Testimony of the
National Association of Insurance Commissioners

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

Regarding:
Federal Assistance in Assuring that Insurance for Terrorist Acts Remains Available to American Consumers

May 18, 2004

Donna Lee Williams
Commissioner of Insurance
Delaware

Testimony of Donna Lee Williams, Chair
Terrorism Insurance Implementation Working Group
National Association of Insurance Commissioners

Introduction

My name is Donna Lee Williams. I am the Commissioner of Insurance for the State of Delaware, and this year I am serving as Chair of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners (NAIC). Speaking for myself and my fellow insurance commissioners, we appreciate the opportunity to testify regarding the role of the Federal government in making sure that insurance against acts of terrorism remains available to American consumers and businesses.

Today, I want to make three basic points:

- First, there is still a need for the federal government to provide appropriate financial back-up to the private insurance market in order to assure that segments of our nation's economy do not falter due to a lack of insurance coverage for terrorism. The insurance marketplace is not yet ready to take on the risk of providing coverage for acts of terrorism on its own.

- Second, the Treasury Department should extend the "make available" requirements in TRIA so that businesses across America will know they can purchase the terrorism insurance coverage they need to sustain a healthy economy.

- Third, Congress should act this year to extend coverage under the Terrorism Risk Insurance Program (TRIP), or enact a comparable federal backstop for acts of terrorism, at least through 2006 because the commercial insurance markets are not yet prepared to underwrite sufficient terrorism coverage without a federal backstop.

Following enactment of the Terrorism Risk Insurance Act (TRIA), the NAIC appointed a Terrorism Insurance Implementation Working Group of state regulators that has worked closely with the Treasury Department to successfully implement the Act's provisions, as well as to monitor the impact it has had on the insurance marketplace. Although we observe that the take-up rate for terrorism insurance coverage mandated under TRIA has not been widespread, coverage is available for those businesses and industries that want to purchase it. We believe the presence of the federal backstop has provided a measure of comfort to the insurance industry, and has encouraged insurers to offer coverage for acts of terrorism that might not have considered otherwise in the wake of the tragic events of September 11th.

The NAIC's Terrorism Insurance Implementation Working Group believes there are two ways that Congress can help to continue the progress that has been made in restoring the market for terrorism insurance. The first is to encourage the Secretary of the Treasury to make an early determination that he will impose the "make available" requirement in Section 103(c)(2) of TRIA to all participating insurers for the third year of the Terrorism Risk Insurance Program (TRIP). The second is for Congress to act this year to extend the expiration date contained in TRIA Section 108(a) to a future date that is consistent with the business cycle for terrorism insurance renewals.

Congress Should Extend the "Make Available" Requirement

Insurance regulators believe that extending the present "make available" requirement in TRIA through 2005 will help ensure marketplace stability by continuing the availability of terrorism insurance in all parts of the United States. If insurers are not required to offer coverage, areas that face low risk of losses from acts of terrorism would probably experience little disruption. However, those areas of our nation and prominent cities with attractive targets for terrorist activity might face availability and affordability problems.

This would have a negative impact on their local and regional economies, particularly real estate development.

During the first week of May 2004, insurance regulators began receiving contingency filings from Insurance Services Office, Inc., the nation's largest insurance advisory organization. In the event Congress does not extend the TRIA program this year, these policy form filings would reinstate terrorism coverage limitations that were in effect prior to TRIA's enactment for any policies written for coverage that extends into 2006. In addition to protecting insurers from additional terrorism liability, these filings demonstrate the insurance industry is not willing to assume the risk of terrorism losses by themselves at this time.

The NAIC's Terrorism Insurance Implementation Working Group believes TRIA's "make available" requirement has contributed to the overall effectiveness of the program during its first two years. American businesses – both large and small – have been offered choices they might not otherwise have had. Through the "make available" provision, TRIA has given them the opportunity to make an informed choice regarding the purchase of coverage for acts of terrorism.

There are many who believe that the United States economy remains vulnerable to terrorist attack. This is evidenced by an increased take-up rate for terrorism coverage observed in a recent survey conducted by Marsh, Inc. In its fourth quarter 2003 survey, Marsh found that 32.7% of companies surveyed purchased terrorism coverage, compared with 23.5% in the second quarter and 26.0% in the third quarter

One of the elements the Treasury Department is required to consider is the capacity of the insurance industry to accept the risk of losses from acts of terrorism. Insurance capacity is generally measured by determining the amount of capital and surplus available to insurers to support their writings. Using that measure, NAIC data shows 2003 was a profitable year for property and casualty insurers, with aggregated policyholder surplus increasing approximately 26% to $375 billion. It should be noted however, that policyholder surplus declined each year from 1999 to 2002, and the $375 billion figure is only 4.3% higher than the $360 billion in policyholder surplus held in 1999. Furthermore, less than half of those funds are used to support commercial lines writings. As part of considering whether the insurance industry has sufficient capacity to underwrite the risk of terrorism losses, the Treasury Department must consider whether the industry is willing to put its capital at risk. We believe the answer is no.

