Consumer Federation of America

TESTIMONY OF

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BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE

REGARDING

OVERSIGHT OF THE TERRORISM RISK INSURANCE PROGRAM

APRIL 14, 2005

Mr. Chairman and members of the Committee, I appreciate the invitation to appear before you today to discuss current issues surrounding the temporary Terrorism Risk Insurance Program. I am J. Robert Hunter, Director of Insurance for the Consumer Federation of America. CFA is a non-profit association of 300 organizations that, since 1968, has sought to advance the consumer interest through research, advocacy and education. I am a former Federal Insurance Administrator under Presidents Ford and Carter and have also served as Texas Insurance Commissioner. As Administrator, I ran a program similar to TRIA in many respects, the Riot Reinsurance Program.

Before I begin, I would be remiss if I did not thank both Chairman Shelby and Ranking Member Sarbanes on behalf of America's consumers and taxpayers for not rushing into consideration of an extension of the Terrorism Risk Insurance Act last year, a full year before the Act was due to expire. You were right to wait, as the Act intended, for the mandated report from the Department of the Treasury that must be completed by July. Renewing TRIA before the Department completed this study could have put taxpayers on the hook for billions of dollars in terrorism losses that the insurance industry could otherwise afford, while thwarting the development of a vibrant private market for terrorism insurance and reducing incentives for businesses to undertake mitigation efforts.

I cannot blame the insurance industry for wanting to keep a federal subsidy that was always intended to be a temporary measure during a difficult period in our nation's history, the immediate aftermath of the attacks on September 11th. If Congress had enacted free health or auto insurance for lower income Americans, I would likely be here asking for that law to be extended. But Congress did not do that. Congress gave temporary free insurance (really reinsurance) to a financially well-off industry for a three-year period. This law should not be extended without a thorough examination of whether this temporary tool is still necessary, and if so, how it should be structured in the future. These are precisely the issues that the Treasury Department is studying.

TRIA Research in Advance of the Treasury Department Study

As you know, TRIA created a three-year program in which the federal government covers 90 percent of all terrorism-related insurance losses (up to $100 billion a year) after individual insurance companies pay an initial deductible. Insurers, who are required to offer terrorism coverage, must repay very little or none of the assistance they receive. The Act expires on December 31, 2005, unless renewed by Congress.

A great deal of information about the successes and failures of the TRIA program is already available, even before the Department of the Treasury issues its report:

1. CBO FINDINGS

The extremely balanced Congressional Budget Office report of January 2005 clearly and accurately points out the pros and cons of letting TRIA expire:

- Terrorism premiums would likely rise for those buying insurance in high-risk situations.

- The number of businesses buying insurance would probably decrease. (Only about half of all businesses are currently purchasing terrorism coverage.) Such a decrease would mean more taxpayer involvement in a post-terrorism attack situation.

- Mitigation efforts would increase. Efforts to lower the risk of terrorism attacks or reduce their effects would be encouraged by the market charging actuarial rather than taxpayer-subsidized rates for terrorism insurance. Steps such as hiring guards and placing metal or explosives detectors at entrances to higher risk buildings would be encouraged by the expiration of TRIA.

- Private sector alternatives to TRIA would be encouraged by the expiration of TRIA, such as reinsurance to replace the free TRIA coverage or the development of securitized responses, such as bonds similar to catastrophe bonds.[1]

- The economy might be affected somewhat, but not as much as the insurers contend. CBO indicates that the analysis presented to the public through press releases sent out by the insurance industry[2] overstates the potential costs to the economy if TRIA expires.

- The cost of insuring against terrorism would not change much for the nation. TRIA does not change the anticipated terrorism costs except, CBO states, to the extent it increases national costs because it undermines the incentives of insurers to insist on mitigation measures and insured parties to implement these measures in order to get lower premium charges. Not extending TRIA would merely shift roughly the same costs from taxpayers to private firms and insurers.

- There could be insurance market disruption if another large terrorism event occurs. CFA believes that Congress knows how to handle this sort of situation, given the success it had in stabilizing the insurance market after September 11, 2001 and during the riots in the nation's cities in the 1960s.

CBO also lists the pros and cons of altering TRIA by requiring that insurers be charged actuarial (or above actuarial) premiums for the coverage that is provided:

- Charging premiums would result in more mitigation by insurance purchasers because increased premiums would encourage the development of discount plans for safety precautions taken by insured businesses.

- Charging premiums would encourage the private sector to grow, since the private sector cannot compete with the free reinsurance provided by the taxpayers under TRIA.

- Charging premiums might result in less terrorism coverage being purchased. This would mean more taxpayer involvement in a post-terrorism attack situation.

