TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM

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INSURANCE, HOUSING AND
COMMUNITY OPPORTUNITY

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TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM

Tuesday, September 11, 2012

U.S. House of Representatives,
Subcommittee on Insurance, Housing and Community Opportunity,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Judy Biggert [chairwoman of the subcommittee] presiding.

Members present: Representatives Biggert, Hurt, Garrett, McHenry, Dold, Stivers; Cleaver and Sherman.

Also present: Representatives Grimm; Maloney and Green.

Chairwoman Biggert. This hearing of the Subcommittee on Insurance, Housing and Community Opportunity will come to order. We are having a ceremony today in the Rotunda and on the Capitol steps at 11 a.m., so we will have to adjourn for a while.

Anyway, just keep that in mind, but good morning, everyone, and welcome to today's hearing to examine the future of the Terrorism Risk Insurance Program. It is no coincidence that we are holding this hearing on the 11th anniversary of September 11th. The Terrorism Risk Insurance Act (TRIA) was established in direct response to the events of that tragic day in 2001, so it is appropriate to reflect on the simple fact that we, as a Nation, continue to grapple with the monumental consequences that 9/11 had on every facet of American life.

Our goal today and always is to ensure that no act of terror or threat of violence can ever again interrupt the lives, prosperity, or liberty of the American people. For this subcommittee, this means talking a little bit about TRIA and how best to insure American commerce and families against an attack, which we pray will never happen again.

That said, it is just one small part of a bigger conversation. Every day, American soldiers are fighting for our freedoms, while firefighters and emergency personnel here at home put their lives on the line for our safety, just as their colleagues did on 9/11.

So before we get into the policy details on matters of terrorism risk insurance, I would just like to take a moment to honor those we lost on 9/11 and offer a simple "thank you" to the people still fighting for our way of life.

While we examine ways to facilitate investment and job growth in America, let us never forget the heroes who sacrificed everything to give us an America worth investing in. That is something to remember.

With that, I would like to announce that after the ranking member and I deliver opening statements, we will hear from our first panel of witnesses. We will then recess the hearing at 10:30 so that Members can attend the 9/11 Congressional Remembrance Ceremony. At 11:45, we will resume this hearing.

As we all know, in the aftermath of September 11th, our country was resilient. Even our financial services sector—particularly the insurance industry—performed well. The record reflects that insurance firms, including those directly affected by the attacks, expedited claims processing and paid and absorbed the loss of $40 billion in today's dollars.

The American people, businesses, and our economy emerged from this disaster but also asked Congress to step in to fill a temporary void in the market that threatened our economy. A new and unique insurance risk, terrorism, had emerged.

For the private sector, this new risk was unpredictable, uninsurable, and excluded from commercial policies. To prevent further economic toil, Congress stepped in, enacting the Terrorism Risk Insurance Act in 2002, which stabilized the marketplace.

TRIA temporarily created a form of reinsurance, a public-private partnership to make available terrorism risk insurance until the private sector could model and price for this new risk. To give the private sector more time Congress has reauthorized TRIA twice. These congressional interventions were the right thing to do and I supported them.

However, today, well in advance of the Terrorism Risk Insurance Program's December 2014 expiration, our subcommittee begins an important examination of the program, its impact over the last decade, and its future. This hearing will assess conditions in the insurance market and the private sector's capacity to offer reinsurance and insurance coverage without a Federal backstop for losses resulting from international and domestic terrorism.

This hearing also will explore options for encouraging greater private sector participation in the market for terrorism risk insurance. I hope that this will be the first of many hearings that our subcommittee will hold on TRIA. It is critical to our families, workers, businesses, and economy that Congress develops a long-term solution to risk—terrorism risk insurance.

With that, let me just welcome our witnesses and thank you for participating in today's discussion, and we look forward to your testimony.

And I will now recognize the ranking member pro tem today, Mrs. Maloney from New York.

Mrs. MALONEY. Thank you very much. I am not even on this subcommittee. I just came by because I thought it was important, so I am sitting here as the ranking member for the moment.

But I want to congratulate my colleague for calling this important hearing and assembling such a well-informed panel. We both had terrific conventions and it is very appropriate that our first hearing is on such a critically important issue for the future of our country.

As one who lived through 9/11, and lost 500 constituents on that day, I know full well how united and determined our country was. I have never seen this Congress more determined and united and I have never seen the public and private sector, the financial industry bounce back so quickly. We opened up our markets within a week.

It was an incredible example of American determination, will, and leadership, how we responded as a Nation to that terrible attack that killed 3,000 innocent Americans who did nothing more than what we are doing today. They woke up, went to work, sat at their desks, and were murdered. It was such a horrific crime that to this day, whenever I meet anyone internationally, or nationally, the first thing they tell me upon finding out I am from New York is what they were doing, how they heard about this tragic attack on us.

This country responded in a multitude of ways to combat terrorism. We totally reorganized our government, our intelligence operations. But truly, the most important thing for our economy, in my opinion, was the enactment of the antiterrorism risk insurance.

In terms of New York and other large cities, no business could get any insurance. There was a fear of terrorism. The economy could not move forward.

I talked to businesses from New York who had to go to Lloyd's of London. All building stopped in New York because there was no insurance.

With bipartisan support in 2002, and then we reauthorized it again in 2007, this tremendously important bill was put into place and has been very successful and has been part of the American dream, the American success story, and the American recovery story. We remember the attack but too often we forget that the response, the rescue, and the recovery were among the most dramatic achievements in our country's history.

Since it is 9/11, I am going to share one story with you. I was at the site the next day. We assembled at a school next to the site. The workers were there, the mayor, the governor.

The reports were that 25,000 people had died in the towers. That was their belief. And a decision was made that they would announce that only 6,000 had died because the number 25,000 was too much for the Nation to bear.

So they announced 6,000; we all know the story. Because of the heroic efforts of volunteers—our police, our fire, our public sector, our private sector—it was the most incredibly successful rescue effort in the history of our country. All of these people were rescued and pushed out of the building and the number dropped every day instead of climbing every day.

The rebuilding started and one of the most important building blocks was TRIA. I strongly support its reauthorization. TRIA has absolutely no cost to the taxpayer unless there is a terrorist attack. And if we have that terrible event, if it happens—and we certainly hope it doesn't—TRIA saves the government money by structuring what would otherwise be hastily drafted emergency spending.

Of course, setting up a public-private partnership to provide insurance coverage is more cost-effective than throwing money at a disaster. This helps our insurance companies to measure and estimate their risk and it does not kick in until after $100 billion in cost.

I believe that this is a very, very important program. It is part of the success of our economy, and our economic success is our people's success.

So I look forward to the new ideas and I look forward to the new insights. I want to thank you all for coming. There is a New York meeting and a remembrance that is coming up, so I cannot stay the whole time, but my staff is here.

I am so thrilled that you called this hearing, Chairwoman Biggert. I think it is appropriate and sensitive that you called it on this incredibly important day as we remember, and we continue to build.

So I thank everyone for being here and being part of the solution.

I yield back and will place more into the record. Thank you.

Chairwoman BIGGERT. Thank you, Mrs. Maloney.

And with that, without objection, all Members' opening statements will be made a part of the record, and we will have any of those when we come back if they wish. Without objection, it is so ordered.

And now, I will introduce the panel of witnesses: Dr. Robert Hartwig, president, Insurance Information Institute; Mr. David C. John, senior research fellow, the Heritage Foundation; Mr. Rolf Lundberg, senior vice president, congressional and public affairs, U.S. Chamber of Commerce and the Coalition to Insure Against Terrorism; Dr. Erwann Michel-Kerjan, professor and managing director, Risk Management and Decision Processing Center, Wharton School of Business, University of Pennsylvania; Ms. Janice Ochenkowski, managing director, Jones Lang LaSalle, on behalf of the Risk and Insurance Management Society, Incorporated; and Ms. Linda St. Peter, operations manager, Prudential Connecticut Realty on behalf of the National Association of REALTORS®.

Welcome to you all. Without objection, your written statements will be made a part of the record, and you will each be recognized for a 5-minute summary of your testimony.

We will start with you, Dr. Hartwig. You are recognized for 5 minutes. And please be sure your microphone is on.

STATEMENT OF ROBERT P. HARTWIG, PH.D., CPCU, PRESIDENT AND ECONOMIST, THE INSURANCE INFORMATION INSTITUTE

Mr. HARTWIG. Madam Chairwoman and members of the subcommittee, good morning. My name is Robert Hartwig and I am president and economist at the Insurance Information Institute, an international property/casualty insurance trade association based in New York. Our members account for nearly 70 percent of all property/casualty insurance premiums written in the United States and financed the overwhelming majority of losses on 9/11.

The terrorist attacks of September 11, 2001, produced insured losses larger than any natural or man-made event in history.

Claims paid by insurers to their policyholders eventually totaled some $40 billion.

The enormity of the loss combined with the possibility of future attacks led insurers and reinsurers to exclude coverage arising from virtually all commercial property insurance policies. The economic consequences of such exclusions were quick to manifest themselves.

Major commercial property construction projects around the country, unable to secure coverage against the now very real risk of terrorist attack, were in jeopardy of being tabled, hurting job growth at a time of rapidly rising unemployment and recession. Banks threatened to choke off credit because their borrowers could not secure terrorism coverage. And even as exclusions proliferated, prices soared.

It was not until 14 months later, when Congress approved the Terrorism Risk Insurance Act in November of 2002, that stability finally returned to the market and coverage for terrorism attacks resumed. Ten years later, the war on terror is far from over, but the Terrorism Risk Insurance Program, by all objective measures, is an unqualified success. The program not only succeeded in restoring stability to the country's vital insurance markets but it continues to deliver substantive, direct benefits to businesses, workers, consumers, and the economy overall, all at no cost to the taxpayer.

Today, the vast majority of businesses in the market purchase terrorism coverage. The coverage is affordable and billions of dollars of private sector capital have been attracted to the market.

Given these statistics, it is tempting to conclude that in the 10 years since TRIA was first implemented, insurance markets have fully adjusted to the post-9/11 environment, and insurers have concluded that terrorism is a fully insurable risk. The reality is quite different.

The fact of the matter is that terrorism risk today is almost every bit as uninsurable as it was a decade ago. Recent major successes in the war on terror, including the killing of Osama bin Laden last year, do not alter this conclusion. This is because the current stability in the terrorism insurance market in the United States is due almost entirely to two factors: there has been no successful attack on U.S. soil since 2001; and the Terrorism Risk Insurance Program remains in place.

As you can see from Table 1 in my testimony, there has been no shortage of attempted attacks on U.S. soil. Fortunately, none have been successful. But without question, TRIA and its successors are the principal reason for the continued stability in the market today.

In 2004 and 2006, as program expirations loomed, terrorism exclusions reappeared in the marketplace. With the current program's expiration now a little more than 2 years away, it is virtually certain that terrorism exclusions will reappear again in 2013.

