STATEMENT SUBMITTED

BY

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TO

SENATE BANKING COMMITTEE

ON

THE TERRORISM RISK INSURANCE PROGRAM

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Willis

Chairman Dodd, Ranking Member Shelby, and members of the Committee, thank you for the opportunity to testify before you today regarding the terrorism risk insurance program. My name is Don Bailey. I am the CEO of Willis North America, Inc., a subsidiary of The Willis Group (Willis). My testimony today is on behalf of my firm, as well as the member firms of the Council of Insurance Agents and Brokers (The Council).

Willis is one of the world's largest professional services firms specializing in risk management. Our 15,400 experienced and highly knowledgeable employees provide a wide range of strategic and operational risk management services across all industries, worldwide.

The Council represents the nation's leading, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government, and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place approximately 80 percent – well over $200 billion – of all U.S. insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

Willis and the members of The Council share your belief that terrorism risk protection is an issue of utmost importance and a critical element in our Nation’s efforts to confront and defeat the terrorist threat. The members of this Committee have been leaders in this effort and we commend you for all of your hard work, including the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the Terrorism Risk Insurance Extension Act (TRIEA) in 2005.

Introduction

It has been more than five years since thousands of our fellow citizens, our friends, colleagues and family members, were killed in the September 11, 2001, terrorist attacks. For many Council members, the loss was personal, and our industry lost many good people that terrible 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. Indeed, not only have federal funds provided by the TRIA "backstop" never been tapped and not one taxpayer dollar spent, the program has proved to be an unqualified success in stabilizing the insurance markets, allowing insurers to provide much-needed terrorism coverage to consumers at prices they are able to afford. TRIA is not about protecting the balance sheets of insurers and brokers – it is about protecting commercial policyholders and creating and sustaining a national economy that encourages investment and development.

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 of nuclear, biological, and radiological risks (NBCR), for which coverage is essentially non-existent even with TRIA in place.

Given these realities, Willis and the members of The Council believe a long-term solution to the terrorism insurance crisis is essential and that the federal government will have an important role to play in terrorism risk coverage for the foreseeable future. The insurance market needs some level of stability and predictability. The prospect of TRIA's demise – or the 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.

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 rather whether the government will work with the insurance industry to thoughtfully and deliberately 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. Any such plan must encompass 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 remains a disaster nearly 18 months after Katrina struck. Pouring billions of dollars into the Gulf Coast in a non-directed and uncoordinated way has not brought that great American city back. In the event of a terrorist attack, we know the federal government will step in to provide assistance, 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. Better TRIA than FEMA.

Insurance Brokers' Interest in Terrorism Insurance

The role of insurance agents and brokers (producers) in general, and Willis and Council members in particular, is to help our clients manage risks and secure the insurance coverage they need to protect them from the risk of loss. As the insurance experts closest to insurance consumers and the insurance marketplace, we understand our clients' needs and the needs and appetite of the market, and thus bring a unique perspective to the discussion of terrorism insurance coverage. Commercial insureds need terrorism coverage not just for piece of mind, but for their businesses. Indeed, in many cases, purchase of terrorism coverage is mandatory – it is required to obtain a mortgage or financing for new construction, the expansion of a business or a new entrepreneurial venture, sometimes by state laws and regulations, and often by contract.

The most important issue for the broker community, therefore, is maintaining consumer access to coverage at a price the business consumer can afford. In order to get this access, we need insurers who are able and willing to provide the coverage. It is clear that they cannot and will not be able to provide terror coverage without a federal backstop or some other mechanism to cap their exposure.

Let me be clear: Willis's business is not dependent on any federal backstop. We will continue to help our clients mitigate their risks with all the best means available. But insurance is an important component in a comprehensive risk management program, and the availability and affordability of terror coverage is a critical issue for our clients and the U.S. economy. We supported TRIA in 2002 and 2005 and do so again today because of our clients' need for terror coverage, the lack of capacity in the private market, and the high cost of the small amount of coverage that was available absent TRIA. For the same reasons, and because TRIA successfully brought stability to the private market for terrorism risk insurance, Willis and the Council believe the creation of a long-term or permanent solution to the terrorism insurance affordability and availability crisis is essential. There is no more important policy issue for Council members.