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[1] Indeed, there is evidence that just the potential of TRIA expiration is causing insurers to develop and risk managers to seek alternative ways to cover the terrorism risk. (See Exhibit 2 for examples of this effect.)

[2] *The Economic Effects of Federal Participation in Terrorism Risk*, Hubbard and Deal, 9/14/04.

CBO sums up their report as follows:

> "In sum, as the Congress considers whether to extend TRIA (and in what form), it is useful to consider what has changed in the two years since the law was enacted. The most significant development seems to be a growing sense that the terrorism threat to the United States will continue for the foreseeable future. That development suggests that the economy, especially the stock of physical capital, needs to be responsive to the prospective losses from terrorist attacks. For example, new construction might be designed, located, and built to withstand such attacks. Existing structures might need to be retrofitted with safety features. *Those needs argue against extending the TRIA program in its current form, which subsidizes insurance and dampens incentives for mitigation activities.* (Emphasis added.)
>
> "*The macroeconomic costs of scaling back the federal subsidy for terrorism insurance are likely to be small*. One reason is that the capacity of insurance companies to provide terrorism coverage has improved recently. Another reason is that TRIA does not lower the costs of terrorist attacks but rather partially shifts those costs from property owners to taxpayers. As noted above, total costs might be lower without TRIA. However, the gains in economic efficiency from allowing TRIA to expire could require a significant trade-off: without the TRIA program, an especially large loss from a terrorist attack would be likely to produce another episode of scarce coverage, rising prices, and uninsured assets." (Emphasis added.)

Thus, CBO concludes that immediately gaining more safety and lowering terrorism costs through mitigation – current real gains stemming from TRIA's expiration– have little possible future downside, except for the possible insurer reaction *after* a terrorist event. CFA believes that the benefits of improved mitigation efforts and increased private sector involvement in insuring against terrorist risk that would be encouraged if TRIA expires far outweigh the potential costs of insurer reaction after some future event, particularly since Congress has shown that it knows how to offset that potential cost through prompt action after such events.

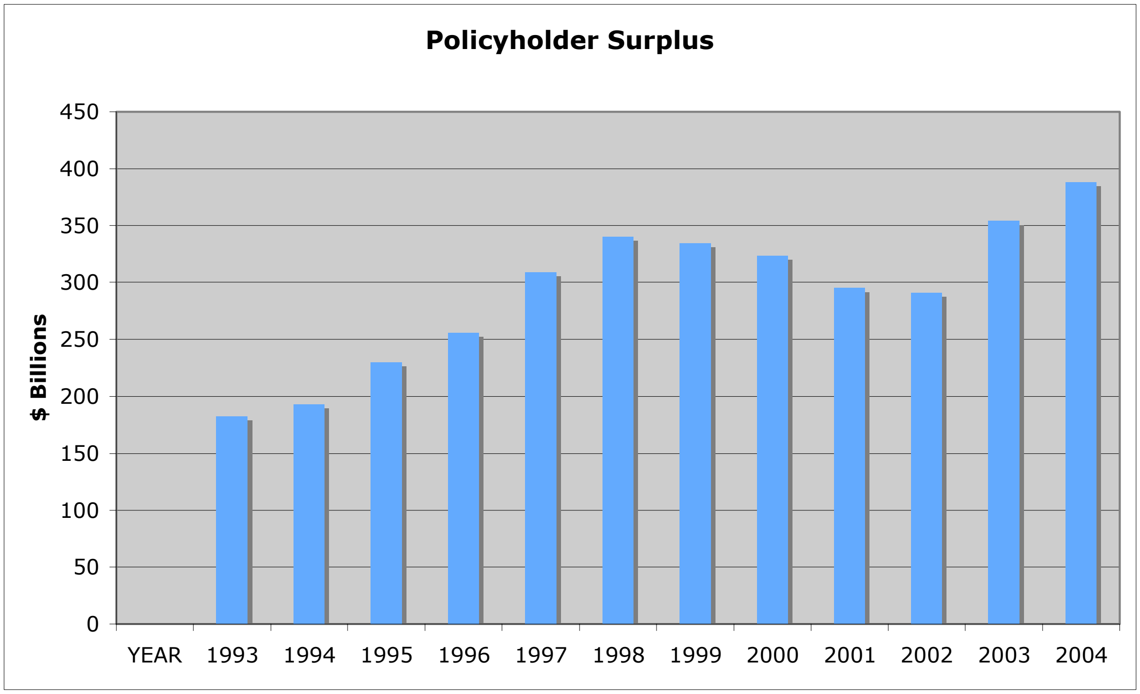
2. THE INSURANCE INDUSTRY IS HUGELY PROFITABLE AND DOES NOT NEED A FEDERAL SUBSIDY TO COVER TERRORISM LOSSES AFTER TRIA EXPIRES

TRIA temporarily subsidizes the insurance industry by offering free reinsurance to back up the sale of terrorism insurance. There may have been an argument that this industry needed support in 2002 – as industry retained earnings (surplus) and profits had slipped – but since then, the situation has changed radically (as CBO reported).

