

**Written Testimony
Terrorism Risk Insurance
Senate Banking Committee
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Introduction

My name is Ernie Csiszar and I am President of the Property Casualty Insurers Association of America. PCI is a trade association representing over 1,000 property/casualty insurers that write almost 40 percent of all the insurance policies in the United States. PCI was founded on the philosophy that consumers are best served by free, fair, and well-regulated insurance markets in which a wide variety of financially healthy companies compete for business on the basis of price, product innovation and quality, and customer service.

I would like to commend the members of this Committee for recognizing that terrorism insurance is a national, economic and homeland security issue, for your commitment to seeking a long-term solution to this problem, and for understanding the critical role of the federal government in solving this problem. I am here today to give you our views of this issue. I am also here to commit to you that PCI will work with you to explore all aspects of this problem and all possible solutions in order find a program that will protect our nation's economic security and our policyholders.

The Importance of a Federal Role in Terrorism Insurance

Our members believe in the power of free markets and support competition-driven solutions to public policy problems. We think consumers are best served, wherever possible, by markets that are free, fair, and well regulated. That being said, there are some instances – terrorism insurance clearly being one of them - where there is clearly a need for federal involvement.

This fundamental point has been underscored recently when Federal Reserve Board Chairman Alan Greenspan said before the House Financial Services Committee, "There are instances in which markets do not or cannot work, and....I have not been persuaded that a private market for terrorism insurance works terribly well."

We all know that the threat of a terrorist attack on our nation and our economy is still very real. CIA Director Porter Goss recently testified that an attack on our nation is "only a matter of time" and that our enemies continue searching for ways to make future attacks much more devastating than September 11, including the use of nuclear, biological, chemical, or radiological weapons.

We believe our nation must fight terrorism on all fronts, using military action, homeland security measures, and programs that protect our economic security. We believe that a public/private partnership, harnessing the power and security of the Federal government with the innovation and agility of private markets, is the best way to protect our economy.

The Impact of TRIA

I want to offer several comments on the Terrorism Risk Insurance Act of 2002. TRIA was adopted in November 2002, more than a year after the September 11 attacks. It was debated significantly in the House and the Senate and emerged from long and thoughtful consideration of the issues involved, observation of the response of private markets to terrorism risk, and evaluation of alternative approaches. It was not done in haste and reflects the well-considered wisdom of the Congress and the Administration. We believe it was a tremendous achievement by the 107th Congress.

TRIA provides essential support and confidence to private insurance markets. The program has created a degree of certainty about the maximum losses that any individual company or the entire insurance industry could suffer and, in doing so, has helped foster what market there is for terrorism insurance. According to the latest statistics, roughly 44 percent of all business insurance consumers buy terrorism coverage. Some have feared that TRIA would “crowd out” the development of a meaningful private market for terrorism reinsurance. On the contrary, we believe it gave the support needed to allow such a market to begin to develop. Without TRIA, we don’t believe we would have seen the limited development that has occurred.

Our members write insurance policies for individuals and businesses in every state and virtually every community in our nation. Their commercial insurance policyholders – real estate developers, builders, manufacturers, retail stores, malls, apartment complexes, churches, mosques and synagogues, schools, and universities - have benefited enormously from TRIA. They know the threat of a terrorist attack is real and many have made a deliberate and considered decision to protect themselves from the economic risks of future attacks.

As you know, TRIA will expire at the end of this year. Given the many benefits it has provided, I am here to tell you that all of us – Members of Congress, insurers, and policyholders – must act now to develop a long-term solution to the problem of insuring terrorism risk.

We commend Senators Bennett and Dodd and their cosponsors for introducing S. 467 to extend TRIA for another two years. They have recognized the very serious nature of this problem and are working to solve it in a constructive way. We favor the modifications they have suggested – including a “soft” landing to allow policies written in the second year to naturally expire, including group life insurance under the program, and keeping individual company retentions level.

At the same time, we also believe that a short-term extension of TRIA can and should be seen as the basis for developing a long-term solution to the terrorism insurance problem. I commit to you today the resources of PCI to work with members of Congress and the business community to develop an effective, market-driven system that establishes a long-term, public/private partnership to address the issue of terrorism insurance once and for all.