Simply put, acts of terror violate basic fundamental principles associated with insurance. In short, it is impossible for an insurer to reliably ascertain the likelihood or frequency of attacks. Also, losses or severity are potential unbounded, even exceeding the claims-paying ability of some insurers, or in some cases, even of the entire insurance industry.

Acts of terror are clearly also intentional in nature. As such, it can be difficult or impossible for an insurer to ascertain the premium to be charged and difficult to achieve the necessary spread of risk to avoid exposing an insurer to an unreasonable risk of insolvency.

In terms of factors that could influence greater private sector participation in the terrorism insurance marketplace, the committee might consider several alternatives, including a long-term extension or permanence of the Terrorism Risk Insurance Program—experience abroad suggests that both of these are effective at creating a stable environment—and also may revisit some early pooling proposals that the industry did propose in the immediate aftermath of 9/11.

So in the 11 years since the tragedy of the September 11th terrorist attack, much has been learned about the nature of terrorism risk and its insurability. There is no question that TRIA and its successors brought much-needed stability to the marketplace. In the decade since, private sector insurers and reinsurers in the Federal Government have successfully created a structure that offers lasting stability, providing tangible benefits for the American economy.

The looming expiration of the Terrorism Risk Insurance Program at the end of 2014 brings to a head the question of whether terrorism risk is now or ever will be a risk that can be managed entirely within the private sector. The evidence, both from the United States and from similar programs abroad, is that market stability, in terms of both pricing and availability of terrorism coverage as well as the ability to maintain adequate and expanding levels of capacity over time, are contingent on the continued existence of the Terrorism Risk Insurance Program.

Thank you very much for the opportunity to testify. I would be happy to answer your questions.

[The prepared statement of Dr. Hartwig can be found on page 61 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. John, you are recognized for 5 minutes.

STATEMENT OF DAVID C. JOHN, SENIOR RESEARCH FELLOW, THE HERITAGE FOUNDATION

Mr. JOHN. Thank you. Chairwoman Biggert and members of the subcommittee, I appreciate the opportunity to testify this morning. I am David John, a senior research fellow at The Heritage Foundation.

The Terrorism Risk Insurance Act and its various successors served a very real purpose in the days after 9/11, when insurance companies and their customers feared the cost of providing coverage for acts of terrorism would be prohibitive. However, we have now reached the point where the private sector is increasingly capable of providing that coverage at appropriate prices without government support.

In fact, the continued existence of TRIA may keep the industry from further progress. However, the industry will need time to make the transition to a fully private terrorism insurance program and it is greatly to the subcommittee's credit that you are starting this discussion now rather than waiting until 2014.

Before TRIA and after 9/11 property and casualty insurers faced a serious dilemma. Many of their corporate policies issued before the 9/11 attacks insured against terrorism attacks in much the same way that they covered natural disasters and more conventional accidents.

Then and now, insurance premiums on most types of loss were based on sophisticated estimates of the likelihood that a particular claim would have to be paid. Until 9/11, insurers and the rest of us never expected the scale of damage inflicted in those attacks. Thus, before 9/11, terrorism coverage often carried a very low price and was often included without much additional thought in more comprehensive coverage.

Then, the world changed. Insurers and the rest of us discovered that these attacks were possible and could cause catastrophic damage. At the time, none of us had any firm idea whether the attacks were isolated incidents or not. As a result, insurers were unable to price terrorism coverage quickly and accurately and were unwilling to expose their companies to claims that could run into the tens of billions of dollars.

Then TRIA came along and that changed the situation. But as we knew at the time, the wrong government response could prevent the market from taking necessary actions to return towards the private coverage of terrorism risks. Any program that essentially transferred the risk from companies to the government by promising that tax dollars would pay off most of the losses would only make it more difficult for private insurers to establish a real market price for terrorism coverage.

While the problem in 2001 was real, it should have been temporary. By now, normal insurance industry processes should have been able to resolve it. The industry should have developed ways to price terrorism insurance properly, which included upper limits on corporate liability. And reinsurers should have found ways to involve sophisticated investors who, for a price, could face the type of losses that could occur.

Recent industry data indicates that there has been a great deal of progress towards making insurance coverage more widely available and affordable. While coverage varies according to geographic area and industry, some industries show that over three-quarters of larger firms have purchased some form of terrorism coverage. In addition, the cost has been dropping.

TRIA was never intended to be a permanent program. As the original bill stated, TRIA would provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy at the time of national crisis while the financial services industry developed systems, mechanisms, products, and programs necessary to create viable financial services market for the terrorism risk insurance. Returning this coverage to the private sector is an important goal because there is no reason why taxpayers should continue to have the ultimate financial responsibility for paying insurance losses on private property.

There is no need to extend TRIA substantially beyond its 2014 expiration date. Some insurance industry people claim that coverage will revert to same types of problems as before TRIA, but this is not necessarily the case.

Insurer cooperation, increasing the event trigger, removing coverage for acts of domestic terrorism, and various other changes could start the process of enabling the insurance industry to phase back to private coverage. That should be followed by a full phase-out of TRIA so that the entire program has ended no more than 2 years after the current 2014 expiration date.

If such additional time is necessary, Congress should also increasingly indicate, at the time of passage in 2013 or 2014, to the industry that further extensions should not come, otherwise the industry is going to assume that this is a permanent program and that they never need to take any additional steps. And the insurance industry should expect to offer coverage without any further taxpayer subsidies.

As I say, Congress should neither extend or expand TRIA without a firm and short phase-out, and if Congress passes any longer extension than I have proposed, whomever is in the White House after January 20th should reject such legislation. It is time now to end the temporary program and go back to the private sector.

Thank you.

[The prepared statement of Mr. John can be found on page 82 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Lundberg, you are recognized for 5 minutes.

STATEMENT OF ROLF LUNDBERG, JR., SENIOR VICE PRESIDENT, CONGRESSIONAL AND PUBLIC AFFAIRS, U.S. CHAMBER OF COMMERCE, ON BEHALF OF THE COALITION TO INSURE AGAINST TERRORISM (CIAT)

Mr. LUNDBERG. Thank you.

Good morning, Chairwoman Biggert, and members of the subcommittee. I very much appreciate the opportunity to testify this morning regarding the key issue of terrorism risk insurance and its importance to the broad economy. My name is Rolf Lundberg and I am senior vice president for congressional and public affairs at the U.S. Chamber of Commerce.

I am appearing today on behalf of the Coalition to Insure Against Terrorism, of which the U.S. Chamber is a founding member. CIAT is a broad coalition of commercial insurance consumers formed immediately after 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance.

The diverse CIAT membership represents commercial real estate, banking, energy, construction, hotel and hospitality, entertainment, manufacturing, transportation, and major league sports, as well as public sector buyers of insurance. CIAT is, therefore, the true consumer voice on terrorism risk insurance, as we are comprised of the principal policyholders of commercial property and casualty lines of insurance in this country.

I am pleased today to offer the policyholder perspective on terrorism risk insurance, to highlight why the TRIA program continues to be vital to our broad economy.

As we saw in the months following the 9/11 attacks, the lack of terrorism risk insurance contributed to a paralysis of the broad economy, especially in construction, tourism, business travel, and real estate finance. Enactment of TRIA changed that by making terrorism risk coverage widely available to commercial policyholders and delivering it through a private insurance mechanism that keeps private industry's skin in the game through the insurer deductible and co-share layers. It also protects taxpayers by providing for recoupment from the commercial policyholders of any Federal share paid out in the wake of a large-scale event.

While private insurance capacity apparently has grown somewhat in the past decade, these years have also taught us that a continuing Federal role in this unique risk remains absolutely vital.

The terrorism peril is simply too intrinsically linked to government policy and intelligence to be solely handled by the private sector alone. TRIA needs to be reauthorized.

We therefore commend you, Chairwoman Biggert, and the subcommittee, for your leadership on this issue and for convening this important hearing.

On the front of the U.S. Chamber building is a 26-foot tall banner that stretches across the building and it spells out one word: "Jobs." That banner has served as a reminder to us all of what our focus must be.

The Chamber believes that stronger and faster economic growth is the best way to successfully put Americans back to work. We must not only affirmatively clear away impediments to job creation but we must avoid taking steps that would create more uncertainty and strangle businesses, stifling our economy's ability to grow and also affect negatively job creation.

America has strong demographics, abundant natural resources, the world's most productive workers, and a long history of picking ourselves up when we are down. We should not inflict additional and unnecessary damage to our fragile economy and possibly extinguish the prospect of economic recovery and new jobs for Americans by failing to properly deal with TRIA.

The terrorists who perpetrated that terrible attack on 9/11 sought to paralyze us and our economy with fear, but the best of America shone through that day and in the weeks and months that followed. It is incumbent to remember the lessons of 9/11, and among those is the importance of maintaining safeguards to ensure that such catastrophic events do not cause lasting harm to our economy. As we saw in the months that followed 9/11, managing the risk of terrorism is one of those imperatives.

In recognition of the critical post-9/11 situation, Congress and the Bush Administration worked together in 2002 to enact TRIA, which is a public-private risk-sharing mechanism to deal with terrorism risk that has served our Nation and its economy extraordinarily well for nearly 10 years.

We have no interest in seeing a return to the standard terrorism exclusions that became the norm in the months following 9/11. We saw that during the two reauthorizations in 2005 and 2007, and we believe that we should not return to those kinds of exclusions in the upcoming renewals of terrorism policies.

Let me just briefly talk about current market conditions. Because of TRIA, today terrorism risk insurance, with one exception—nuclear and biological, chemical, and radiological—coverage is generally available for commercial policyholders. It would not be available were it not for TRIA.

CIAT members have generally seen a decline in pricing for terrorism insurance, which we attribute not just to the normal ebb and flow of the insurance market but rather to the continued availability of the TRIA mechanism, which has worked extraordinarily well since its enactment.

The TRIA program has worked well and we encourage the committee to examine it carefully and to extend it before its expiration.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Lundberg can be found on page 97 of the appendix.]

Chairwoman BIGGERT. Thank you.

Dr. Michel-Kerjan, you are recognized for 5 minutes.

STATEMENT OF ERWANN O. MICHEL-KERJAN, MANAGING DIRECTOR, CENTER FOR RISK MANAGEMENT AND DECISION PROCESSES, THE WHARTON SCHOOL OF BUSINESS, UNIVERSITY OF PENNSYLVANIA

Mr. MICHEL-KERJAN. Thank you, Chairwoman Biggert.

Let me open by saying that if our common goal is to make the Nation more financially resilient to future terrorist attacks and also to limit the spending of taxpayers' money, then our debate should not be on whether to let TRIA expire. Rather, it should be on how we work together to make TRIA more effective. That is a very different question.

As it was designed to do, TRIA makes a supply of coverage available and affordable. Terrorism insurance costs in the United States have been going down continuously and are among the least expensive in the world. In a recent study, I have also shown that insurers are willing to provide more capacity for terrorism than for other catastrophic risks because they collect all the premiums but are responsible for only the portion of losses.