The profits of insurers selling TRIA-backed terror coverage are excellent, as is the financial solidity of the industry. A. M. Best estimates that policyholder surplus (retained earnings) reached $388 billion at year-end 2004.[3] In 2000, before the terrorist attack, this figure was $323 billion, and in 2001, after the attack, it was $295 billion. The attacks of September 11th caused an estimated $35 billion in claims before taxes, or $23 billion after taxes ($35 billion reduced by 35 percent, which was borne by taxpayers).

The surplus growth is shown in the following chart:

[3] Review and Preview, A.M. Best and Co., January 2005, page 19.



Best's estimates that the current property/casualty insurance premium writings-to-surplus-ratio is a very safe 1.2 to 1. By historical standards, this is a very wealthy and healthy industry. It does not need a continued taxpayer-funded handout.

The commercial lines segment of the industry was reported by Best's to have a surplus of $155 billion at year-end 2003, which Best's estimates grew by 10.3 percent in 2004 to $171 billion.[4] At year-end 2000, the surplus was $122 billion. This growth in surplus of $49 billion alone would be able to pay for losses for an attack of more than two times the size of the World Trade Center attacks of September 11th.[5]

Recently, several senators introduced S. 467 to extend the TRIA program. The bill is similar to last year's bill, S. 2764. The bill would extend TRIA for two years (to a total of five years), with increased insurer retentions in years four and five of $17.5 billion and $20.0 billion respectively. The fifth year would allow a "run-off" of coverage for policies written in 2007 to cover through the end of 2008, which represents a three-year extension of TRIA for all practical purposes, since insurers could write policies in such a way to run off at that third-year termination time. The bill would also require the program to reinsure group life insurance policies for the first time and set up a working group to seek a permanent solution to the terrorism insurance issue.

CFA opposes this bill. First, it is premature, as Congress needs the Treasury Department's mandated input prior to crafting solutions. With the information from Treasury almost available, there is no need to legislate without complete information about how TRIA has performed until

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[4] Best's Aggregates and Averages, 2004 Edition, page 30 for 2003 data; 2004 growth in Best's Review/Preview, January 2005, page 20.

[5] An attack that resulted in losses of $49 billion after taxes would be $75 billion before taxes ($49/.65). This is 2.2 times the estimated $35 billion before taxes that the WTC event cost insurers and taxpayers.

now. Second, the bill unnecessarily expands coverage to group life insurance (see below). Congress should be reducing, not increasing, taxpayer exposure at this time of huge budget deficits. Third, as the bill would essentially extend TRIA for three years, it would reduce mitigation incentives and private insurance alternatives for too long a time. Fourth, the mandated study from the Treasury Department may address the issue of a permanent solution, so the establishment of a working group may not be necessary.

3. EXTENDING TRIA "AS IS" WOULD BE COSTLY TO TAXPAYERS

The attached Exhibit 1 shows the value of the TRIA program given by taxpayers to the insurance industry by year for the slightly more than three years that TRIA is authorized to cover risk. These data show that, under the current TRIA program of slightly more than three years, taxpayers have subsidized the insurance industry to the tune of $2.8 billion. Had insurers been required to pay premiums for this coverage, this $2.8 billion would now be available to the Treasury Department to pay for any attacks that might come during the rest of 2005.

What follows is a recap of Exhibit 1 findings:

Year	Large attack	Small attack	1:2 average	Old Cost 35% of $5.75	New Cost	Increase
12/02[6]				$0.2 B	$0.4 B	$0.2 B
2003	+125%	+94%	+90%	2.0	4.1	2.1
2004	+115	+78	+90	2.0	3.8	1.8
2005	+104	+62	+76	2.0	3.5	1.5
Cost of the original TRIA program (@ 100% coverage)						**$5.6 B**
Cost of the original TRIA program (@ 50% coverage)						**$2.8 B**

But that is history -- taxpayers have given this benefit to the insurance industry. The question now before Congress is what is the cost to taxpayers for continuing the program?

If TRIA were extended "as is":[7]

I estimate the following cost to taxpayers (assuming 50 percent coverage would continue to be bought by the market):

2006	+104	+62	+76	2.0	3.5	$1.5 B

But only 50 percent is purchased, so **the projected cost to taxpayers is** **$0.75B**

[6] Calculated as 1/12 of 2003.
[7] With the same regulatory requirements as for year three of current TRIA, with no coverage of group life insurance included.