The Unique Challenge of Underwriting Terrorism Insurance

Our members are in the business of assessing, pricing, and underwriting risk. They work closely with their policyholders to reduce their exposure to all types of loss, including terrorism. Insurers have always risen to the challenge of underwriting and paying for catastrophic losses. Our industry paid nearly \$35 billion in claims from the September 11 attacks, not to mention the

enormous payments we have continued to make, as always, from “normal” natural disasters such as hurricanes and earthquakes.

When we tell you that terrorism risk is different from other catastrophes, we do so for several reasons. The differences arise mostly from differences in severity and predictability. The size of the potential losses from a terrorist attack dwarfs the financial resources of the insurance industry. The cost of the September 11 attacks was by far the largest insured loss in history. The amount of insurance industry capital devoted to insuring the lines of business most likely to be affected by terrorist attacks (commercial property, workers compensation, etc.) amounts today to approximately \$148 billion or 40 percent of the total capital of the industry. Since September 11, insurers and catastrophe modeling experts have modeled many potential terrorist attack scenarios – these experiments convince us that there are many attacks, especially those involving the use of nuclear, biological, chemical, or radiological weapons, that are well beyond the financial capacity of our industry to withstand. CIA Director Goss’ recent testimony underscored our concerns.

Second, this risk is impossible for insurers to assess and price based on our current knowledge. Weather-related catastrophes are much more predictable. We have years of experience with sophisticated models that tell us not only where these losses are likely to occur, but on average how large they might be and how often they might happen. We know none of this about terrorism. Without a distribution of either the ultimate cost or the probability of loss, we don’t have a method to develop the appropriate charge for the coverage nor do we know what losses to expect.

These problems are the reasons that a vibrant, substantial, and healthy private market for terrorism reinsurance has not emerged since September 11. We are concerned that there appears to be a belief in some quarters that allowing TRIA to expire with nothing in its place will automatically spur the development of a significant private market that can handle all terrorism risk. We see no reason to expect that will happen.

Limits on the Private Sector Role

I have spoken above of our support for the greater use of private sector responses to this risk. At the same time, it is critical that policymakers also recognize the limits of the private sector response and why a federal role is essential. As already noted, insurers face significant problems underwriting this risk because of the enormous potential losses and because we don’t know size or frequency distributions for the risk.

In addition, private markets require that buyers and sellers are able to determine for themselves whether a product will be offered and under what terms and conditions. If there is to be a greater private role in solving the terrorism insurance problem, there must also be federal support for giving insurers and insurance markets more freedom to negotiate these terms and conditions. Let me offer some examples of the problems we face:

- In 19 states, insurers writing commercial property insurance are still required to cover losses from a “fire following” a terrorist attack, due to restrictions in 1940s-era laws enacted for a very different world. This is true even if insurers and policyholders would prefer to alter coverage.
- State regulators in three key states (New New York, Florida and Georgia) continue to refuse to allow insurers to exclude or limit coverage for terrorist attacks after the expiration of TRIA this year. This refusal continues even if the insurer and the policyholder both might want the flexibility of a free market.

- TRIA itself provides state oversight and control of the rates insurers can charge for terrorism coverage, with the result that insurers cannot truly experiment with the appropriate price for this coverage and, if they try, must fear potential future requirements that they return supposedly “excessive” rates.
- No state allows an insurer writing workers compensation to exclude or limit coverage for losses caused by terrorism. The only way workers compensation insurers can avoid this risk is to stop writing certain insureds – i.e., to walk away from policies they think may pose excessive risk. However, even when they do so, they face exposure in many states to losses from those same policies through mandatory residual market pools and guaranty funds.

We understand the desire for consumer protection behind many of these requirements, but we must emphasize that it is inconsistent to urge a more robust private sector response without giving the private sector the tools it must have to build that response.