On the demand side, take-up rates among firms increased from just 20 to 27 percent in 2003 to 60 percent in—since 2006, a figure which, by the way, combined all type of terrorism coverage, not just TRIA, from what U.S. companies can get for the market. Still, this means that about 4 out of 10 large corporations don't have coverage against terrorism today.

Let's remember that on 9/11, the coverage was virtually 100 percent, which allowed for a quick economic recovery of the country. I think we can do better on the take-up rate than where we are today.

I will now turn to challenging the main argument that ending TRIA will limit the financial exposure of the government. I think, to put it simply, the logic is wrong. The world without TRIA will actually mean not less but more exposure for all of us as taxpayers.

Let's say we are in September 2016. TRIA expired in 2014; 15 years have passed since 2001. Attention to terrorism has faded somewhat on the demand side. On the supply side, the only insurers that offer the coverage are at a very high price to account for the cost of capital needed to underwrite extreme events. Many firms go unprotected

Terrorists inflict a large-scale attack with massive economic losses. An injured firm called on Congress to rescue them. Not only is it an election year—again, my scenario is we are in 2016—but a trend toward increasing Federal disaster relief and corporate bailouts in the past 10 years has created new and fairly high expectation. I detail that aspect at more length in my written testimony and refer you to figure one on page seven, which is fairly striking.

The cost of government relief in the wake of that new terrorist attack will likely be very expensive for taxpayers. That is why I think a better option moving forward is to redesign TRIA.

Some of the concepts developed by other OECD countries may be relevant here. I discuss five of them in my written testimony. Let me briefly mention three here.

Israel: Israel has 100 percent government coverage. In the U.K., there had been a public-private risk-sharing arrangement based on pooling with unlimited government debt issuance that the pool can draw from. So contrary to what is often mentioned, this is not a reinsurance program; this is an unlimited line of credit from the British government. Germany, the largest economy in Europe, also uses a public-private risk-sharing, again based on pooling, but with limited reinsurance from the government.

I would like to note here that in both cases—in the U.K. and Germany—the government receives a premium to cover that coverage. It is not free.

To summarize, this is not a question of TRIA or no TRIA. This is about strengthening the current program to make the Nation more resilient financially to future attacks, not less, and to do that by making the American taxpayers less exposed, not more. My colleagues at the Wharton Research Center and on the OEC board that I have been honored to chair over the past 6 years look forward to working with you and the President on how we do this.

Before I stop here, and on a more personal note, I want to congratulate the subcommittee, and especially you, Congresswoman Biggert, for you leadership in supporting and renewing the National Flood Insurance Program that was signed by the President in early July. I trust you will be as successful in reforming TRIA. Thank you.

[The prepared statement of Dr. Michel-Kerjan can be found on page 104 of the appendix.]

Chairwoman BIGGERT. Thank you, Doctor.

Ms. Ochenkowski, you are recognized for 5 minutes.

STATEMENT OF JANICE OCHENKOWSKI, MANAGING DIRECTOR, JONES LANG LaSALLE, ON BEHALF OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS)

Ms. OCHENKOWSKI. Thank you, and good morning, Chairwoman Biggert, and members of the subcommittee. I am Janice Ochenkowski, the managing director responsible for global risk management at Jones Lang LaSalle, a real estate and financial services company headquartered in Chicago.

I am pleased to testify this morning on behalf of the Risk and Insurance Management Society, known as RIMS, and I thank the subcommittee for this important policy debate regarding the reauthorization of the Terrorism Risk Insurance Act, especially on this anniversary of 9/11.

RIMS is a not-for-profit organization dedicated to advancing the practice of risk management for the benefit of our nearly 4,000 members. Those members span all types of organizations and they include corporations, universities, hospitals, and public entities such as the City of San Francisco, the Miami-Dade School District, and Orange County, California. However, as diverse as RIMS members organizations are, they share the common characteristic of wanting the availability of terrorism insurance.

At Jones Lang LaSalle, we purchase insurance for properties owned by our clients, which in the United States is just under 70 million square feet of real estate with an aggregate insured value of just under $9 billion. All of them are commercial properties. They span various investment types, such as warehouses, but most are office buildings.

Since the enactment of TRIA, although there are some limitations on specific high-risk locations, in general we are able to buy the coverage we need at a premium that can be absorbed by our tenants and our investors. TRIA has been a success.

And if we consider the economic impact of the lack of terrorism insurance, we have to consider that the inability to acquire sufficient terrorism coverage could result in the inability to secure financing for new schools, factories, and construction projects. Without TRIA, many companies would not be able to comply with loan requirements and the buying and selling of real estate would be impacted, which also would affect the general economy.

Public entities also face terrorism exposures. Public and private transportation, schools, hospitals, and special and sporting events all have terrorism coverage needs but they don't have unlimited budgets to purchase it.

Because there is no historical data, insuring the terrorism risk is not like other insurance. We are not able to predict frequency or severity of a potential terrorist event because the timing, the location, and the target can't be identified in advance. Without some form of backup like TRIA, RIMS believes that insurance companies will review their portfolios of business and will refuse to insure risks in areas where the exposure is greatest. Large and small businesses as well as public entities would be affected by this.

As we evaluate the success of TRIA, we should look back to congressional actions since 9/11. Following 9/11 and prior to the passage of TRIA in 2002, the required limits of terrorism insurance were not available. RIMS members had difficulty purchasing the insurance needed for their operations as well as to protect their employees through workers' compensation programs.

Passage of TRIA in 2002 was followed by a demonstrable increase in the number of insurers willing to write the coverage. In 2006, prior to the passage of TRIPRA, 75 percent of RIMS' members reported that terrorism coverage was conditioned upon the extension of TRIA; 76 percent of our members stated that their terrorism coverage limits would decrease and 82 percent felt that premium would increase if TRIA was not extended.

However, in 2010 our members indicated that capacity and pricing was available. In July 2012, nearly 85 percent of our members wanted Congress to reauthorize TRIPRA and said that without another long-term extension, issues of affordability and availability will resurface.

In our written testimony, we outline several policy principles for the subcommittee's consideration. I will highlight three of them.

First, a completely private market solution in the long term is probably not feasible because of the difficulty in predicting and pricing the risks. Insurers, as part of their corporate governance, need to be able to assess what business risks are and how they can be quantified and treated.

Second, a public-private partnership provides the best alternative and the Federal Government will likely continue to be involved in a reinsurance capacity at some level, with that involvement decreasing over time.

Third, the solution needs to address insurance coverage for nuclear, biological, chemical, and radiological events caused by terrorism. Our Federal Government has stated that potential acts of terrorism from these sources are likely, so including them in the solution is reasonable.

That concludes our formal remarks, and RIMS appreciates the opportunity to testify and thanks the subcommittee for beginning this very important discussion. We stand ready to serve as a resource as you begin your work.

Thank you.

[The prepared statement of Ms. Ochenkowski can be found on page 116 of the appendix.]

Chairwoman BIGGERT. Thank you.

Ms. St. Peter, you are recognized for 5 minutes.

STATEMENT OF LINDA ST. PETER, 2012 COMMERCIAL COMMITTEE VICE CHAIR, THE NATIONAL ASSOCIATION OF REALTORS® (NAR)

Ms. ST. PETER. Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the subcommittee. On behalf of more than 1.1 million REALTORS®, I want to thank you for inviting me to testify about the future of the Terrorism Risk Insurance Program, an issue of great importance to commercial real estate.

My name is Linda St. Peter and I am the 2012 vice chair of the NAR commercial committee. Currently, I am the operations manager for Prudential Connecticut Realty in Wallingford, Connecticut. I have specialized in commercial and investment real estate brokerage since 1988.

I am pleased to testify on behalf of the National Association of REALTORS® and its commercial affiliates: the CCIM Institute; the Institute of Real Estate Management; REALTORS® Land Institute; and the Society of Industrial and Office REALTORS®.

Although we have been safe at home since September 2001, we continue to fight the threat of terrorism. Given the existing global and economic realities, it is in the best interest of America's economic security to ensure the maximum coverage for our commercial real estate industry.

Immediately following the horrific 9/11 terrorist attacks, terrorism insurance coverage was virtually nonexistent for commercial property owners. Only when Congress enacted the Terrorism Risk Insurance Act in 2002 did coverage for terrorist attacks resume. The passage of TRIA made terrorism coverage available and, over time, more affordable.

Today, there is a concern that the uncertain future of TRIA may cause insurance prices to fluctuate. Further, this uncertainty may prompt insurers to drop terrorism coverage if a reauthorization of the program is not in place by the end of 2014.

This became evident in 2005 when private insurers became more reluctant to offer terrorism coverage due to uncertainty regarding the program's extension. Ultimately, the uncertainty of insurance pricing impacts our net operating income and property values. The potential unavailability of this coverage at the end of 2014 will impact our financing agreements and potentially hurt the fragile commercial real estate market.

Affordable and available terrorism insurance is a vital component of most commercial real estate transactions. It is estimated that 84 percent of outstanding commercial mortgage balances require terrorism insurance. Thus, if TRIA were to expire and insurers subsequently dropped terrorism coverage, these loans would be in technical default.

While the commercial real estate finance market is starting to show signs of life, any disruption in the availability of terrorism insurance in this sector would have serious consequences on its fragile road to recovery. Currently, we are seeing improved access and lower premiums due in part to the continued improvement in an insurer's ability to manage terrorism risk and to model the measurement of an insurer's aggregate loss exposure.

Despite improvements in the measurements, the frequency and severity of terrorism attacks cannot be reliably assessed by insurance companies. Insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses and continue to have limited availability to reinsurance. Thus, without the Federal program for potential insurance losses related to terrorism, we believe coverage availability could decline significantly.

Furthermore, we believe an effective homeland security strategy is central to our Nation's economic security. To protect our economic assets, we believe the time has come for Congress to enact a long-term solution for insuring against terrorism. Ideally, we would envision a structure that would finance all terrorism risks.

In conclusion, affordable and accessible terrorism insurance is an integral part of the health of all commercial real estate markets. The TRIA program has been successful because it provides for the sharing of risk between government, private insurers, and policyholders.

Ultimately, it is critical for the U.S. economy that commercial policyholders be able to obtain coverage for terrorism risk. Therefore, I strongly urge that TRIA be extended beyond its 2014 authorization.

Thank you.

[The prepared statement of Ms. St. Peter can be found on page 131 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

As I previously announced, the subcommittee will recess and reconvene promptly at 11:45. At that time, any Members wishing to give opening statements may do so, and then following any Member statements, panel one witnesses should plan to participate in a question-and-answer period with Members, and then we will go to the second panel.

The subcommittee stands in recess.

[recess].

Chairwoman BIGGERT. This committee will reconvene, and we have an opening statement from Mr. Green from Texas.