If TRIA were extended as proposed in S 467:

I estimate the following cost to taxpayers (assuming 50 percent coverage would continue to be bought by the market):

2006	+98	+60	+72	2.0	3.4	$1.4 B

But only 50 percent is purchased, so **the projected cost to taxpayers is** **$0.7B**

This is an identical estimate to the CBO calculation of this cost: $0.7 billion.[8]

4. IF TRIA EXPIRES, THE ADDITIONAL COSTS TO POLICYHOLDERS ARE LOW (ON AVERAGE)

In 2003, Best's reported commercial premiums of $176 billion.[9] I estimate that 2006 commercial P/C premiums will be $206 billion (Best's estimates growth in premium of 6.4 percent in 2004 and 4.5 percent in 2005, with my estimated 5 percent growth in 2006)[10]. This means that if TRIA were to charge actuarial rates and the costs were spread across commercial policyholders, the surcharge for TRIA would be 0.7 percent ($0.7 billion divided by half of $206 billion, assuming that half of the buyers purchase the coverage). This small surcharge is extremely affordable. Of course, in the higher risk cities, the costs would be much greater, and they would likewise be much lower in the low-risk rural areas. As Congress is aware, TRIA represents a subsidy from rural to urban, particularly mega-urban, areas.

Taxpayers have already given insurers a multi-billion dollar free reinsurance program. This industry does not need a continued handout from taxpayers, particularly at a time of high industry profits and mounting federal deficits.

If any program is determined to be necessary after Congress reviews the findings of the Treasury report, the program should be paid for by full actuarial rate charges (or charges somewhat higher than that) to encourage private alternatives to develop. The charges will also have the benefit of encouraging mitigation steps to be taken that free reinsurance has undermined.

5. THE RISK OF TERRORISM IS BEING MODELED AND INSURANCE COMPANIES ARE USING THE MODELS – PROVING THEIR WORTH

The insurance industry argues that predicting terrorism risk for insurance purposes is impossible. The truth is, insurers are doing it already. Modeling terrorism risk is an imperfect science, but it is improving fast. A huge amount of research has been done in this area since TRIA was enacted, and several private companies have produced and are selling models to measure the actuarial and underwriting implications of the terrorism risk. The fact that insurers use these models is proof that they are of at least some value. Insurance companies pay significant dollars for the licenses to use these models. Businesses would not do that if they did not think the models were

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8 Federal Terrorism Reinsurance: An Update, January 2005, page 16.
9 Aggregates and Averages, 2004 Edition, page 31.
10 Review/Preview, January 2005, page 20.

valuable. For instance, many insurers use the Insurance Services Office (ISO) model for setting terrorism rates. ISO's research shows that the terrorism insurance risk is limited to a fairly small number of cities and that for the vast majority of the nation, the risk is low and the cost can be fully borne privately.[11]

6. GROUP LIFE COVERAGE SHOULD NOT BE ADDED TO TRIA

CFA strongly believes there is no meaningful evidence that justifies expanding TRIA to cover group life insurance. The Department of the Treasury studied the matter and refused to expand TRIA to cover group life. Even the National Association of Insurance Commissioners, a group well known to be very industry-friendly and particularly concerned about solvency and any possibility of undue risk, has refused to allow group life exclusions.

We believe that a major reason that both the Treasury Department and NAIC have rejected the appeals of life insurers for relief is that these insurers have not attempted all meaningful measures to spread their risk privately.

CFA has not received a single complaint from a consumer or business indicating that there is a problem in the life insurance market. Since there are no exclusions allowed by the NAIC, we would likely be hearing about rising costs if they were rising, but we are hearing no complaints at all.

To test this hypothesis, CFA did research using the NAIC complaint database.[12] The top ten group life insurance writers had 294 complaints under "group life" in 2001 and 361 in 2003 (2004 data will be posted on the NAIC website in late March). The increase in complaints (67) was virtually all related to Metropolitan Life Insurance Company, which had a growth in complaints of 65. Looking in detail at Metropolitan's complaints, we found zero complaints related to "terrorism" in either 2001 or 2003.[13]

If Congress extends TRIA in some form, it should narrow the coverage that exists in TRIA today and should definitely not expand TRIA to group life insurance.

Conclusions and Recommendations

Based on the relatively low risk of terrorism attacks and low rates in much of the country, as well as strong industry profitability and financial soundness and the growing capacity of insurers to offer terrorism coverage, CFA has tentatively found no compelling reason to extend TRIA beyond the end of 2005. Perhaps the Treasury Department's report will prompt us to revise this conclusion.

