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Testimony of Bill Henry for The Council of Insurance Agents & Brokers

Senate Committee on Banking, Housing and Urban Affairs
Hearing entitled "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II"

February 25, 2014

Chairman Johnson and members of the Committee, thank you for the opportunity to testify today regarding the terrorism risk insurance program. My name is Bill Henry. I am the CEO of McQueary, Henry, Bowles and Troy, Inc. (MHBT), of Dallas, Texas. 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).

MHBT is one of the largest insurance agencies in Texas. With origins dating back to 1925, we have 315 employees in five cities across the state. 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, with nearly one in five members with presence outside the United States, Council members conduct business in more than 5,000 locations, employ well over 250,000 people, and annually place approximately 85 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.

MHBT and the members of The Council believe that terrorism risk protection is an issue of utmost importance and a critical element in our Nation's efforts to be prepared for threats of terrorism and the aftermath of terrorist attacks. 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 extensions of the Terrorism Risk Insurance Program (the Program) under the Terrorism Risk Insurance Extension Act of 2005 (TRIEA) and the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA).

As we near the December 31, 2014, sunset of TRIA's reauthorization, we are already seeing market reaction to the possibility that the Program might not be extended. Commercial policies usually run for twelve months or more, and policies being placed today that run past December 31 of this year contain exclusions for terrorism risk if the Program is not extended. I anticipate that this will cause problems for long-term construction projects, workers compensation, and other coverages as the end of the year draws closer.

Although we understand and appreciate the need for a careful and deliberative process, the facts make clear that the Program has been a success in stabilizing the terrorism risk insurance market, enabling insurers to provide affordable terrorism insurance to policyholders across the country. Moreover, we know the effect that the absence of the federal backstop has on the marketplace. Therefore, we urge you to take quick action to reauthorize the Program to avoid any negative repercussions resulting from the lack of affordable coverage.

TRIA Has Stabilized the Terrorism Risk Insurance Market, Preventing Economic Destabilization, and Providing an Orderly Structure for Covering Terror Risks

It has been more than a decade 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 has taken to protect Americans from the effects of terror attacks was the enactment of TRIA in 2002, and extension of the Program in 2005 and 2007. 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. The impact of the loss of insurance coverage on the economy and jobs would be significant in the best of economic times. Its effects would only be exacerbated today, as we continue the sluggish recovery from the Great Recession.

TRIA has prevented the economic devastation – the loss of economic activity and the loss of jobs – that would have occurred in its absence. 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 – and American jobs.

When TRIA was originally adopted in 2002, many of us assumed 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 and reinsurance companies, the capital markets and rating agencies – has 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, the members of The Council believe a long-term solution to the terrorism insurance crisis is essential and that the federal government will continue to have an important role to play in terrorism risk coverage for the foreseeable future. The insurance market needs some level of stability and predictability. The prospect of TRIA's demise – or the 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 a terrorist 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, as opposed to reacting in crisis mode after an attack occurs. We know the federal government will step in to provide assistance after a terrorist attack, particularly if there is insufficient private sector relief available. We are all on the hook as taxpayers when tragedy strikes our fellow citizens. TRIA, however, brings the private insurance market into the equation with the financial support and organizational expertise the 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. Thus, 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 and cost-effective way possible. Better TRIA than FEMA.

Insurance Brokers Support TRIA Because Terrorism Coverage is Critical for Commercial Policyholders

The role of insurance agents and brokers (producers) in general, 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. We primarily serve the needs of commercial insureds, who are the major policyholders of terrorism risk insurance. 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 peace 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. For example, most states prohibit excluding terrorism coverage from statutorily-required workers compensation coverage, and many states prevent exclusion of fire caused by a terrorism event from standard fire policies. This affects our clients because if insurers cannot provide such required coverage, they will simply pull out of the market, resulting in less capacity and higher prices for commercial policyholders.

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 give you an example: In addition to running MHBT, I serve on the board of Signal Mutual, a mutual insurer that provides workers compensation coverage under the U.S. Longshoreman & Harbor Workers Act. The first members joined Signal in January 1985. (Mutual insurers are not-for-profits whose members are the owners and policyholders of the company.) The first year, we had 5 members contributing $3,000,000 premium. In 2014, we anticipate 240 members in all US ports and nearly all maritime employments and close to $200,000,000 premium.

Signal policies cover workers in over 800 locations along the water for workplace injury. Many of our members are Navy contractors building and repairing vessels. Others are stevedores loading and unloading all the exports from of our country and imports to our country from all over the world.