You are recognized for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman.

I especially thank you for this hearing. I think that it is one that is quite timely and needed.

Madam Chairwoman, having just left the 11th observance of the September 11th circumstance, the Congressional Remembrance Ceremony, I think it is appropriate for me to take just a moment and remind ourselves that we are the land of the free because we are the home of the brave—not an original quote, but one that is still a reminder to us that we should appreciate the many persons who make it possible for us to have all of these opportunities that we have in this great country, who make liberty and justice for all real, government of the people, by the people, for the people real, more than just an ideal.

And I would just like to thank all of those first responders who rushed in on that day 11 years ago, and all of the persons who were not first responders but who stayed behind to help people, just ordinary citizens who found themselves in an extraordinary circumstance. I just want to be grateful. To live in the United States of America is really a blessing and I am grateful to those persons.

And I am also grateful to those who are in distant places who risk their lives on a daily basis to protect the freedoms that we cherish. They mean something to me and I want them to know it. So for just this moment, I want to be grateful and thankful to our first responders and those who serve in our military, wherever they happen to be.

Now, this hearing addresses TRIA and I will be quite candid with you, dear friends. My feelings on this topic are somewhat ambivalent; my thoughts are ambivalent because on one hand I—Mr. John, I appreciate what you said about developing a private market. I really do.

But on the other hand, I have some degree of consternation as to what happens if we back off and the market doesn't step forward? How does that impact an economy that is fragile now—I am not sure what the circumstance will be then, but I do have some concern.

So hearing you today has been a benefit to me, and I will have some questions in just a moment, but this is not an easy question to answer. It really is not. I think that this requires that we be exceedingly thoughtful because of the broad implications associated with our actions. This is not something to take lightly.

A lot hinges on how this program will work, and ultimately the question seems to be "to backstop or not to backstop?" I am sure that there are other ways to express it, but will the Federal Government have a hand, whether hidden or openly available to be seen, have a hand in this program?

Thus far, it seems to have functioned rather effectively. Perhaps some tweaking is necessary, but it is not a program that I am eager to abandon although, Mr. John—I hate to keep singling you out and mentioning your name—I think you make a good point about how will you ever know if there can be a private market if you don't give the private market an opportunity to become the market—to accept its responsibility and do what it can to the extent that it will?

So my feelings are ambivalent. I want to hear more about what you have to say, but I respect every one of you and the positions that you have outlined.

Ms. St. Peter, what you said about the REALTORS® was important and I appreciate your positions, all of you, and I look forward to having you answer some questions.

And I yield back the balance of the time, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

Are there any further opening statements?

Then, we will proceed with the questions and Members will be recognized for questions for 5 minutes, and we will try and keep to that time. And I will yield myself 5 minutes.

Obviously, I think what Mr. Green has just talked about is the crux of the problem right now or what is going to happen for the future, so I wanted to start with that. And obviously TRIA, and what you have all said, it was created on the assumption that it would be temporary until the private sector develops models to assess and price for terrorism risk.

So part of the question is, why have the basic assumptions that the creation of TRIA changed from a temporary nature to show now something resembling a permanent government insurance program? And have government or private sector entities developed those models anticipated at the creation of TRIA?

And so, could someone explain why the models haven't been developed and described, if they can be developed and—whoever would like to start with that.

Dr. Hartwig?

Mr. HARTWIG. I could start with that. You talked about TRIA being a temporary solution 10 years ago, but unfortunately, the war on terror, as it turns out, is not temporary and it is going on today, and it is a constantly evolving threat. It morphs over time, the nature of the threat, from when at one time we were all haunted by the face of Osama bin Laden, okay? Now he is dead but we know that there are plenty of other problems even if you listen to the report—in my testimony, I quote the State Department's most recent point on country risk—on country risk, and they talk about even al Qaeda and other entities as being an ongoing risk and threat to the United States.

It is also the case that the nature of terrorism risk is different in that we harden targets like the new World Trade Center, but then terrorists move to softer targets. If you look at the list of targets where there were attempted attacks in my testimony, it is only by the grace of God that we escaped some of those. And we might be having a very different hearing today.

But, at the end of the day, we have a number of issues with respect to being able to model terrorism risk and I hinted at them. We have no sense of when or where or how these attacks might occur.

This is very different from hurricanes. We know where they occur, we know roughly what they do, we know when they occur. We don't know anything, really, about that with respect to terrorism.

And it is also the case that the tactics are changed by terrorists over time. Whereas, we can design stronger buildings and we know that is ultimately going to reduce losses from hurricanes, we don't know that about terrorist attacks because terrorists can change their strategies at any time.

It is very much the situation that the war on terror is, in fact, a war. And war risk has always been excluded from all policies basically worldwide, and that is the situation we find ourselves in today.

Chairwoman BIGGERT. Thank you. I know with hurricanes and tornadoes and everything, we know about the time, but we never know about the extent of them or how dangerous they are going to be, or whether it is going to be another Katrina, or whether Isaac doesn't hit as hard.

Mr. HARTWIG. Right. But we do have good models that tell us what range they are likely to fall in, and all insurers model these and make sure they have enough capital on hand to handle this. And unfortunately, we are not able to do that with terrorism.

Chairwoman BIGGERT. We have had the flood insurance bill and, similar to the flood insurance, does the existence of TRIA preclude any meaningful development of the private sector terrorism insurance market? In the flood insurance bill, we are having a study but want to phase in or have some of the insurance companies take over the risk there when we have more of the actuarial tables. Is this similar, is that something that we could do with the terrorism factor?

Mr. MICHEL-KERJAN. Let me say I think that is exactly what TRIA has done. When you look at how TRIA was designed originally to—but that program being temporary, I think being temporary gives you, Congress, and the White House the flexibility to renew the program as things change around the world or within the United States. I think that being a temporary program is not necessarily a bad thing if it is not to be renewed every 3 months, as we have seen with the—until you took the leadership on that.

I think TRIA has evolved from heavily exposing the Federal Government and the American taxpayers at the beginning of TRIA to being less so today, and one route would be to continue that increased take-up rate of the private sector. The question is at what price, and that is really what this is about.

We talk a lot about capacity, what the private market can do. The question I would like to raise is, what would be the price of that coverage as we go up, and up, and up in terms of coverage? So I don't think that being a temporary program is a bad thing in itself.

We had the same discussion back in 2002 and 2003 about whether it should be capped at $100 billion. Is $100 billion a magic number? What about $90 billion? What about $150 billion?

Chairwoman BIGGERT. If I may, then, reinsurance assumes some or all of the risk currently assumed by the Federal Government and the taxpayers?

Mr. MICHEL-KERJAN. It is already happening, but maybe other companies would like to—already happening for the deductible that these insurance companies have today.

Chairwoman BIGGERT. Is there a percentage of what is being done by reinsurance now? Do we know that?

Mr. MICHEL-KERJAN. Mr. Hartwig—

Chairwoman BIGGERT. Okay.

Mr. HARTWIG. I don't know that offhand. I believe there is a substantial share that is reinsured, and the share that is reinsured is a decision that each individual insurer makes based on many criteria according to how much exposure they have, and how concentrated that exposure is. But reinsurance plays an extremely important role in this, as it does in any major catastrophic or potentially catastrophic event.

Chairwoman BIGGERT. Thank you. Maybe if you could get back with—if there is a percentage or numbers there. Thank you.

Mr. Green, you are recognized for 5 minutes,

Mr. GREEN. Thank you very much, Madam Chairwoman.

So that the record will be very clear and I will gain some degree of clarity, if you are for simply extending TRIA as is would you kindly extend a hand into the air? I am sorry I have to do it this way. It probably will make it a lot faster. Just raise your hand if you are for extending it as is—TRIA—persons on the panel.

Some of you are conferring. All right.

All right, so Mr. Lundberg, is that correct?

Mr. LUNDBERG. That is correct.

Mr. GREEN. Anyone else? Okay.

If you are for extending TRIA, but with some modifications, give me your yea or nay. Okay. So that is Ms. St. Peter and Ms. Ochenkowski. Okay. All right. So only two?

Okay. Mr. Hartwig and Dr. Michel-Kerjan? Okay. All right.

Now, if you are for eliminating TRIA and moving straight to the private market—I knew your hand would go up, Mr. John. Okay, Mr. John, you are there. Okay.

So, did I cover everybody with those questions? Is everybody in one place or another now?

Mr. Hartwig, you said—actually, your comments led me to conclude that you are concerned about risk assessment and the inability to engage in intelligent risk assessment causes you to conclude what, that we—

Mr. HARTWIG. Right. The conclusion is that terrorism fundamentally is not fully insurable in the private sector because the risk cannot be fully assessed either in terms of the likelihood of such events or the ultimate cost of such events.

Mr. GREEN. And as a result, you would have a hybrid system—a system that has the Federal Government as well as the private market involved in the insurance process?

Mr. HARTWIG. Right, that there is a role for the Federal Government there, and after a 7-year extension such as we have had, it is appropriate to take a look at that program and see where it might be tweaked in hopes of improving that program. But the experience here in the United States and abroad suggests that these programs work best when there is a sovereign or a—

Mr. GREEN. That is a great segue into my next question. How are other industrialized countries managing this problem? Is anyone aware?

Mr. HARTWIG. Probably a number of us may be—I will just take one shot and then maybe—

Mr. GREEN. Okay. If you can do it quickly, I have a couple of questions—

Mr. HARTWIG. In our testimony, I think these are documented on the part of some of us, but maybe the most commonly cited example is in the U.K., which established a pool, the Pool Reinsurance Company, literally known as Pool Re. It is a mutual insurance company. It was established in 1993 as a result of the IRA, so it has been in operation, very smoothly been operating for 20 years now.

It has since been expanded to incorporate all sorts of terrorism risk. And that was actually the original model—something like that was put forth in the wake of 9/11 right here in Congress.

Mr. GREEN. Mr. John, I have to give you an opportunity to offset, to the extent that you desire—how would you have the model work, please?

Mr. JOHN. We have a model, basically, that was developed—

Mr. GREEN. Could you get closer to your microphone or turn it on? I am not sure which.

Mr. JOHN. Sorry. We have a model that was developed with negotiations with the Bush Administration as—after the 9/11 situation. The problem is that the model is flawed, and this is, unfortunately, true with most Federal insurance programs or reinsurance programs because it assumes that it will continue precisely as is until a set date when hypothetically it ends. And essentially what happens is that industry gets comfortable with it and their customers get comfortable with it because they know what the—

Mr. GREEN. What would you have us do? I have about 40 seconds left. What would you have us do?

Mr. JOHN. What I would have us do basically is phase it out, that essentially there were a series of measures that were ironically put forth in the 2011 Obama budget, which is not something I usually praise, that actually would set to gradually end the government involvement and we will see precisely how the industry develops and how they react to that. I expect they won't be happy. I expect there will be a lot of catastrophic talk about the disaster that will overtake their customers and the like. I expect that—

Mr. GREEN. How will this talk—a lot of things have to do with certainty in the minds of consumers as well as in the marketplace.