If Congress decides to go ahead and extend TRIA now, a move CFA would oppose, we suggest that you modify TRIA in the following ways:

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[11] For a complete discussion of the implications of ISO's research, see CFA's report, "The Terrorism Risk Insurance Act: Should it be Renewed?" at http://www.consumerfed.org/terrorism_insurance_report.pdf. The report was presented to this Committee at its hearing of May 18, 2004.
[12] The database can be accessed from the NAIC web page, www.naic.org at the Consumer Information Source (CIS).
[13] "Terrorism" is itemized as a complaint area in the NAIC complaint database.

- **Target only the cities where the risk of attack is moderate or high**. In fact, it is highly unlikely that the five cities at moderate risk of attack will need assistance, as 95 percent of all potential terrorism losses are being covered by the insurance industry today, according to the ISO models. Outside of the nine cities at moderate or high risk of attack, insurers are fully covering the risk that ISO's models have projected.[14] Areas with a **high risk** of attack are: New York City; San Francisco County; Washington, D.C., and Cook County, Illinois (Chicago). Areas with a **moderate risk** of attack are: Suffolk County, Massachusetts (Boston); King County, Washington (Seattle); Los Angeles County; Harris County, Texas (Houston), and Philadelphia County. The remainder of the country is at a **low risk** of attack.

- **Increase the retentions that insurers must pay for losses in these few cities**. CFA suggests industry-wide retentions of $50 billion after tax considerations[15] – a pre-tax deductible of $77 billion (roughly the surplus growth of the insurance industry since the year before the September 11 attacks) for the first year of any new program, increasing by $10 billion a year thereafter.

- **Increase the share of losses that insurers must pay above the deductible amount** from 10 percent to 15 percent, increasing by 5 percent a year.

- **Only provide taxpayer back up for truly exceptional terrorist events**, such as attacks with weapons of mass destruction.

- **Ensure that taxpayers pay no costs for backing up terrorism losses**. The Treasury Department should require that insurers pay premiums for the coverage that taxpayers are providing that are actuarially sound, if a not a little higher. Requiring insurers to pay rates that are slightly higher than estimated will, as CBO noted, encourage private insurance mechanisms to quickly compete by offering lower rates and will encourage mitigation efforts.

- **Beware of insurer attempts to use TRIA renewal as a pretext to deregulate insurance.** Insurers appear to be opportunistically seeking to cripple key aspects of insurance oversight under the guise of creating a uniform, national market for terrorism insurance. There is simply no connection between TRIA renewal and regulatory issues. There is no evidence that over-regulation has in any way hampered the ability of insurers to innovate and come up with viable private alternatives to TRIA. Indeed, some insurers are creating terrorism insurance alternatives today, such as stand alone policies and automatic coverage in some instances. Several insurers are prepared to offer stand-alone terrorism coverage should TRIA expire. Given the soft market, market sources say that some insurers stand ready to "give away" terrorism coverage to attract business.[16] Insurers are poorly regulated in most states regarding necessary consumer protections. Congress should not interfere with state

[14] For details on the ISO model and the rates it calculates, see CFA's report, "The Terrorism Risk Insurance Act: Should it be Renewed?" at http://www.consumerfed.org/terrorism_insurance_report.pdf. The report was presented to this Committee at its hearing of May 18, 2004.

[15] $50 billion is the level of impact that the General Accountability Office (GAO) believes might produce adverse consequences. See "Catastrophe Risk -- U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks," GAO, February 2005.

[16] Liability and Insurance Week, March 21, 2005, page 2.

insurance regulation unless a balanced, thorough study of such action is undertaken separate and apart from TRIA issues.

- **Non-governmental alternatives to TRIA**. Private markets can handle most, if not all, of the terrorism risk. Stand-alone policies are ready to be used should TRIA expire. Except in the largest cities, terrorism coverage should be available at little or no increase in price should TRIA expire. TRIA itself has hampered the development of private alternatives such as normal reinsurance and securitization alternatives, such as catastrophe bonds. Expiry of TRIA will very likely result in the development of such mechanisms to cover terrorism risk. Creating private pools of like risks, similar to the pooling done in several other countries, is another method for covering terrorism risk that requires no federal role. There has been no need to create such private pools given the availability of free, taxpayer-subsidized TRIA reinsurance. TRIA also does not cover terrorist attacks involving most weapons of mass destruction (WMD), including attacks using biological, chemical or nuclear methods. This is one area where a federal role might be needed to create such coverage in the future. If a federal backstop for WMD is created, it should require actuarial rates for the reinsurance so that taxpayers are not subsidizing insurers that don't need the help. Finally, the federal government could assist in the development of private alternatives by allowing catastrophe reserves to build up tax-free on funds earmarked for the sole purpose of paying terrorism losses and nothing else, perhaps by placing such funds into fiduciary accounts not available except for the purpose of funding payments after terrorism losses are incurred.