Insurers and the marketplace at large are finding it very difficult to accurately price coverage for acts of terrorism. Unknown frequency, coupled with the potential for severe losses, makes coverage for acts of terrorism one that insurers might choose to avoid if given the opportunity. Until insurers and their reinsurers become more comfortable that government efforts are adequate to protect citizens from terrorist acts, or at least become more predictable than they are today, they will be reluctant to accept complete risk transfers from American businesses. In particular, those businesses viewed by insurers as having a greater risk of terrorism losses will have trouble finding insurance.

Consequently, the NAIC's Terrorism Insurance Implementation Working Group urges the Treasury Department to extend the "make available" requirement into Program Year Three of TRIA. This action will help avoid market disruptions which might otherwise occur, and will ensure the insurance market's continued role supporting economic development.

Congress Should Extend the Terrorism Risk Insurance Program

The NAIC urges action by Congress this year on a federal solution to ensure continued marketplace stability when TRIA expires at the end of 2005. Because some terrorism risks are largely uninsurable without a financial backstop, state regulators are very concerned that significant market disruptions will develop before TRIA's expiration. This is due in large part to the deadlines contained in TRIA, which do not match the business cycle for insurance renewals.

The commercial insurance business cycle operates in such a way that insurers and their policyholders will be required to make decisions as early as September 2004 regarding coverage well into 2006. At present, annual policy renewals with effective dates of January 2, 2005 or later must contemplate there will be no federal backstop for any losses occurring in 2006. For this reason, state insurance regulators anticipate widespread insistence by insurers that conditional policy exclusions for terrorism coverage be included in renewal policies starting later this year. This is the same situation we encountered in the aftermath of September 11, which prompted enactment of TRIA.

To address this situation, Congress could simply change one line of TRIA. If Section 108(a) were changed to read "The Program shall terminate on December 31, 2007," then Congress would be able to receive the report from the Treasury on June 30, 2005, and would thus have roughly fifteen months to digest and debate the future federal role related to acts of terrorism before reaching another milestone for insurers and American businesses.

An alternative to extending the expiration date of TRIA would be to extend the coverage period in TRIA without extending the actual effective date in the law. This could be accomplished by amending Section 108(a) as follows: "The Program shall terminate on December 31, 2005, however, the Program shall continue to provide shared public and private compensation for insured losses resulting from acts of terrorism for policies or contracts issued or renewed before December 31, 2005, until the policy expiration date or one-year from their inception or renewal date, whichever is less."

Another alternative is to develop a different type of federal backstop for acts of terrorism that provides some form of funding for the risk of losses resulting from acts of terrorism.

The NAIC stands ready to assist Congress in developing an appropriate method for continuing the federal terrorism reinsurance backstop.

Workers' Compensation and Group Life Insurance

There are two major types of insurance that cause insurers special concern about whether they can continue to underwrite them without some form of assistance from the federal government. The first is workers' compensation, which is a property-casualty product that provides coverage for work-related injuries and illness. It covers lost wages, provides unlimited medical benefits and, in most states, provides rehabilitation benefits to get injured workers back on the job. In the event of death on the job, worker's compensation provides a monetary death benefit to the surviving spouse and children. It also provides employers with liability coverage if an employee pursues legal action against an employer in court. Workers' compensation is currently included under TRIA.

State laws do not allow an insurer to exclude or limit worker's compensation coverage, except as permitted by state law. As a result, an insurer underwriting this risk without adequate reinsurance is subject to a large potential loss if there are a significant number of employees at a single location. The American Academy of Actuaries estimates that "a modest-sized insured with 200 employees could easily generate a terrorism related event of $50 million. This presumes death of all employees and typical death benefit of $250,000 per employee.[1]"

The second type of coverage causing insurers special concern is one that is not currently included in TRIA—namely group life insurance. Like workers' compensation, this insurance coverage is vulnerable to risk concentration problems. For example, if a business has 1,000 employees at a given location, the pricing employed by life insurers for group products probably assumes that three or four employees might die in a given year. If instead, a location with 1,000 employees is hit by a terror attack and all of them die, the insurer has an enormous financial exposure from a single occurrence.

Unlike worker's compensation, there is no statutory requirement for group life that prohibits an insurer from limiting available coverage for acts of terrorism in some fashion. However, the employer, the insurer, the insurance industry in general and the American economy would suffer if an insurer is only able to pay a fraction of the policy face amount in a mass casualty situation. Furthermore, state insurance regulators are not inclined to approve exclusionary or limiting language in those states that have approval authority over the wording in group life insurance contracts. Although there is some level of private reinsurance available for group life coverage, it is not sufficient to cover a catastrophic terrorism loss situation. While the NAIC has not taken on formal position on whether group life should be included in TRIA or another form of federal backstop, I wanted to alert you that regulators have heard these concerns expressed by group life insurance underwriters.

Conclusion

We strongly urge Congressional action to extend TRIA this year, or enact an alternative form of federal backstop for acts of terrorism, in order to avoid market disruptions likely to occur in the absence of a federal backstop program. Such action will ensure the insurance market's continued role supporting economic development. In addition, it will allow Congress adequate time to fully evaluate the Treasury Department's June 2005 report and recommendations.

[1] American Academy of Actuaries, P/C Extreme Events Committee May 4, 2004 Report, P/C Terrorism Coverage: Where Do We Go Post-Terrorism Risk Insurance Act?, Page 14.