How will this uncertainty impact the economic order, is the question?

Mr. JOHN. Oh, I think any change is going to have some impact on the economic order. However, if you give them a firm glide path to end the program and phase it out, they will deal with it.

Mr. GREEN. My time is up.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

Mr. Hurt, you are recognized for 5 minutes.

Mr. HURT. Thank you, Madam Chairwoman. Thank you for holding this hearing on this important subject at this auspicious time.

It occurs to me it is proper to agree with Mr. Green and I know everyone on this dais agrees that obviously what we saw 11 years ago is something that we don't want repeated and we certainly should always take the time to recognize those who made that ultimate sacrifice and who lost their lives in that terrible, tragic—on that occasion.

I think as we just left from the Capitol steps and I think it was said more than once that we will not forget, I think this is—this hearing is a reminder of—that we will not forget in many ways. I don't think we as Americans should live in fear and I think that we are committed to doing that, but I think also there are very real impacts of what happened on September 11th and how we go about doing our business.

And so I appreciate each of the witnesses being here and helping us try to figure out as Members of Congress how to go forward in making sure that we protect ourselves and our property as best we can.

I guess my first question would be for Mr. Lundberg. I would be interested to know from your perspective, if the program were to expire are you all able to—is the Chamber able to give us some idea of what the immediate impact or the short-term, long-term impact of just having—suddenly not having this insurance available would be?

Mr. LUNDBERG. Sure. Congressman, I think we already have experience with what the impact might be as an expiration date approaches of the TRIA program. We saw it in 2005 and we saw it again in 2007 where insurers began to inform policyholders that their terrorism coverage would be withdrawn and that coverage would no longer be available after the expiration of the TRIA program.

So TRIA really has been, in our view, kind of a silent pillar supporting the economy—the broad economy—and to pull it out from under the economy would be a grave mistake. And we just merely need to look back at our experience with two reauthorizations already to know how the market and how insurers react as that expiration date approaches.

Mr. HURT. Great.

Dr. Hartwig, I was wondering if you could elaborate a little bit on some of your testimony, and I apologize for missing your initial testimony, but I was wondering, are there figures that are widely accepted for what insurance companies paid out as a consequence of September 11th and what the government ultimately paid out as a consequence of September 11th for losses?

Mr. HARTWIG. The private insurance sector, including reinsurers, at the time paid $32.5 billion. In today's dollars, that is exactly $40 billion.

Mr. HURT. Okay.

Mr. HARTWIG. That is $40 billion in private insurance losses.

The Federal Government obviously declared disaster areas and there was a lot of aid not just to the New York metropolitan area but other areas as well. That did total, I think, tens of billions of dollars, but in terms of direct aid to businesses, that money was—essentially the vast majority of it came from private insurers. The dollars that came to treat workers who were killed—sorry, who were injured or the families of those who were killed, that was all private sector dollars that came in there.

And so it really was the case that the private insurance industry was the economic first responder at ground zero and helped literally—literally, when you go there today is rebuilding those towers.

Mr. HURT. Mr. John, could you elaborate a little bit more on—I think in a perfect world, everybody would like to see the taxpayer not bear any burden for something that is a proper risk function in the private sector, but what stands between having a policy—having the private marketplace offer this insurance? You talked about his modeling that is not complete. Is it realistic to think that is something that is going to emerge?

Mr. JOHN. Yes. I hear the stories of how every terrorism risk is different. But the fact is that every hurricane is somewhat different, also. If you look at the effect of Hurricane Katrina on the property prices—the property insurance prices all along the east coast in relatively low-lying areas you see that in the years—couple of years immediately succeeding that you see an adjustment where companies raised rates, they dropped risks, and things along that line.

Yes, we can start to model this sort of thing but the fact is that the industry has no need to model it at this point. The industry has a situation that it is very comfortable with and it doesn't need to do anything else.

Mr. HURT. I think my time has expired.

I thank you all.

Chairwoman BIGGERT. Thank you.

Mr. Stivers, you are recognized for 5 minutes.

Mr. STIVERS. Thank you, Madam Chairwoman. I would like to thank you for calling this important hearing on this appropriate day to talk about terrorism risk insurance and the future of the program, even though we have a couple of years before we have to worry about expiration.

Mr. Hartwig already discussed how the exposure to terrorism at 9/11 was about $40 billion to the private marketplace. At what point would—if 9/11 had happened and TRIA had been in place as it exists today, at what point would TRIA have kicked in and how much would it have helped the private insurance market?

Mr. HARTWIG. The overall—and subject to check, I believe the overall industry retention today is about $27 billion or so, so it is—the vast majority of attacks that would occur today would likely be covered in whole or at least the majority by the private sector. And over time the industry's retentions have been ratcheted up, I think precisely for that reason.

Mr. STIVERS. So if 9/11 were to occur today, how much of that $40 billion would the private sector pay?

Mr. HARTWIG. The private sector would wind up paying somewhere around 70 to 75 percent of that.

Mr. STIVERS. Okay.

Mr. HARTWIG. And then ultimately, of course, there are recoupment mechanisms in place so that the Federal Government does not wind up with any obligation.

Mr. STIVERS. And the recoupment mechanism today is at 133 percent, no 100 percent. Is that correct, or—

Mr. HARTWIG. I am not quite sure at the moment. I would have to check.

Mr. STIVERS. Okay.

I will move on to the next question, again for Mr. Hartwig, and then I do want to move to Mr. John.

One of the key points you brought up, Mr. Hartwig, was that the private sector in the reinsurance market doesn't have the information they need to be able to price the risk. So, for example, unlike a hurricane, where there are many predictive models, all the information is public, many of the risks that are associated with terrorism are not public information and are hard to price because of that. Is that what you were saying earlier?

Mr. HARTWIG. Absolutely. Much of the information insurers would need to actually price this risk, were it possible, is classified. We do not have any access to information at the NSA or the CIA or anyplace else like that so we don't have any understanding other than what we can read and glean from the ordinary press and public sources about what the likelihood of an attack might be.

This is very different, whereas such things as hurricanes and earthquakes and tornadoes are the subject of research constantly. We learn more and more about it every year.

Mr. STIVERS. Great. Thank you.

Mr. John, at the end of Mr. Hartwig's testimony he called for a pooling proposal similar to what they do in Great Britain. It is not similar to what you would like to see, the whole program just expire. But is that better than the current TRIA program, the way you see it, or is there no good answer other than just letting it expire?

Mr. JOHN. There is no great answer. Let's put it that way.

The pooling mechanism would probably be superior depending on what was done to limit the taxpayer risk. That is going to be the continued question here and the industry, as I say, is going to continue to press for just a continuation of what they have had in the past.

Mr. STIVERS. And I do want to follow up with you, because I share your concern, Mr. John, and I think the empirical evidence shows that government does not price risk very well. In this subcommittee, we have tried to shore up the flood insurance program, which is one example of that. Fannie Mae and Freddie Mac are a second example of that. FHA's pending financial crisis—I won't call it a collapse—is a third example of that. And today, the only reason

TRIA hasn't been a problem is there have been no claims under TRIA because we haven't had a big incident to cause that.

So I am concerned with the issues you bring up but I am intrigued, I will say, by Mr. Hartwig's pooling mechanism because I do think that there needs to be some type of way to price this risk, and it might be an example that can do it with some reserves, and there would have to be some information-sharing with this mutual insurance company. But it is an intriguing proposal to me, I guess, I would like to say, and I wanted—since you were kind of the hardest-core witness on the panel, I figured I would ask you about it.

Mr. JOHN. You have a couple of years, and that is one of the beauties about starting this process early. You can examine a wide variety of different situations and proposals and make a decision accordingly.

Mr. STIVERS. Thank you.

Does anybody else have any comments on the pooling proposal? I have 19 seconds left.

Mr. MICHEL-KERJAN. I might say, I think it is important in the case of Pool Re that it is not just a pooling proposal. The pool has an open line of credit from the British government in case of something that happens. The pool today has 4.7 billion pounds of reserve, which is barely taxed by the British government. There are a lot of details to be looked at, and there are other countries with developing pools with and without intervention from the Federal Government as well.

Mr. STIVERS. Thank you. I yield back the nonexistent balance of my time.

Chairwoman BIGGERT. The gentleman yields back.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Thank you.

First, a general comment about the whole idea of Federal involvement in disaster insurance: I remember, I think it was Midas Muffler that had the commercial, "You can pay me now or you can pay me later."

Disasters are going to happen, and when they happen, Ayn Rand is not going to be in control of the United States Congress and we are going to appropriate money for the uninsured losses of victims. This may not have been true in the 1800s; it may have not been true in "The Fountainhead." But it is true in today's America and it has been true since the great floods along the Mississippi radically changed the view of what the Federal Government should do in a disaster.

Those who believe that if we spend zero money promoting disaster insurance now we can also have a zero special appropriation when a disaster hits had better get themselves time machines because that is the only way they are going to be able to live in the 1800s.

So it is in our interest to make sure that uninsured losses are as low as possible.

Ms. St. Peter, the commercial real estate industry is in the midst of a really tough liquidity crisis, perhaps the worst since the Great Depression. How would the limited availability of affordable terrorism insurance impact the ability of commercial tenants and property owners to access credit?

Ms. ST. PETER. Thank you, Congressman, for that question.

As you mentioned, financing is still a challenge in our fragile market. And I don't work in large towers, I work in what I will call "Industrial Way" and "Main Street," where manufacturers are looking to finance 10,000- or 20,000-square foot properties where 30, 40, or 50 people are employed. What we are seeing now with the limited financing available, the "yes" may have a qualifier of about 45 contingencies, which is sort of like a "no," but it is a "yes, but." If the terrorism insurance were not available that could be a deal-breaker. That could be a deal-breaker—

Mr. SHERMAN. So you find that banks are not willing, lenders are not willing to loan to an industrial facility with 50 employees, not particularly in the news, not one of the places that al Qaeda dreams of hitting, that even then the lenders have on their list, "Do you have terrorism insurance?"

Ms. ST. PETER. Yes, they do. And a host of a whole other contingencies as well.

Mr. SHERMAN. Okay.

Now, some of my colleagues have raised the concern over the Federal Government's costs in this area. I just want to confirm with the panel: So far, TRIA has cost the taxpayers virtually nothing? Is that true, Ms. St. Peter?

Ms. ST. PETER. Not a red cent, save, of course, the administrative fees.

Mr. SHERMAN. Does everybody else on the panel generally agree?

Mr. JOHN. I am just going to point out, it has never been used so the—

Mr. SHERMAN. Yes.

Mr. JOHN. —one of the ways of reducing costs is never to use—

Mr. SHERMAN. Right. The most important thing we can do is prevent another terrorist attack, and that is the work of other committees in this Congress.