Congress wisely built in a Treasury study to be finalized prior to the expiration of the program. That study will be in your hands soon. Once you have it, consideration should be given to fashioning a program, if one is needed at all, to address any real need identified by Treasury.

CFA looks forward to working with the Committee on fashioning a response to the Treasury report once it becomes available.

I would be pleased to answer any questions you may have.

This chart compares what taxpayers were responsible for when the World Trade Center was attacked to what taxpayers pay under TRIA, for two types of attacks: mid-sized (about $25 billion in insured losses) and larger (about $40 billion in losses).

In the case of the World Trade Center attacks, taxpayers picked up 35 percent of this loss (the federal corporate write-off rate).

	Large Attack	**Mid-Sized Attack**
Taxpayers:	$40 billion * .35 = **$ 14 billion**	$25 billion * .35 = **$9 billion**
Insurers:	$40 billion * .65 = **$ 26 billion**	$25 billion * .65 = **$16 billion**

Year 1 of TRIA (2003):

Under the current TRIA (Year 1):	**Large Attack**	**Mid-Sized Attack**
Insured Loss	$40 billion	$25 billion
Estimate of total insurer deductible	$8 billion[1]	$8 billion[1]
Repayment to Taxpayers	$1.8 billion[2]	$1.8 billion[2]
Losses subject to sharing	$32 billion	$17 billion
90% taxpayer share	$28.8 billion	$15.3 billion
10% insurer share	$3.2 billion	$1.7 billion
Taxpayers =	**$31.55 billion (79%)**[3]	**$17.5 billion (70%)**[4]
Insurers =	**$ 8.45 billion (21%)**[5]	**$7.5 billion (30%)**[6]
Insurer Savings Under New Law =	**68%**	**53%**
Taxpayer Increase in Liability =	**125% (+$17.55B)**	**94% (+$8.5 B)**

[1] Estimated by applying a $40 billion loss to insurance companies based on their size.

[2] 90 percent of the difference between $8 billion in insurer deductibles and $10 billion, the "cutoff" amount under the law, above which no payback is required.

[3] Taxpayer share and 35 percent (tax write-off rate) of insurer deductible, insurer share of losses and insurer payback. *[$28.8 billion - $1.8 billion + ($8 billion + $3.2 billion + 1.8 billion) * .35]*

[4] [15.3 billion – 1.8 billion + ($8 billion + 1.7 billion + 1.8 billion) * .35]

[5] Insurer deductible, insurer share of losses and insurer payback less the 35 percent federal tax write-off allowed. *[($8 billion + $3.2 billion + $1.8 billion) * (1 - .35)]*

[6] [$8 billion + $1.7 billion = $1.8 billion) * (1 - .35)]

Year 2 of TRIA (2004):

Under the Current TRIA (Year 2):	**Large Attack**	**Mid-Sized Attack**
Insured Loss	$40 billion	$25 billion
Estimate of total insurer deductible	$10 billion[7]	$10 billion[7]
Repayment to Taxpayers	$2.25 billion[8]	$2.25 billion[8]
Losses subject to sharing	$30 billion	$15.0 billion
90% taxpayer share	$27 billion	$13.5 billion
10% insurer share	$3.0 billion	$1.5 billion
Taxpayers =	**$30.08 billion (75%)**[9]	**$16.06 billion (64%)**[10]
Insurers =	**$ 9.92 billion (25%)**[11]	**$8.94 billion (36%)**[12]
Insurer Savings Under New Law =	**62%**	**44%**
Taxpayer Increase in Liability =	**115% (+$16.08B)**	**78% (+$8.5 B)**

Year 3 of TRIA (2005):

Under TRIA:	**Large Attack**	**Mid-Sized Attack**
Insured Loss	$40 billion	$25 billion
Estimate of total insurer deductible	$12 billion[13]	$12 billion[13]

7 Estimated by applying a $40 billion loss to insurance companies based on their size.

8 90 percent of the difference between $10 billion in insurer deductibles and $12.5 billion, the "cutoff" amount under the law, above which no payback is required.