The Success of TRIA and TRIEA

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

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

- Prior to September 11, 2001, 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. For example, in 2003, the first full year of the program, less than 40 % of large- and mid-sized U.S. businesses, according to some estimates, obtained insurance to cover property terrorism risks. That number has jumped to more than 60% today.

- The increase in take-up rates reflects the increasing demand by America's business community for terrorism coverage at commercially viable prices. Statistics show that the average rates for terrorism coverage dropped 25% between 2004 and 2005, and another 25% between 2005 and 2006, providing much-needed stability to the market. This is because of the "make available" provisions in TRIA and TRIEA. 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.

- Statistics also show that terrorism risk is not limited to urban, coastal areas and is not limited to particular industries. 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. According to industry reports, take-up rates were highest in the Northeast and Midwest, followed by the South and West. Within specific industrial sectors, the largest percentage of insureds buying terrorism insurance were in real estate, financial services, health care, media, hospitality, transportation and education. Even companies in the sectors with comparatively low take-up rates – energy and manufacturing, for example – each had take-up rates exceeding 30% percent in 2006. These relatively high rates show not only demand, but that we are making progress toward the public policy goal of encouraging coverage in affected areas and industries. By comparison, in California – where the likelihood of a major earthquake can be better modeled, understood and underwritten – price and complexity have capped take up rates of earthquake insurance at only 11%.

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 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 has to be preserved in order to avoid the potentially devastating effects caused by the expiration of TRIEA. This conclusion will be obvious if we consider the following facts:

First, the treat of terrorism remains unabated and unpredictable. More than five years after September 11, we have been fortunate enough 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 worse.

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 11 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 to $8 billion in global terrorism reinsurance capacity available, and only $1 to $2 billion in capacity available for nuclear, biological, chemical and radiological (NBCR) coverage. 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 "springing 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, all primary insurers are again asking policyholders in the market shopping for policies that run past the end of 2007 to accept those springing exclusions in their insurance policies. It is obvious that if TRIA were allowed to expire after 2007, a large percentage of those policyholders who have no choices but to accept those springing exclusions would see their terrorism risks uninsured—and their business plans disrupted or even put to a halt as a result.

Ways Forward

The purpose of my testimony today is not to discuss any particular plans in details. We understand that there will be a lot of issues, whether we will choose to modify and extend the current TRIA program or to create a different long-term private market solution. We just want to emphasize that the path forward should be carefully chosen based on considerations of economic realities, and whatever we choose to do, we need to do it with inputs from all relevant players—the government, the policyholders, the insurers and reinsurers, and the brokers.

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

Considering the inability of the insurance industry to handle terrorism risk on its own, as discussed in detail above, we believe that the first option is not an option at all. Simply letting TRIA expire would throw our economy back to the post September 11 and pre-TRIA era and 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 TRIA program. Extending the life of TRIA, expanding 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, which would continue the positive trends I outlined earlier. For example, we believe the dollar threshold and the applicable lines of coverage included within the program merit review although any change must recognize the financial abilities of smaller insurers.

Another option is to create an alternative permanent private market solution. We are aware of a number of proposals circulating which envision a 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 11. 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 will stabilize prices and decrease the need for the federal backstop over time until the government’s potential liability is zero.

Conclusion

We have come a long way since TRIA was first enacted. With the help of TRIA, the terrorism insurance market has been largely stabilized, the terrorism coverage has been steadily expanding, and the price of coverage has been becoming more affordable. All of this provided relief that is essential to the smooth functioning of our economy. Best of all, we have managed to achieve all of this without tapping any taxpayers’ money.

Despite the success of TRIA, now is not the time for the federal government to withdraw its involvement in the terrorism insurance market. As seen above, the terrorism threats facing our country remain significant and unpredictable, our reinsurance industry still lacks sufficient capacity to address terrorism risks on its own, and the primary insurers are still not willing to expose themselves to enormous terrorism risks without charging prohibitively high prices. Allowing TRIA to expire at this time will certainly cripple, if not completely paralyze, a non-insignificant portion of our economy. It is our duty, we believe, to keep that from happening.

Once again, we commend you for holding this important hearing today.