Ms. OCHENKOWSKI. An additional comment to the question on lenders, with respect to my own company, Jones Lang LaSalle, as well as some of my colleagues in the risk management group, I do know that in addition to the comment about lending, we also have tenants who require that they have terrorism insurance before they move into certain property, and absent having evidence of terrorism insurance, they will choose to go to a different property.

And in addition to tenants, there are also investors in commercial real estate who look for confidence in the ability to rebuild following an event, and if they can invest in a country that has—because investments are global, if they can invest in a country in which a concern about terrorism is not going to impact their investment, they may take their money out of America and put it into another area.

Mr. SHERMAN. Thank you.

I believe my time has expired.

Chairwoman BIGGERT. Thank you.

And this will conclude the questions and answers. The Chair notes that some Members may have additional questions for this panel, which they may wish to submit it writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

I would like to thank you all so much for your testimony. You really gave us a lot of knowledge that we will be using in the future. So with that, this panel is dismissed, and we will bring up the second panel now. Thank you so much.

We will resume with the second panel: the Honorable Steve Bartlett, president and chief executive officer, the Financial Services Roundtable; Mr. Darwin Copeman, president and chief executive officer, Jewelers Mutual Insurance Company, on behalf of the National Association of Mutual Insurance Companies; Mr. Jon A. Jensen, president, Correll Insurance Company, on behalf of the Independent Insurance Agents and Brokers of America; Mr. Michael H. Lanza, executive vice president and general counsel, Selective Insurance Group, Incorporated, on behalf of the Property Casualty Insurance Association of America; Christopher M. Lewis, senior vice president and chief insurance risk officer, The Hartford, on behalf of the American Insurance Association; and Mr. Edward B. Ryan, senior managing director, Aon Benfield, on behalf of the Reinsurance Association of America.

I would like to welcome all of you here today. This is probably the easiest panel I have had in a long time as far as how to pronounce your names, so I thank you for that, and I thank you all for being here.

And we will start with Mr. Bartlett. You are recognized for 5 minutes.

STATEMENT OF THE HONORABLE STEVE BARTLETT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE FINANCIAL SERVICES ROUNDTABLE

Mr. BARTLETT. Thank you, Chairwoman Biggert, Congressman Green, Congressman Hurt, and other members of the subcommittee.

Let me confess to you, I don't relish my role today, and I suspect the other witnesses don't either—the role to be the bearer of bad news. It had been my hope, and I think the hope of most of those in the industry that today we would be able to come to you and say there is no longer a need for TRIA, but in fact, there is an enhanced need for TRIA today moving forward. The nature, the severity, and the predictability, or lack of predictability, of a terrorist attack in fact ensures that a continued Federal backstop for insurance—paid for by the industry but a Federal backstop—continues to be essential.

The threat of terrorist attacks is just as real today as it was 10 years ago. There still exists that essential need—it is not an option—of a public-private partnership, a backstop, if you will, to protect against catastrophic losses arising from a terrorist attack. And let me stop at this point, and I will repeat this again and again. That backstop would be paid for, the cost would be borne by the private sector. Most of the costs would be—in the event of an attack would be borne up front by the private sector, and should there be a need for additional funds, you would be using the backstop.

TRIA sets in place a vehicle to recoup those losses. So the fundamental of TRIA is that it sets in place an ability to recoup the losses. Without the Terrorism Risk Insurance Act reauthorized, there would be no mechanism for recoupment.

So in at least a considered opinion of the entire industry—lending, insurance, business, operations, real estate—TRIA should be renewed by this committee in this Congress sooner rather than lately. I don't come to that conclusion lightly. I looked for other answers but did not find them.

Roundtable member companies, as you know, consist of finance, lending, insurance, and investing in the economy, so we come at it from all places. There is no government money involved in TRIA except in the event of a catastrophic loss that cannot be contained within the private sector, which is quite large. And even then, there would be no government losses; all the government losses would be recouped.

So the two parts: One is, what does TRIA mean for the economy ongoing in the absence of an event? TRIA is designed to mitigate the negative economic impact from stalled or stopped real estate development and activities of ongoing operations that did occur following 9/11 and then began to occur in the run-up to the reauthorization of TRIA subsequent to that.

So in fact, after 9/11 we saw fairly quickly $15 billion in real estate-related transactions delayed or cancelled and 300,000 jobs lost, and it was getting bigger and faster and worse by the day. TRIA includes a make-available provision, which means that insurers must offer terrorism insurance to commercial clients. With that coverage available then banks looking to lend and investors looking to deploy their capital can do so while also protecting their investments from the threat of an attack.

Without that Federal backstop, insurers' limited ability to manage terrorism risk would become unstable and they would withdraw from the market. That is not supposition or hyperbole. That is exactly what would happen.

Even in the case of operations that are currently in place with an existing loan would be as they did begin to shut down, because if you have a loan in place and you lose your insurance you are in default on the loan and really bad things start to happen in the market.

Now, in the event of an attack—I am going to the other—so either no attack or in the event of an attack—in the event of an attack TRIA, at its heart, establishes a mechanism for the private sector to absorb most of the loss, and anything that the private sector does not absorb would be repaid to the government by a mechanism put in place by mutual assessment on all policyholders.

Some would contend erroneously that TRIA exposes U.S. taxpayers to losses. The opposite is true. Without TRIA, taxpayers would be subject to those losses but they would be uncontained and there wouldn't be a legal ability to recoup those losses.

The initial losses—nothing triggers it until $100 million. The initial losses of each company pays their entire loss up to 20 percent of its direct written premium. In most cases, that is about $1 billion. And then losses above that 20 percent deductible would trigger a 15 percent copay or co-insurance.

So if government funds are used it would be a loan and TRIA provides for a recoupment of the loan.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Bartlett can be found on page 47 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Copeman, you are recognized for 5 minutes.

STATEMENT OF DARWIN COPEMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, JEWELERS MUTUAL INSURANCE COMPANY, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES (NAMIC)

Mr. COPEMAN. Good afternoon, Chairwoman Biggert, and members of the subcommittee. Thank you for the opportunity to speak with you today.

As mentioned earlier, my name is Darwin Copeman and I am president and chief executive officer of Jewelers Mutual Insurance Company, a small company licensed in all 50 States, and the only insurance company in the United States that specializes exclusively in protecting the jewelry industry. The majority of our policyholders are one-to three-location enterprises. Our company participates in the TRIA program and understands firsthand its importance.

I serve on the board of directors of the National Association of Mutual Insurance Companies. NAMIC represents more than 1,400 property and casualty insurance companies, including small farm mutuals, State and regional insurance carriers, and large national writers. NAMIC members write about one-third of the commercial business in the United States.

The subcommittee has our appreciation for its attention to the Terrorism Risk Insurance Act and for discussing its vital role in helping protect our country and our economy as we continue to consider how best to handle the terrorist threat.

It is our firm belief that the presence of the TRIA program has provided the stability and predictability needed to allow insurers to actively participate in the market for terrorism risk coverage. Without the TRIA program, coverage for terrorism will become very difficult to find and the result when the next terrorist attack occurs will be more, not less Federal exposure as the government will be under extreme pressure to pay for all losses.

Before the events of September 11th, the abstract possibility of a major terrorist attack on the United States was known but largely dismissed and was included in most all-risk commercial policies. After the tragedy in 2001, every American's understanding of the nature of terrorism risk forever changed.

Insurers also realized this new risk threatened the solvency of their businesses. Accordingly, the terrorism coverage market greatly contracted, particularly in high-risk urban areas. This had a punishing effect on the U.S. economy. It was estimated at the time to have delayed and canceled $15.5 billion in real estate transactions and to have cost 300,000 construction workers their jobs.

The significant lack of coverage prompted Congress to pass the Terrorism Risk Insurance Act in 2002 to create a viable market for terrorism coverage, which allowed lenders to provide the necessary capital to resume building in high-risk areas. TRIA set a ceiling on potential insured losses and reduced the fear that a worst-case terrorist event could render an insurer insolvent.

At the time it was thought that a truly private market for terrorism would develop after insurers had time to build capacity and study the risk. However, it soon became apparent that the program is indispensible to protect our national economic security.

The nature of the terrorist threat presents significant complications for the insurance industry. The lack of relevant event data usually used in disaster modeling makes it impossible to meaningfully calculate the likelihood, the nature, or the extent of a potential event, particularly in an age of mass casualty terror. This makes adequate pricing and reserving virtually impossible.

The interconnected nature of our local, national, and global systems complicates both underwriting terrorism risk and mitigating against it. The vulnerability of one organization is not simply dependent on its own security decisions but also on the choices and actions of other organizations and agents beyond its knowledge or control.

For example, a company might spend a significant amount of money to secure a facility, while a neighboring company does not, and is then used as a staging area for an attack.

The only truly effective mitigation tools, if there are any, reside within the government's national security apparatus, and these are understandably kept secret.

Finally and most importantly is the human element. In other words, terrorist events are not random events. The presence of human volition drastically reduces the value of preventative measures. A hurricane cannot study wind damage mitigation efforts and then think up new ways to get around them; but humans intent on committing acts of terrorism can and do find ways to circumvent security measures.

Over the last 10 years, the private insurance industry has increased its capacity to handle risk from terrorism events. However, we must recognize that the marketplace, as it stands today, has developed with TRIA in place. We should not hastily conclude that because the private sector can handle a portion of the risk, it could handle all of it. In fact, we know that it can't.

Without a Federal program that provides a clearly defined cap on the potential risk to an insurer, the supply of terrorism risk insurance would be drastically curtailed, just as it was in the aftermath of 9/11, and in the end the government would bear the ultimate risk of uninsured losses. The presence of a well-managed partnership between the government and private insurers serves to ultimately reduce, not increase Federal liability for terrorism losses.

In conclusion, in order to encourage private sector involvement in the terrorism insurance marketplace and thereby protect and promote our Nation's finances, security, and economic strength, we must maintain a long-term Terrorism Risk Insurance Program. While there is room for debate about the proper scope of government involvement, there should be no question that the Federal Government should continue to collaborate with the private insurance industry to allow Americans to recover and rebuild if such an attack should ever occur.

As we move forward, NAMIC stands ready to work with Congress on this vital issue. Again, thank you for the opportunity to speak here today, and I look forward to answering any questions you may have.

[The prepared statement of Mr. Copeman can be found on page 53 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Jensen, you are recognized for 5 minutes.

STATEMENT OF JON JENSEN, PRESIDENT, CORRELL INSURANCE GROUP, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA (IIABA)

Mr. JENSEN. Good afternoon, Chairwoman Biggert, and members of the subcommittee. My name is Jon Jensen and I thank you for inviting me to testify today on behalf of the Independent Insurance Agents and Brokers of America, also known as the Big "I."

I began my insurance career over 35 years ago and now serve as president of Correll Insurance Group, a South Carolina-based insurance agency with 12 offices and 132 associates. Independent agents sell nearly 80 percent of all commercial lines policies in the country, which affords our membership a one-of-a-kind perspective to speak to the topic of terrorism insurance and businesses' needs for such coverage.