Guiding Principles for a Long Term Solution to the Terrorism Insurance Problem

As you consider how to proceed, we believe there are several important principles for you to keep in mind when evaluating long term solutions to the terrorism insurance problem:

- Terrorism is the most significant risk facing our nation’s economic security today. It is critical that it be addressed. It requires uniform protection and a nation-wide response (not state by state). The fight against terrorism is a long-term battle and we should now build on the steps initially taken by Congress to provide a long-term solution.
- The insurance industry does not have the financial capacity to bear the total risk of terrorism losses due to the nature of the exposure and the scale of the risk. Addressing this risk to our nation’s economic security requires a partnership between the private sector (and its infrastructure) and the Federal government. This partnership must protect the public, the nation’s economy and insurers’ ability to meet their many obligations to their policyholders.
- A long-term solution should minimize cross-subsidies by line of insurance and by insurer, maximize incentives for sound economic underwriting and pricing, and cover exposures most seriously threatened by terrorism. There should be an equitable distribution of costs based on geographical location and risk of loss, including potential losses to life, property and agriculture, and critical economic infrastructure.
- The program should cover losses from both domestic and foreign terrorism events.
- The program should be consumer friendly and implementation costs kept reasonable by following standard industry business practices.

Components of an Alternative Solution

I want to emphasize the need for us to develop a long-term solution to the terrorism insurance problem. PCI believes that all reasonable ideas should be considered and, to that end, I’d like to offer several thoughts on such a design. Such ideas might include:

- Federal support for giving insurers and insurance markets more freedom to negotiate terms and conditions of coverage. This point has been discussed above and I would only add that if

solutions are going to be based on free market principles, then the market must be allowed to work freely.

- Treating the unique exposures resulting from use of nuclear, biological, chemical and radiological weapons differently than those involving other terrorist tactics. These risks have never been part of the insurance industry's assumed risk profile – there has never been a true, private market for this insurance and there is no reason to believe one will arise now in the face of the threats we face. Such attacks pose the risk of damage and losses far beyond the financial capacity of the insurance industry to sustain and may require a different approach to solve.
- There is also a need to recognize and, in the longer term, to deal with the exposure faced by homeowners and their insurers due to the risks of a devastating attack using nuclear, biological, chemical, or radiological weapons.
- We understand that some want to see individual company and/or industry-wide retention levels increase so that private insurers accept more of the responsibility for paying terrorism insurance losses. We have significant concerns about this and want to make clear that any such change must be coupled with a program that allows insurers to reduce their own individual retention levels. Moreover, such increases would have to be gradual so that each insurer can manage the increase in its own exposures. A sudden, ill-planned transition could have a catastrophic impact on America's economy. Finally increasing the exposure of private markets must be coupled with more freedom to underwrite and a way to allow insurers to collectively access wider capital markets supported by the federal government.
- Enabling the industry to form a tax-exempt entity or entities to provide reinsurance or to allow companies to reduce their individual company retention level to some manageable level. The tax-exempt entity might also be allowed to issue post-event bonds or to use some other financing mechanism to pay for losses and allow the use of longer time horizons to absorb those losses.
- Allowing the accumulation of funds through the establishment of individual company tax-deferred reserves.
- Ensuring that market-based solutions are built on the concept of risk-based pricing. Cross-subsidies by line of insurance and by insurer should be minimized, and sound underwriting and pricing should be rewarded.
- Allowing group life insurers to gain access to the public/private partnership, given their very serious exposure to catastrophic losses from terrorism, and ending the arbitrary split now in TRIA between foreign and domestic terrorism losses.

Right now these are just ideas, not fully developed solutions. PCI has been reviewing the merits and consequences – including unintended ones – of each and the association is committed to working with you to explore these options and to create a solid, long-term public/private partnership to address this critical problem.

Conclusions

Our members again commend you and your colleagues for addressing this issue and for offering ideas for a solution. We believe terrorism is the most significant threat today to America's economic security and we applaud your efforts to address this very serious problem.

We believe TRIA represents the considered will of the Congress and has worked well at very low cost to the government. It has been a success and has promoted the ongoing development of private markets for terrorism coverage.

Finally, we want you to know that our members are committed to addressing this issue. We have been working closely and diligently with them, and will continue to do so, to identify and explore potential solutions to this problem. We look forward to continuing to work with you and your colleagues to find a solution.