terrorist attack, so if the Federal government is going to be involved after the attack, it behooves the Federal government to be involved prior to the attack in order to receive the benefits of advance planning, risk management, capital accumulation, and the opportunity to use the underwriting and claims expertise of the insurance industry.

Respectfully submitted

Peter Neeson, Chair
Tort Trial & Insurance Practice Section

February 2007

[62] *See* RAND, *supra* note 1, at 58.

Risk and Insurance Management Society

Statement for the Hearing "Policy Options for Extending the Terrorism Risk Insurance Act"

Tuesday, April 24, 2007

Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises of the House Financial Services Committee

As the country's largest professional risk management organization, RIMS represents nearly 4,000 industrial, service, nonprofit, charitable, and government entities. Our members buy insurance and have a strong view on the need for, and availability of, insurance to cover risk against terrorist acts.

We appreciate the opportunity to share our views on a number of policy issues related to the further extension of the Terrorism Risk Insurance Act (TRIA). We have developed a set of principals that comprise our TRIA Policy Statement (attached) and believe they provide a strong foundation for the development of any long-term solution. In submitting this supplemental statement, we hope to provide further details on a few key issues that have been raised as part of the current TRIA debate.

- **Length of Program Extension**

  RIMS strongly supports the reauthorization of TRIA and believes that a permanent TRIA program would be the most effective way to protect the interests of both the public and private sectors. Having adequate insurance coverage for U.S. businesses is important to the economic well-being of the nation. As an absolute minimum, a fifteen year extension is needed to provide market stability.

- **Coverage of Domestic Terrorism**

  The distinction between "foreign" and "domestic" acts of terrorism should be eliminated. The delivery mechanism for terrorist acts has expanded and includes domestic groups and/or individuals with a loose association to an overseas group but with an agenda consistent with the objectives of TRIA. Without clarification that TRIA would cover all types of terrorism, both foreign and domestic, insurers are left with the uncertainty that the federal backstop program would apply depending on whether the event qualified as a "certified TRIA terrorism event".

- **NBCR**

  There are a number of proposals that have been circulated with respect to the issue of a make-available requirement for nuclear, biological, chemical, and radiological events (NBCR). But, because the NBCR exposure is not calculable for premium purposes, and therefore is essentially an uninsurable risk, RIMS has expressed concern that forced to offer NBCR coverage, many smaller companies would opt to exit the market and leave larger companies to offer minimum limits at very high prices. We are pleased to see that current make-available NBCR discussions/proposals include suggestions to lower or eliminate the insurer deductible, eliminate the insurer co-pay and clarify that insurer liability does not extend beyond the $100 billion annual cap. We believe these adjustments would help frame the risk, minimize uncertainty and encourage private market involvement in the program. However, if Congress decides to include make-available language in the final TRIA bill, RIMS would strongly suggest that this be structured so that NBCR-related terrorism coverage be offered as a separate line item, giving buyers the option to accept or decline coverage independently, similar to the current structure of TRIA.

For the Committee's consideration, attached is a copy of RIMS TRIA Policy Statement, which outlines our recommendations on a number of other aspects of TRIA.

Finally, as an indicator of the importance of this issue to the nation's risk managers, RIMS points to the results of an informal survey that it conducted last summer. Eighty-six percent said that if TRIA or some other federal backstop were not in place, they did not believe that they would be able to obtain sufficient coverage for acts of terrorism at affordable prices. RIMS considers the availability of adequate insurance for

acts of terrorism to be not simply an insurance problem, but a national security and an economic issue.

RIMS appreciates the opportunity to submit our views on this very important issue and we look forward to continuing to work with Congress as the TRIA debate progresses.