9 Taxpayer share and 35 percent (tax write-off rate) of insurer deductible, insurer share of losses and insurer payback. *[$27 billion - $2.25 billion + ($10 billion + $3.0 billion + 2.25 billion) * .35]*

10 [13.5 billion – 2.25 billion + ($10 billion + 1.5 billion + 2.25 billion) * .35]

11 Insurer deductible, insurer share of losses and insurer payback less the 35 percent federal tax write-off allowed. *[($10 billion +$3.0 billion + $2.25 billion) * (1 - .35)]*

12 [$10 billion + $1.5 billion = $2.25 billion) * (1 - .35)]

13 Estimated by applying a $40 billion loss to insurance companies based on their size.

Repayment to Taxpayers	$2.7 billion[14]	$2.7 billion[14]
Losses subject to sharing	$28 billion	$13 billion
90% taxpayer share	$25.2 billion	$11.7 billion
10% insurer share	$2.8 billion	$1.3 billion
Taxpayers =	**$28.63 billion (72%)**[15]	**$14.6 billion (58%)**[16]
Insurers =	**$11.38 billion (28%)[17]**	**$10.4 billion (42%)[18]**
Insurer Savings 3rd Year of Law =	**56%**	**35%**
Taxpayer Increase in Liability =	**104%(+$24.63 B)**	**62% (+$5.6 B)**

[14] 90 percent of the difference between $12 billion in insurer deductibles and $15 billion, the "cutoff" amount under the law, above which no payback is required.

[15] Taxpayer share and 35 percent (tax write-off rate) of insurer deductible, insurer share of losses and insurer payback. *[$25.2 billion - $2.7 billion + ($12 billion + $2.8 billion + 2.7 billion) * .35]*

[16] [11.7 billion – 2.7 billion + ($12 billion + 1.3 billion + 2.7 billion) * .35]

[17] Insurer deductible, insurer share of losses and insurer payback less the 35 percent federal tax write-off allowed. *[($12 billion +$2.8 billion + $2.7 billion) * (1 - .35)]*

[18] [$12 billion + $1.3 billion + $2.7 billion) * (1 - .35)]

EXHIBIT # 2

A PRIVATE MARKET FOR TERRORISM INSURANCE EMERGES: EXCERPTS FROM BUSINESS INSURANCE MAGAZINE

From: "Market contemplates a world without TRIA -- Responses vary to possibility that federal backdrop won't be extended," Business Insurance, March 21, 2005.

"D. Terry Fleming, director of the division of risk management for Montgomery County, Md., said that he's already talked to his property insurer, which he declined to identify, about how terrorism would be covered when he renewed the coverage midyear.

"'They told us they would offer the coverage whether or not TRIA was extended,' said Mr. Fleming. They were offering full limits for the same price as they were last year. Because of our loss experience, they gave us a very competitive rate. We're very happy with what happened-definitely…

"'The renewals that we have just bound, which include major real estate holdings in key central business districts, were renewed with full terrorism (coverage) and the understanding by the underwriters that coverage would continue for the full 12 months, regardless of what happened on Dec. 31,' said Alexandra Glickman, area vice chairman and managing director of the real estate and hospitality services division of Arthur J. Gallagher & Co. in Glendale, Calif…

"'The market response at this point is anything but uniform,' agreed Aaron Davis, a vp with Aon Corp.'s Aon Risk Services in New York. 'Certain carriers have committed to offering terrorism capacity beyond the expiration of TRIA. Other carriers are offering terrorism on a sublimited basis, and a majority of the carriers are still relying on conditional exclusions that will allow them to either exclude the risk altogether or sublimit it, or reprice the terrorism premium post-Dec. 31.'

"American International Group is 'in a little different position than some other companies,' noted Richard Thomas, senior vp and chief underwriting officer for AIG's domestic brokerage group in New York. 'Under TRIA, we have a very large retention in 2005. Our retention this year is just under $3.3 billion for terrorism. In other words, we would have to sustain slightly less than $3.3 billion from a terrorism event before we could recover from TRIA. With a retention that size, we're underwriting to that. Our underwriting today contemplates managing our aggregate exposures for workers compensation and property insurance in the various target areas where we have insureds. Obviously, if TRIA is not extended, we'll continue the practice of monitoring our aggregate exposure by target locations, and there will be a cap on that,' he said…

"Randy Schreitmueller, a vp at Johnston, R.I.-based Factory Mutual Insurance Co., which does business as FM Global [*said*,] 'What we've done to prepare-we are going forward with a set of provisional renewal conditions. Basically, what it boils down to is terrorism sublimits in the event that TRIA expires.' The sublimits depend on geographic location, and they vary from $100 million to $250 million. The lower limits apply to locations in major city centers…

"'We don't see our individual capacity contracting. We currently have in place the discipline to operate in year three of the program or post-TRIA,' said Mr. Schupp. 'There's just so much capacity to go around. Right now, some of that capacity is federal capacity provided by TRIA. If that goes away, yes, there will be exclusions as the industry adjusts to a lower amount of capacity.'

"'We're working with insurance companies to try to come up with alternatives' if TRIA expires, so that underwriters can reserve some capacity for terrorism coverage, at a price, said Marsh's Mr. Blumber.

From: "Standalone terrorism coverage available, affordable. Some say standalone capacity could be exhausted if TRIA is allowed to expire," Business Insurance, March 21, 2005.

"If the Terrorism Risk Insurance Act expires at the end of the year, risk managers will not be left completely without options if they want to buy terrorism coverage.

"Standalone terrorism coverage, which is not supported by the government backstop, is available for risk managers and the price of the coverage, though sometimes high, is not always prohibitively expensive, observers say.

"However, while there is sufficient capacity to meet most of today's demand for standalone coverage, the expiration of TRIA could fuel demand to such a level that standalone capacity might be exhausted, some observers say.

"When Caesars Entertainment Inc. made its first foray into the standalone terrorism insurance market, for example, Lance Ewing, vp-risk management, found the market to be responsive and the pricing satisfactory.

"'I found the standalone to be much easier with regard to the purchase of' terrorism insurance, he said.

"High limits for a price

"The standalone terrorism insurance market has grown significantly in the last two years, observers say. New York-based American International Group Inc. and Lloyd's of London have traditionally been the main players in the standalone market and still provide a significant portion of the capacity.

"AIG's Lexington Insurance Co. unit provides up to $100 million in terrorism capacity for property risks and up to $25 million for casualty coverages, said Charles Benda, practice leader for Lexington's homeland security practice, who works in New York and Boston.

"Lloyd's entities offer about $400 million in terrorism limits, said Ben Garston, partner of London-based MAP Underwriting and chair of Lloyd's Market Assn.'s Terrorism Insurance Business Panel.

"But recent increases in capacity in the standalone market have come from Pembroke, Bermuda-based AXIS Capital Holdings Ltd., Hamilton, Bermuda-based ACE Ltd., Bermuda-based Montpelier Re Holdings Ltd., and a few other players. Omaha, Neb.-based Berkshire Hathaway Inc. can also provide significant capacity-upwards of $500 million-although its pricing tends to be prohibitive, brokers say.

“The influx of new capacity means standalone terrorism coverage with limits of less than $500 million is generally easy to secure, but securing limits above that level can be difficult and expensive, brokers say.

“Policyholders can buy as much as $1.25 billion in capacity, if they are willing to pay the price, but that kind of demand is rare, said Will Farmer, director of Aon Crisis Management in London. ‘Generally smaller limits have been the norm and Berkshire Hathaway has been barely active in the market in the last 12 months,’ he said.

“Generally, pricing for terrorism coverage has fallen significantly from the levels that were charged shortly after the Sept. 11, 2001, terrorist attacks because of the increase in capacity and a better understanding of the exposure, brokers say. ‘I think the standalone market has become more competitive with TRIA,’ said Robert Blumber, managing director of Marsh's property practice.

“Underwriters develop quotes for specific risks based on a variety of factors, including the location of the insured property, size of the organization and their aggregation of risks in particular geographic areas. ‘There's no way to quantify the average premium,’ Mr. Benda said.

“A building in Manhattan, for example, could potentially have a premium of 0.20% to 0.25% of its value while the premium for a building in a more remote area could be 0.02% to 0.04%.

“Standalone terrorism policies cover terrorist attacks committed for political, religious and ideological purposes and they offer broader coverage than TRIA-backed policies because they cover acts of both foreign and domestic terrorism.

“The policies exclude chemical, biological and nuclear risks because this type of terrorist attack ‘would probably involve so much property we wouldn't be able to pay all the claims,’ said Mr. Garston of MAP.

“Some insurers, however, do offer coverage endorsements that extend terrorism coverage…

“Brokers are already looking at alternatives, such as reserving standalone capacity, if TRIA expires. The standalone market has offered products that provide an option for coverage-at 20% of the annual premium-that insureds can pick up if TRIA expires, Mr. Farmer said. ‘I think the smart buyers are trying to reduce uncertainty now by spending money so that whatever happens with TRIA, they'll be in reasonable shape,’ he said.

From: “Little terror demand in Canada,” Business Insurance, March 21, 2005

“…the Canadian market functions without government reinsurance… While sufficient capacity is available in the Canadian market-provided by foreign insurers such as New York-based American International Group and Hamilton, Bermuda-based ACE Ltd.-the demand for terrorism insurance tends to be limited to companies with properties in major metropolitan areas such as Montreal, Vancouver and downtown Toronto, and to owners of sporting facilities.”