The first point I would like to make is that the need for terrorism insurance is not limited to simply urban areas. My agencies operate in primarily rural and suburban areas and I have many clients with a need for this coverage.

For example, I have two colleges, a large public hospital system, and more than 300 emergency service organizations such as volunteer fire departments, municipal fire departments, rescue squads, and first responders who opt to purchase terrorism insurance. Serving the needs of these and other clients is a top priority for me, and the Terrorism Risk Insurance Program has helped ensure that they have their necessary coverage.

With the scheduled expiration of the program quickly approaching at the end of 2014, I applaud the committee for holding this hearing now to examine the program and how it is serving businesses throughout the country. Even though the program expires on December 31, 2014, because of the forward-looking nature of insurance contracts, the real deadline for congressional action is December 2013.

The enactment of TRIA in November of 2002 was a key element of our government's response to the heinous acts of 9/11. The attacks quickly produced severe disruptions in the insurance marketplace and in our national economy. The underwriting and pricing of these unique exposures proved nearly impossible due to the inability of carriers to measure the likelihood and the magnitude of future terrorist attacks and many insurers were forced to stop providing terrorism coverage to commercial policyholders as a result.

The inability of businesses to secure adequate terrorism coverage also had negative effects across broad sectors of the national economy, particularly in commercial real estate. The original enactment of TRIA, and its extension in 2005 and again in 2007, successfully stabilized the insurance marketplace and helped eliminate the market disruptions that followed the September 11th attacks.

In addition, Congress wisely structured the program so as to involve the private sector as much as possible and created a successful and limited public-private partnership for commercial property and casualty insurance that is operated at virtually no cost to taxpayers. Should the worst happen and a need for the backstop arise, TRIA also has numerous cost-sharing provisions that limit the exposure of the Federal Government and ensure skin in the game for the private sector. These include provisions such as a program trigger as well as deductibles, copays, and minimum loss retention amounts for the private sector.

The bottom line is that many of the factors and marketplace realities that caused Congress to originally enact and reauthorize TRIA largely remain in place today. Despite the significant progress that has been made in protecting our country from terrorists, the threat of terrorism remains with us daily.

Such risk can still not be assessed by traditional methods. In many instances, insurers simply do not have access to the data and information to perform proper underwriting as much of the information does not exist, is available only to governmental entities, and they fiercely guard it for understandable security and law enforcement reasons.

We believe that it will be extremely difficult or even impossible in some instances for many businesses to obtain adequate and affordable terrorism insurance coverage if the program is allowed to expire with no public policy solution in its place. Although our Nation has thankfully been spared from further terrorist attacks in recent years, the threat of an attack is as great as ever and our country must take the steps necessary to protect itself and its economy from a similar future event.

The Big "I" believes that the TRIA backstop has worked well and that some form of limited Federal involvement is still needed to maintain a stabilized and viable market for terrorism insurance. Again, we applaud the committee for its foresight to review TRIA now, and we look forward to working with you as Congress considers solutions to address the unique nature of the risk presented by terrorist attacks.

[The prepared statement of Mr. Jensen can be found on page 78 of the appendix.]

Chairwoman BIGGERT. Thank you so much.

Mr. Lanza, you are recognized for 5 minutes.

STATEMENT OF MICHAEL H. LANZA, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, SELECTIVE INSURANCE GROUP, INC., ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA (PCI)

Mr. LANZA. Thank you.

Good afternoon. I am Michael Lanza, executive vice president and general counsel of Selective Insurance Group. Selective is America's 49th largest property/casualty insurance group. Today, I am testifying for the Property Casualty Insurers Association of America, our national trade association. PCI members write about 40 percent of America's home, auto, and business insurance. Today marks the 11th anniversary of the terrorist event that killed thousands and created significant economic loss and disruption.

With investment markets freezing, this committee responded swiftly to President Bush's call and passed the Terrorism Risk Insurance Act, or TRIA, in just 2 months. The House approved TRIA in 2002 and renewed it in 2005 and 2007. All three votes passed by wide margins under different Majorities, reflecting TRIA's bipartisan support.

Since 9/11, terrorist attempts have continued. Fortunately, our national security apparatus detects and thwarts most of these. TRIA is part of our economic national security defense. It provides a low-cost, fiscally prudent economic safety net if, God forbid, another attack is successful.

Absent TRIA's extension, and as State law permits, insurers in 2013 will begin to send notices excluding terrorism coverage or not renew policies on major underlying risks.

PCI and Selective strongly believe in the private insurance market. We also believe the private market can cover fully insurable risks.

TRIA protects American taxpayers in two important ways by intruding into the private insurance markets. First, by keeping the private sector largely responsible, it avoids the kind of Federal bailout that occurred after 9/11 when victim protection funds had to be established. Second, because terrorism, like crime or acts of war, is not fully insurable, TRIA creates a private market for terrorism insurance coverage. In short, it makes private capital ultimately responsible for all but the most catastrophic terrorist attack.

To be fully insurable, a risk potential loss and loss severity must be predictable. With freely available information and experience, insurers can estimate roughly how many car accidents, house fires, or industrial accidents will occur and what their costs will be. Similarly, with free access to weather pattern science and over 100 years of weather history, insurers can model storm paths and predict weather losses.

We can't do that for terrorism. The experience—notably what happened 11 years ago—is very limited. More importantly, the information needed to underwrite is not freely accessible. Properly, thin information is classified and in the hands of our government national security experts.

National security is the Federal Government's primary responsibility. That is why there is a myriad of agencies focused on anticipating and preventing terrorist acts and assessing their likelihood against major economic centers and other public and private symbols of our country. These agencies also track the pool of potential terrorists that fluctuates with changes in U.S. domestic and foreign policies.

Insurers and their policyholders cannot and should not replicate these efforts. Companies such as Selective, which writes primarily in 22 States east of the Mississippi, certainly don't have the necessary resources, and Selective's small business clients, who pay an average of $10,000 for 3 commercial policies and elect to pay for TRIA coverage 86 percent of the time, certainly don't either.

That is why we need TRIA. TRIA enables the private insurance market to provide terrorism coverage without having the information it does for other risks.

By providing insurance for terrorist events TRIA also does three other things. First, TRIA permits business capital to remain unrestricted and available for economic investment before and after a terrorist event. Second, because State workers compensation laws mandate terrorist coverage, TRIA facilitates reinsurance and keeps worker comp rates lower. And third, TRIA protects taxpayers. According to CBO, TRIA's net cost to taxpayers through 2017 is roughly zero.

We would appreciate your support for the extension of TRIA. Thank you very much.

[The prepared statement of Mr. Lanza can be found on page 87 of the appendix.]

Chairwoman BIGGERT. Thank you.

Mr. Lewis, you are recognized for 5 minutes.

STATEMENT OF CHRISTOPHER M. LEWIS, SENIOR VICE PRESIDENT AND CHIEF INSURANCE RISK OFFICER, THE HARTFORD FINANCIAL SERVICES GROUP (THE HARTFORD), ON BEHALF OF THE HARTFORD AND THE AMERICAN INSURANCE ASSOCIATION (AIA)

Mr. LEWIS. Thank you.

Chairwoman Biggert, Congressman Green, and members of the subcommittee, thank you for the opportunity to appear before you today to discuss terrorism risk insurance. My name is Christopher Lewis and I am the chief insurance risk officer for The Hartford. In the interest of time, I would respectfully request that my written testimony be submitted into the official record, and I will just briefly highlight a couple of key points for the committee.

First, over the past 11 years, the capabilities, tactics, preferred targets, weapons of choice, and even the main protagonists in the war on terrorism have dynamically changed and evolved. We are fortunate that the United States has not experienced another major attack on our soil and sincerely grateful for the tremendous efforts of our security forces to interdict and defend our country from these attacks.

Unfortunately, what has not changed over the past decade is the fundamental fact that the risk of terrorism remains an uninsurable risk. Insurers still have no credible basis for quantifying the likelihood of a terrorist attack and a limited ability to understand the potential impacts of an attack if carried out using nuclear, biological, chemical, or radiological weapons. The private sector simply does not have the information to assess this risk.

Further, the benefit of private sector mitigation is somewhat limited, as hardening security at one location only shifts terrorist selection of target or access point to a different location. And unfortunately, the capacity of the reinsurance through capital markets to finance the peril of terrorism remains de minimis. Why? Because reinsurers face the same insurability challenges that primary insurance companies face.

Second, TRIA and its successors have worked and serve as a critical component of our national economic security. By helping to finance and limit private insurers' exposure to the largest catastrophic terrorism events—events with projected losses greater than any historical commercial insurance loss on record for any peril—TRIA enables insurance companies to offer terrorism coverage to commercial policyholders.

In the event of a future attack, private insurance payments will immediately flow to affected businesses that have purchased coverage and to their employees—payments that will provide stability and minimize economic disruptions not only to the people and businesses that suffer the attack directly, but to all Americans, keeping the wheels of commerce moving.

Finally, TRIA is not a giveaway to insurers but an effective means of pooling terrorism risk over time. The program preserves significant industry skin in the game. Federal assistance occurs only in the case of an extremely large-scale terrorism loss. For a large, wide-area terrorist event, insurers would need to absorb an estimated $25 billion to $30 billion in insured losses before Federal payments are even triggered.

And in the unlikely event that government funds are needed, they are ultimately recaptured and returned to the U.S. Treasury through a recoupment mechanism established in the legislation. As a result, any program costs are greatly mitigated.

Bottom line, TRIA has brought stability to the private market for terrorism insurance and it is a critical component of our national economic security. The program has been a success. From a risk management perspective, letting the program expire is simply not a risk that our country should take.

Thank you.

[The prepared statement of Mr. Lewis can be found on page 92 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Lewis.

And Mr. Ryan, you are recognized for 5 minutes.

STATEMENT OF EDWARD B. RYAN, SENIOR MANAGING DIRECTOR, AON BENFIELD, ON BEHALF OF THE REINSURANCE ASSOCIATION OF AMERICA (RAA)

Mr. RYAN. Thank you, Chairwoman Biggert, and members of the subcommittee. I am Edward Ryan, senior managing director at Aon Benfield, the world's leading reinsurance intermediary and full-service capital advisor with more than 80 offices in 50 countries around the world. I thank you for the opportunity to testify on behalf of the Reinsurance Association of America on the reinsurance perspective of this hearing entitled, "TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program."

As we mark the 11th anniversary of the attacks on the United States, we remember all the victims of 9/11. Aon Benfield and the 1,100 of us who worked in the World Trade Center continue to mourn the 176 colleagues and friends whom we lost that day.

We know the commercial insurance market and know that reinsurance availability is a key component of our economy. We therefore urge Congress to act to extend the Terrorism Risk Insurance Act.

Aon and the RAA supported the adoption of the Terrorism Risk Insurance Act in 2002, its reauthorization in 2005, and the 2007

Extension Act. The response to 9/11 by the insurance industry was to pay tens of billions of dollars in claims but also to exclude terrorism losses going forward.

TRIA created an essential Federal backstop that enabled the primary insurance industry to provide terrorism insurance to our Nation's businesses. The program has enhanced the private market for such coverage and has had a stabilizing influence on the economy. Under TRIA, the availability of terrorism risk insurance has increased.

There is a role for private reinsurance under the program. In an event certified by the Secretary of the Treasury as a terrorist attack, TRIA provides reinsurance-like protection for primary commercial insurance loss. The program provides coverage for 85 percent of the eligible loss up to an industry loss of $100 billion. Coverage is subject to an individual company retention of 20 percent of the prior year's direct earned premium on covered lines.

These company retentions and the 15 percent copay above that mean that insurers retain a significant portion of the loss before TRIA funding is triggered. Private reinsurance provides the vehicle for insurers to manage that retained loss.

Since 2001, insurers, modelers, and reinsurers have worked to develop a better understanding of terrorism risk. Companies have consulted military and intelligence experts and hired specialty risk modeling firms. Despite these efforts, terrorism risk poses great challenges as an insurable risk.

The main hurdle in assessing and underwriting terrorism risk is that the frequency of loss is neither predictable nor random. Terrorists continually attempt to defeat loss prevention and mitigation strategies. In addition, the insurance industry does not have access to all the existing information about terrorism targets and potential attacks for obvious national security reasons.

Despite these issues, reinsurers have but capital at risk to manage terrorism losses. Reinsurers offer coverage for foreign acts of terrorism—that is, acts committed by non-U.S. agents—in stand-alone terrorism contracts rather than in all-peril catastrophe contracts. The amount of such stand-alone terrorism treaty reinsurance capacity available in the private market is estimated to be between $6 billion and $8 billion, a figure largely unchanged in recent years.

The bulk of the terrorism reinsurance currently comes via existing reinsurance programs. Coverage for personal illnesss, which is not subject to the program, coverage for workers compensation, as well as for acts of terrorism committed by U.S. agents is generally available in existing catastrophe programs. Insurers with exposures in rural or suburban areas have generally secured terrorism coverage within existing reinsurance programs with limitations on the size of subject risks or events.

Regarding NBCR—nuclear, biological, chemical, and radiological exposures—there is little reinsurance appetite for this risk. When it is available, pricing for NBCR coverage comes at a significant premium and capacity is significantly less than that available for conventional terrorism.

For the foreseeable future and based on current demand, there is adequate supply of reinsurance capacity for coverage around the structure provided by the Federal program. However, were the program to terminate in 2014, we expect insurers to curtail the provision of terrorism insurance.

U.S. businesses would be more exposed to the financial consequences from terrorist activities. To the extent that this additional risk forces businesses to seek insurance, insurers would offer meaningful but not unlimited insurance products. The private reinsurance marketplace would work productively with insurers to provide reinsurance coverage for terrorism but the capacity would be severely constricted.

TRIA has served an important role to our Nation's economy. As TRIA expires in 2014, we urge this committee and the Congress to reauthorize the program in 2013 to eliminate any uncertainty around reauthorization and to meet the needs of insurers and insureds whose contracts will expire throughout the year. We commit the full resources of the Aon Corporation as well as the Reinsurance Association of America to work with the committee to achieve this goal.

Thank you.

[The prepared statement of Mr. Ryan can be found on page 127 of the appendix.]

Chairwoman BIGGERT. Thank you, Mr. Ryan.

And I note that without objection, the written statements of all the witnesses will be made a part of the record. And we will now turn to the question-and-answer period.

I will recognize Members for 5 minutes each to ask questions, and I will first yield 5 minutes to myself.

Mr. Bartlett, on page four of your testimony you state that TRIA puts in place an orderly system to make sure that the private sector absorbs most if not all of the losses. If the private sector would already absorb such losses, why could it not be put in place an orderly system of its own and continue to absorb the losses absent a government backstop?

Mr. BARTLETT. Terrorism risk is nearly impossible to model. You cannot predict frequency, location, or severity. It is an asymmetrical risk, so the upside from the premiums cannot begin to compensate for the potential downside of covering the losses.

In addition to that, the core of TRIA is a make-available provision, so that all coverage would have to make that available. Without a make-available provision, what we found out when we didn't have TRIA was the insurers would be forced to avoid the risk and they would limit their product offerings. They would limit the coverage.

So TRIA ensures that coverage is offered. It makes sure that the private sector absorbs most of the initial losses. And if there are any additional losses, then the private sector is required to recoup the losses and repay the government. So it protects all three.

Chairwoman BIGGERT. Thank you.

And then, Mr. Copeman, you say on page three of your testimony—or in the context of discussing the actuarial data insurers need to underwrite and price for terrorism risk, you state that much of the relevant data that might be used by an insurance company is appropriately kept secret by the Federal Government for national security reasons. What kind of actuarial data that is inaccessible to insurance is—that they need to underwrite and price for terrorism risk?

Mr. COPEMAN. Thank you. The primary information that would need to be available for our actuaries as well as those who develop the models is really the incidence or potential incidence of terrorism that may have occurred that we are not made aware of—those that have been stopped rather than those that actually occurred.

So again, building a model requires a great deal of data points, and the only data point that we have, for all intents and purposes, to develop these models is really two: the Oklahoma City issue, which was a domestic violence level of terrorism; as well as the New York incident. With two data points, it is inadequate information for us to be able to model that kind of data—that information.

Chairwoman BIGGERT. Okay. Thank you.

Mr. Jensen, you mentioned that terrorism coverage will once again become extremely difficult or impossible for many businesses to obtain if the program is allowed to expire and no policy solution is in place. Beyond TRIA, what other kinds of policy solutions do you envision?

Mr. JENSEN. Thank you, Madam Chairwoman. I am not sure what will be there. What we hear from our company partners, of course, is that coverage may be limited and very—a broad spectrum. It concerns us and it concerns me on behalf of my clients that without TRIA in place, they truly won't have options available to them from the private insurance carriers. And our concern, of course, is to make sure that their insurance portfolio and the products that we provide them do provide them all the coverage that they need.

Chairwoman BIGGERT. Okay. Thank you.

Mr. Lanza, you state that absent its extension, insurance policies will begin in 2013 to exclude terrorism coverage, or to the extent permitted under State law not be renewed for major underlying risk. This is supposed to be a temporary program, but it appears that the industry is unanimously asking for a permanent extension of the program?

Mr. LANZA. We are asking for an extension to match the risks of terrorism.

Chairwoman BIGGERT. Okay. At what point could the private sector assume the risk?

Mr. LANZA. I think that has been touched on. The issue is related to what information is available about what kind of risks are taking place against the country. In addition to that, you have a correlation issue, which is, for example, we can know that a hurricane in Florida is not correlated with an earthquake in California. In terrorist attacks, we have shown that they are correlated. In addition to that you have a concentration problem, which makes the severity or the amount of the loss very complicated to predict.

Chairwoman BIGGERT. Thank you.

My time has expired.

The gentleman from Missouri, Mr. Cleaver, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman.

I hope this question is not ideological, and if it is, I apologize. I am more interested in learning than ideology.

Why couldn't the private sector handle this program completely on its own? Why is it absolutely necessary? I am assuming that all six of you believe that it is necessary for the government to play the backstop role. But is it necessary? Is it absolutely essential? Can't we do it without the government involvement?

Mr. BARTLETT. Congressman, Steve Bartlett. I wish that it could be done without any government involvement at all. This program at least establishes it so there is no government money involved that would be recouped. But without a backstop it is unpredictable—the risks are unpredictable and they are uninsurable because they are so large. And the frequency and the location are totally unpredictable and the size is uninsurable. There is simply not enough money in the overall market to provide the—in the private market to provide the initial backstop, but it could be recouped over time and this law provides that it would be.

Mr. CLEAVER. Mr. Lewis?

Mr. LEWIS. Yes, thank you. I think it is also important to keep in mind what a private market solution could be. Given the insurability issues that we have mentioned with respect to terrorism insurance—we can't predict the frequency, we don't understand the severity, these are non-random acts, terrorists are out to inflict maximum damage by picking the soft points. As insurance companies in the private sector trying to just intermediate that risk for our policyholders, if we can't price it and we can't manage it like a traditional risk and we need to be there to make sure that we can meet the payment obligations of our clients when they have a claim we can't put too much risk against our surplus.

So the private market solution is really to start restricting coverage and reducing exposure so a private market solution in this context may be a non-insured coverage and more of it goes back to companies which have to self-insure or goes into residual markets. The best example of unregulated markets you can look at are the reinsurance markets and the capacity there, as we mentioned earlier, is de minimis.

So I think a private market solution here, given the nature of terrorism, is really less of an insurance peril. TRIA actually gives you an orderly process for a Federal loss-sharing program with the private sector so that, in fact, there is a response mechanism already in place should, heaven forbid, we ever have a future terrorism event.

Mr. COPEMAN. Congressman, if I could give an example, too, as the smallest company sitting at this table, we insure jewelry. And for anyone who has been to the diamond district in Lower Manhattan, 47th and 5th Avenue is one of the greatest concentrations of jewelers in the country.

Given the TRIA program that is in place today, our exposure between the deductible and the co-participation is 16 percent of our policyholder surplus. That is $150 million of surplus; 16 percent of that would go away.

The only way we can participate and provide our customers coverage in that location is because TRIA is in effect and we are able to purchase private reinsurance as well as rely on the Federal Government to be the backstop.

Mr. CLEAVER. Ideologically, the biggest discussion in Washington, no matter how it comes across, is really a discussion about the role of government. And you can't answer that question. For me it is, when is the government intruding?

What is the difference, then, between flood insurance and terrorism insurance, particularly as it relates to pricing? Everything that you said, Mr. Lewis, about TRIA is also true about floods. They are unpredictable; we don't know the scope when they hit. You could say the exact same thing.

Mr. LEWIS. Let me follow up. With respect to natural catastrophes—and it applies to floods, it applies to hurricanes and earthquakes—we actually have hundreds if not thousands of years of data to look at frequency and severity of these events. Now, they could be highly uncertain and it could be a challenge, but with respect to terrorism we have no basis, no understanding of frequency for a terrorist event.

The second thing is that fortunately, floods happen largely in floodplains or just outside floodplains. The floods don't actually seek out the weakest spot, like a terrorist would. These are actually non-random acts trying to find that soft spot and actors who really have a political agenda trying to strike at the soft belly of the country.

So there is a difference, and I appreciate the challenges on the flood program and natural catastrophe, but we do draw the distinction with terrorism.

Mr. CLEAVER. I was the mayor of Kansas City from 1991 to 1999. We had two 500-year floods.

Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Thank you.

The gentleman from Virginia, our vice chair, Mr. