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

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Good morning, Mr. Chairman and members of the committee. 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.

I have drawn many of my conclusions regarding the Terrorism Risk Insurance Act of 2002 (TRIA) based on my experience administering a similar federal reinsurance plan, the Riot Reinsurance Program. This program kept insurance in the inner cities in the early 1970s, when riots threatened the withdrawal of property insurance from the nation's inner cities. We charged insurers actuarially sound premiums for the reinsurance and, when the program was terminated, taxpayers actually realized a profit from the transaction.

The nation's terrorism insurance law is not necessary to ensure the availability of affordable terrorism coverage for most areas of the country and should be allowed to expire. CFA reached this conclusion after undertaking a major study of the workings of TRIA and of current market conditions for property/casualty insurance. A copy of the report is attached to this testimony.

We found that insurance experts have set terrorism insurance rates for the third year of the program, 2005, at quite low levels in most of the country and that, according to insurance risk models, private insurers will be completely responsible for all terrorism insurance losses in all but nine large cities by 2005.

The study clearly documents that the insurance industry is more than ready to stand on its own two feet and that taxpayer back up should end. The ability of the industry to insure against terrorism is enormous and growing, profits are quite substantial, and the financial condition of insurers overall is rock solid. Profits leapt ten-fold in the last year, and surplus (retained earnings) skyrocketed by $65 billion!

However, if Congress decides to keep some form of back up, it should only target the few areas of the country where getting affordable terrorism coverage might be a problem. Congress should also require insurers to broaden the amount of coverage they offer, pay for the reinsurance that taxpayers provide, only back up truly large terrorism events, and increase incentives for the further development of a private terror insurance market.

<u>Background on TRIA and Major Findings</u>

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 no assistance. The act ends on December 31, 2005, unless renewed by Congress.

The CFA study, *The Terrorism Risk Insurance Act: Should It Be Renewed?*, assesses current prices for terrorism insurance and the increasing ability of the property/casualty insurance industry to cover terrorism losses without taxpayer back up.[1] CFA based its analysis in large part on a determination by the Insurance Services Office (ISO) that the risk of terrorism in the U.S. varies geographically

- 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.

The report has several major conclusions:

1. **Terrorism insurance rates are relatively low in most areas of the country and will continue to be so when TRIA expires,** as industry experts have concluded that most of the country has no significant terrorism risk under TRIA. Based on data collected by ISO, CFA estimates that terrorism insurance rates will be extremely low in these areas when TRIA expires. For example, in the lowest risk areas of the country, CFA calculates that a $10 million building with $5 million in contents would cost only $300 to insure against terrorism once the law expires, the same cost as in the final year of TRIA. In moderate risk areas, this cost would only be $6,526 when TRIA expires, only $326 more than during the last year of the program.

2. **The private sector will cover all terrorism losses in all but nine large cities by 2005, before TRIA expires. Even in those nine areas, insurers will be covering the vast majority of the risk.** This is according to the calculations of the ISO model regarding the risk of terrorist attacks, including attacks using weapons of mass destruction (WMD) and other catastrophic possibilities. This means that the insurance industry should have the capacity to cover all but perhaps the most risky areas of the country without help from taxpayers. In the five moderate-risk cities mentioned above, private insurers will be covering 95 percent of the risk by 2005. In the four high-risk areas of the country, insurers will be covering 70 percent of the risk.

3. **Commercial insurance buyers in most of the nation are reluctant to buy taxpayer backed insurance coverage.** This is because of the perception that terrorism will not impact them and that, even at very affordable rates, the price is too high. According to a recent survey by the Council of Insurance Agents and Brokers, half of the commercial brokers they questioned said that only 20 percent of their clients are actually buying federally backed terrorism insurance.

4. **Industry experts have projected that terrorism insurance losses will be relatively modest.** ISO has projected terrorism insured losses annually to be $5.75 billion before tax considerations. To put this projection into perspective, industry losses on 9-11 have recently been lowered to $30 to $35 billion before tax considerations (about $20 billion after taxes). ISO thus projects a 9-11 level of loss just about every six years.

[1] The report can be found at: http://www.consumerfed.org/terrorism_insurance_report.pdf.

5. **Insurers are in an excellent financial position to cover all terrorism losses after TRIA expires**. The profits of insurers selling TRIA-backed terror coverage are excellent, as is the financial solidity of the industry. The return on equity for four of the five top stock insurance groups exceeded a very substantial 16 percent in 2003. These profits are expected to remain good for some years to come, as the industry continues to benefit from a "hard market" cycle that has kept premiums and profits high. Overall, the property/casualty insurance industry added 22 percent to policyholder surplus in 2003 (a whopping $65 billion) according to A.M. Best and Co. Meanwhile, financial soundness, which is measured by the amount of surplus the industry has compared to the coverage it has extended (net written premium), is very strong.

Public Policy 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 found no compelling reason to extend TRIA at the end of 2005. The only possible reason Congress might want to consider some form of limited taxpayer back up after TRIA expires would be to assist the nine cities at moderate or high risk of terror attacks.

However, if Congress considers such a plan, it should:

- **Target <u>only</u> 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 will be covered by the insurance industry by the end of 2005.
- **Increase the deductibles that insurers must pay for losses in these few cities**. CFA suggests an industry-wide deductible of $50 billion after tax considerations – a pre-tax deductible of $77 billion – for the first year of a 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 WMD, and
- **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 than estimated taxpayer costs. Requiring insurers to pay rates that are slightly higher than estimated will encourage private insurance mechanisms to quickly compete by offering lower rates.

I hope you will keep in mind these findings, which are based on a market assessment being used by the insurance industry itself, when considering the future of TRIA. The evidence strongly suggests that it is no longer necessary for taxpayers to provide free reinsurance to property-casualty insurers.

Thank you. I will be happy to respond to your questions at the appropriate time.