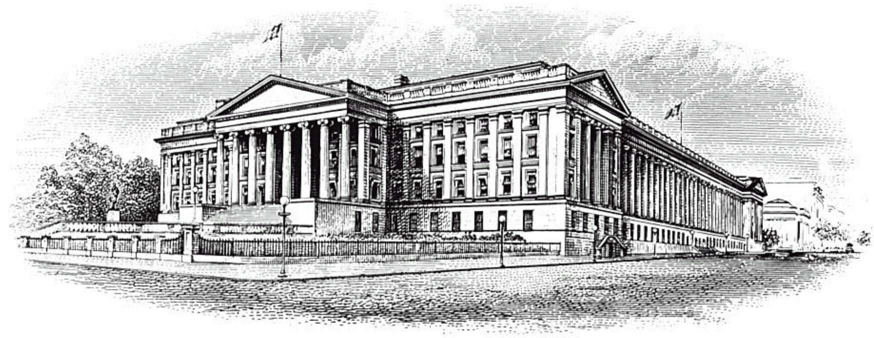

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

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Testimony of
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Before the
Committee on Banking, Housing, and Urban Affairs
United States Senate

Thank you, Chairman Shelby, Ranking Member Sarbanes, and members of the Committee on Banking, Housing, and Urban Affairs for this opportunity to testify today on the implementation of the Terrorism Risk Insurance Act (TRIA) of 2002.

The market for property and casualty terrorism risk insurance was significantly affected by the terrorist attacks of September 11, 2001. In the aftermath of September 11, reinsurers by and large refrained from offering coverage for property and casualty terrorism risk or offered reinsurance coverage at costs that were generally considered prohibitive. This then caused property and casualty insurers in general to respond by excluding terrorism coverage from commercial property and casualty insurance policies, leaving many American businesses exposed and uninsured. Perhaps the most notable negative impact of this development was the drag it created on businesses' ability to finance new job-creating economic activity in the midst of our economic downturn caused in part by the events of September 11.

To address this condition, Congress enacted TRIA in the fall of 2002. TRIA establishes a temporary Federal program of shared public and private compensation for insured commercial property and casualty losses resulting from acts of terrorism covered by the Act. TRIA in effect places the Federal government in the property and casualty terrorism risk reinsurance business through December 31, 2005.

By most indications TRIA has been successful in achieving the fundamental goal of enhancing the availability and affordability of property and casualty terrorism risk insurance, particularly for economic development purposes. No longer are heard the same level of concerns from real estate developers, for example, that new projects are on hold because financing has been frozen by a lack of terrorism risk insurance. In terms of affordability, while the information is still somewhat preliminary, accounts that we have seen indicate that premiums for terrorism risk insurance have decreased significantly throughout the early stages of TRIA and continue to do so.

Despite TRIA's apparent success, there have been widespread reports that the "take up" rates for TRIA coverage have been low, or in other words, the demand for this coverage has been low. Whether this reflects a lack of interest in terrorism risk coverage at current prices, a lack of awareness of the availability of coverage, an assessment by businesses of low terrorism loss risk, or some combination of the above will require careful study and analysis of information reflecting as comprehensive a view of markets as possible.

Treasury's Implementation of TRIA

Treasury has the chief responsibility for implementing the Federal reinsurance backstop that was established under TRIA. In broad terms, as Treasury has undertaken the overall implementation of TRIA, we have focused on five main administrative goals: ensuring that the program was operable immediately; implementing the program in a transparent manner; relying on the State insurance laws and regulatory structure as much as possible; allowing insurers to participate in program through their normal course of business where possible; and ensuring that insurance benefits, if needed, can be provided in an expedited manner.

Perhaps the most daunting, immediate administrative task was to prioritize and undertake the actions needed to make the program operational right away. One of the key factors in this regard was that TRIA became effective immediately on November 26, 2002, when the President signed the Act into law. The instant effective date of TRIA meant that terrorism exclusions on existing insurance policies were removed and all policyholders had the ability to secure coverage for terrorism risk. In addition to the effective date, Treasury also had to address the wide range of businesses, insurance companies, and types of policies that are affected by TRIA.

To address the immediate effective date of TRIA and provide the necessary guidance to the insurance industry and others to make the program operational, Treasury's first action was to issue promptly a series of three interim guidance notices. The first interim guidance notice was issued on December 3, 2002, about one week after TRIA was signed into law. Other interim guidance notices were issued on December 18, 2002, and January 22, 2003. Treasury relied on the process of issuing interim guidance notices because it provided us with the ability to respond quickly to implementation issues, and to prevent confusion prior to the issuance of formal regulations. These interim guidance notices provided the basis for insurance companies to proceed with offering coverage by addressing issues such as: compliance with TRIA's required disclosure and “make available” requirements; determining what insurers were required to participate in the program and how their deductibles would be calculated; and the scope of coverage under the program.

Even while the interim guidance process went forward we began the next step in the implementation process of preparing formal rulemakings that would incorporate and supercede our interim guidance. In general, the first rules were issued as interim final rules, as authorized in the statute, because of the immediate operational needs. The first interim final rule was issued on February 28, 2003. That rule and an interim final rule that was issued on April 18, 2003 took many of the issues that were addressed in interim guidance notices and transformed them into formal implementing regulations. Subsequent rulemakings have addressed issues associated with State residual market mechanisms, claims processing, and litigation management. Overall, Treasury has published two interim final rules and three proposed rules, and three of these rulemakings have been finalized.

It is important to stress that while we have been moving progressively through the rule making process, the program from the beginning has been and continues to be fully operational. These rules have been put forward as refinements to and improvements on practices and operations, but from the earliest days of the program, we have had procedures and resources ready to respond to any covered event that might arise.