Without TRIA, Signal would not be able to provide the workers compensation coverage these people need – and that the law requires. Signal buys reinsurance above $5,000,000 per occurrence to protect members for normal losses, as well as for our liability up to the attachments of TRIA for standard terror risk coverage and for nuclear, biological and chemical terror risks. After September 11, we were one of the first to step up and buy reinsurance for our terrorism exposures, despite the huge price increases we faced due to the lack of capacity in the reinsurance markets to cover terror risk. But we had no choice because terrorism losses cannot be excluded under USL&H coverage. Like 2001-2002, reinsurance capacity remains very limited. Without TRIA, I fear that it would dry up – and the limited amount of availability that remains would be prohibitively expensive.

If this happens – if TRIA goes away – the increased costs will be felt in the prices of everything that enters or leaves the country through our ports and in the cost of Navy contracts, as well. This is not about Signal maintaining a huge surplus, or keeping its investors happy and secure. This is about individual businesses, crucial businesses to our economy and our defense, that will be forced to foot the bill – if they can afford it – if the federal government makes the mistake of ending the structural support for the terrorism risk insurance market that TRIA provides. (Additional information regarding Signal Mutual and its workers compensation and terrorism risk focus is attached.)

With or without TRIA, Council members 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 enactment of TRIA in 2002 and its extension in 2005 and 2007, 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, the Council believes 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.

TRIA Has Been Successful in Providing Capacity and Affordability to the Terrorism Risk Insurance Market

Since its inception in 2002, TRIA has been incredibly successful in providing the commercial property and casualty market, and insurance buyers, with increased terrorism capacity and significantly decreased 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 September 11illustrates 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. Even in Dallas and elsewhere in Texas, we had difficulty getting insurance companies to insure workers compensation (for which terrorism risk exclusions are not allowed) for employers with over 50 employees, for example. This pressure eased with enactment of TRIA.

- 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. In 2003, the first full year of the Program, 27% of commercial insureds obtained insurance to cover property terrorism risks. That number jumped to 49% in 2004 and increased steadily thereafter, remaining in the low 60% range since 2009.

- The initial increase in take-up rates and the strong, stable take-up rates in the past 5 years reflects the demand by America's business community for terrorism coverage at commercially viable prices. Statistics show that the average premium rates for terrorism coverage dropped 25% between 2004 and 2005, and another 25% between 2005 and 2006 thanks to TRIA's "make available" requirements. These price decreases, and the corresponding increase in take-up rates, provided much-needed stability to the market. 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. And it has not cost the government anything.

- 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 are highest in the Northeast and South, followed by the Midwest and West. Within specific industrial sectors, the largest percentage of insureds buying terrorism insurance are in media, education, financial services, health care, tech/telecom, real estate, and transportation. Even companies in the sectors with comparatively low take-up rates – energy and manufacturing, for example – each had take-up rates exceeding 40% percent in 2012. 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%.

TRIA is Still Needed to Ensure Terrorism Risk Insurance Coverage is Available at Affordable Prices

Despite TRIA's success in stabilizing the terrorism insurance market, the basic facts that prompted the enactment of TRIA in the first place have not changed and still require federal involvement in providing terrorism insurance. This conclusion will be obvious if we consider the following facts:

- First, the threat of terrorism remains unabated and unpredictable. Although we have been fortunate enough to not have had another terrorist attack on American soil (last year's Boston Marathon bombing was never certified as a terrorist act, although some thought it should have been), we know the threats are out there and they are real, so we need to be prepared. And although we think of cities like New York and Washington as the primary targets, I am convinced that at some point, terrorists will try to hit “softer” but meaningful targets in Middle America, too.

- Second, without 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 was 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, global reinsurance capacity remains nowhere near the level needed to adequately insure our economy against terrorism risk without the TRIA backstop. Terrorism loses in an attack on a major metropolitan area like Chicago, Los Angeles or Dallas, could be in the hundreds of billions of dollars. Without the TRIA backstop, private reinsurers would be unable to take on this risk. Indeed, even with TRIA backstop now, reinsurers are not meeting the capacity demand of primary insurers for their deductible and coinsurance layers.
- Finally, without the 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 before TRIA was enacted after September 11, and during the months prior to its reauthorization in 2005 and 2007. At that time, primary insurers were including “springing exclusions” in policies that would have voided terrorism coverage beginning on the date of TRIA’s expiration. With the possible expiration of TRIA at the end of this year,

we are seeing the same thing: primary insurers are again forcing policyholders purchasing coverage that runs past the end of 2014 to accept those springing exclusions in their insurance policies. It is obvious that if TRIA were allowed to expire after 2014, a large percentage of those policyholders who have no choice 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.

Conclusion

Insurance coverage is essential to the smooth running of our economy and to American jobs. Since September 11, 2001, terrorism risk coverage has been an unavoidable element of comprehensive insurance coverage for commercial enterprises across the country. Since TRIA was first enacted in 2002, the terrorism insurance market has stabilized, terrorism insurance coverage has been steadily expanding, and the price of coverage has become more affordable. Thankfully, this has occurred in the absence of any certified terror attacks, and without the outlay of any taxpayer money.

The success of TRIA does not mean the Program is not needed. As we know, terrorism threats facing our country remain significant and unpredictable, the private reinsurance industry still lacks sufficient capacity to address terrorism risks on its own, and primary insurers are still not willing to expose themselves to enormous terrorism risks without charging prohibitively high premiums – unaffordable by the prospective insureds who need the coverage. Thus, allowing TRIA to expire at this time would be a grave mistake, resulting in destabilization of the terrorism risk insurance market, and significant harm to the overall economy. We urge you to work toward swift passage of an extension of the Program and we are prepared to assist you in any way that we can.

Thank you for your consideration of our views.

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Attachment

Signal Mutual

Signal Mutual may be the truest form of capitalism and free enterprise at work! As a mutual, Signal is made up of employers directly sharing risk with other employers – because the insurance industry does not want to assume the risk. Back in the mid 1980's, workers comp was extremely hard to underwrite for insurance companies due to market timing and losses. Federal workers compensation (under the United States Longshoreman & Harbor Workers Act) was the toughest of all. Most workers comp is mandated by state law, but USL&H, for maritime employers nationwide, is regulated by the Department of Labor. The benefits are much higher than the state benefits and the losses are much higher and more severe due to the nature of the work…loading and unloading ships with heavy & dangerous equipment, building and repairing ships, ports, and any kind of maritime employment around water.

In 1985, all the insurance companies writing USL&H either ceased offering the coverage or their prices went up considerably. Much of the maritime business was forced to self-insure (for the larger employers), go in an assigned risk pool at exorbitant rates, or go out of business. At McQueary & Henry, Inc., we had customers, but no insurance company to write their USL&H. In our search for coverage for customers, we met a London based company Charles Taylor. Charles Taylor was a manager for Maritime Mutual Insurance companies for marine protection and indemnity (liability for ships) for over 100 years. In the early 1980's, Charles Taylor formed a group self-insured vehicle named Signal Mutual, approved by the Department of Labor. Charles Taylor had been promised a lot of business from various sources through Signal, but it did not develop, so for the first several years, Signal was shelved.

Through a mutual industry friend, we at McQueary & Henry met the people from Charles Taylor and we agreed to begin underwriting USL&H workers compensation for our customers. Due to severely deteriorating market conditions, we were forced to move quicker than we thought and the first members joined Signal in January 1985. The first year had 5 members contributing $3,000,000 premium. In 2014, we anticipate 240 members in all US ports and nearly all maritime employments, and close to $200,000,000 premium. Employees in over 800 locations along the water are covered for workplace injury.

Unlike "for profit" insurance companies like Hartford, Travelers, AIG, Chubb, etc., Signal is a true mutual and not for profit (although we are licensed as a U.S. taxpayer, the norm is to underwrite USL&H workers compensation at cost to the members). There are no stockholders – the mutual is owned by the employer members. The members are business people in privately held companies and public companies. Each member is assigned a rate each year based on occupation and loss history over the past five years. Everyone pays premium based on their rate and their individual payroll and at years end, the expenses and the losses are totaled and if Signal runs at a deficit, each member is assessed their percentage of that deficit. Each member secures their payments of premium and assessments with a letter of credit or other acceptable means approved by the DOL. In addition, as a true assessable mutual, the collective balance sheets of each member are at risk if they loss is too large.

Signal buys reinsurance above $5,000,000 per occurrence to protect the members for normal losses, for our liability up to the attachments of TRIA for regular terror events and for nuclear, biological and chemical terror risks. After 9/11, we were one of the first to step up and buy reinsurance for our terrorism exposures and paid a huge price increase. There is no choice as terrorism losses cannot be excluded under USL&H. The capacity was very limited and it continues to be. There is some availability currently, but no one knows what the capacity of the insurance market is for terror attack related exposures if TRIA goes away.

As Signal, our members/customers are among the most "at risk" and the most sensitive to the overall economy of the USA. First of all, our U.S. ports are a prime target for terrorism. Many of our members are Navy contractors building and repairing vessels. Many of our members are also stevedores loading and unloading all the imports and exports of our country from all over the world. If TRIA goes away and our costs escalate considerably, which they most certainly will (assuming reinsurance for terrorism will be available), these cost will translate into the price of everything that enters or leaves the country and also to the Navy contracts.

Unlike a normal insurance company, this is not about a huge surplus for Signal and its investors. This is about individual businesses – crucial businesses to our economy and our defense – which will be writing checks to recover if we have a terrorism event. They will also be writing much larger checks for expenses it the price or availability of terrorism reinsurance goes up considerably – if they can afford it.

Respectfully,

Bill Henry