In addition to the regulatory actions outlined above, Treasury has also created and staffed a Terrorism Risk Insurance Program (TRIP) office to administer the Act. Among its accomplishments, the TRIP office has developed systems to handle claims processing, payment, and auditing of claims should a covered event occur. The TRIP office has been working to provide detailed operating procedures for claims filing, processing and payment that are separate from the claims procedures regulation. In addition, the TRIP office has been consistently responding to requests for interpretation of the Act and its regulations from insurers; many of those interpretations have been made available to the general public on the TRIP website (www.treas.gov/trip).

TRIA created an interesting hybrid program jurisdictionally; it provides a Federal reinsurance backstop to commercial property and casualty insurance entities that are regulated almost exclusively at the State level. This type of program would likely be unmanageable without the cooperation of the State insurance regulators—cooperation among themselves and cooperation with the Federal government. Throughout the implementation process, Treasury consulted and worked closely with the NAIC, and the NAIC’s assistance has been invaluable in implementing TRIA. We look forward to continuing to work closely with the NAIC regarding Treasury’s remaining responsibilities under TRIA.

Comprehensive Market Information and Analysis Requirement

An important requirement of TRIA is to implement the Act with a careful eye on market conditions and developments, and report to Congress. In particular, Treasury is required to report to Congress by June 30, 2005, on an itemized list of issues associated with the Act and its purposes. Specifically, Treasury is required to assess—

- The "effectiveness of the Program;"
- The "likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the Program;" and
- The "availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit."

Together with this analysis, Treasury is also required under TRIA to compile information on premium rates for property and casualty terrorism risk insurance.

To assist in the evaluation of the Act's effectiveness and to meet TRIA's premium information collection requirement—and to ensure that we do so with as comprehensive a view of the markets as possible—Treasury has contracted with an outside survey research firm to conduct a comprehensive survey with a nationally representative sample of policyholders and insurers. Some of the information being collected through the surveys includes the cost of terrorism risk insurance as compared to total insurance within eligible lines, basic financial data, insurance deductibles and limits for terrorism as compared to non-terrorism insurance, use of reinsurance and self insurance, and the types of risk management programs.

Each company chosen for the survey will be contacted at least twice and possibly three times (depending on its policy renewal dates) in order to capture effects of changes in TRIA's insurer deductibles in successive program years. The first survey wave collected data from 2002 and 2003. Surveys for the first wave were mailed out late in 2003 and early 2004 to over 30,000 policyholders and almost 500 insurers. A second survey wave to collect 2004 data is planned for early this fall, and the last survey wave is planned for January and February of 2005. This phased structure will allow us to move beyond snapshots and anecdotal evidence to obtain a broader and more dynamic view of the conditions in the market place. We believe that anything less would not provide to the Secretary the full and reliable information needed to make the sort of careful, trustworthy, and responsible evaluation called for by Congress in the statute.

The completed survey results, as well as consultations with a wide range of interested parties, will form the basis for Treasury completing by the June 30, 2005 statutory deadline its report to Congress on the effectiveness of TRIA and the capacity of the property and casualty insurance industry to offer insurance for terrorism risk after termination of the program.

Determination on Extending the "Make Available" Requirement

The Secretary of the Treasury is required by TRIA to determine by September 1, 2004, whether to extend the “make available” provisions into the third year of the program (i.e., through December 31, 2005). The “make available” provisions of TRIA require that, from the date of enactment (November 26, 2002) through the last day of the second year of the program (December 31, 2004), each insurer must make available, in all of its commercial property and casualty insurance policies, coverage for insured losses under the Act. In this regard, TRIA also requires that such insurance coverage must not differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism.

TRIA requires that Treasury’s determination on whether to extend the “make available” requirements through the third year of the program be based on the same statutory factors described above that are to be considered in Treasury’s overall study of the effectiveness of TRIA.

Treasury is now developing a base of information from which the Secretary can make this required determination, consistent with the terms of the Act. As part of the information gathering process, on April 29, 2004, Treasury submitted to the Federal Register for publication a request for comments regarding the Secretary’s determination of whether to extend the “make available” requirements of the Act into the third year of the program. Comments will be accepted through June 4, 2004. We encourage anyone who has views on this question to respond to this request for comments with as much detail as they can provide.

In making this determination, however, while examining similar issues as those outlined for the larger examination due by June 2005, Treasury will be looking at those issues with the specific, narrow focus of the “make available” question, and with the use of much less information than will be available for the larger, broader study. Therefore, each examination will be conducted independently of the other.

Conclusion

We must all remember that the basic goal of TRIA was to develop a temporary backstop for property and casualty terrorism risk insurance so that private markets would have a chance to adjust. We encourage insurance companies, state insurance regulators, other financial services providers, and other interested parties to think creatively in this regard, and to consider what methods can be employed to allow for broader private sector involvement in the market for managing property and casualty terrorism risk. Treasury looks forward to completing our review of the effectiveness of TRIA and considering the many complicated issues presented to us in a thorough manner with the best information that can be obtained. Our obligations to the taxpayers, and the need for the long-term health and vitality of our financial markets, require nothing less.

In summary, while we hope that we will never be called upon to trigger coverage under TRIA, the program stands ready today—as it has from its earliest days—to meet its responsibilities. The extensive work done by Treasury in developing the basic framework of TRIA through interim guidance notices and regulations, the proposed claims regulations, the drafting of claims forms and review with industry organizations and the NAIC, and contingency procurement plans, all have contributed to an effective program that the Treasury will continue to refine over the life of the program. We look forward to moving forward with the implementation process and evaluating the effectiveness of the program in the weeks and months ahead.

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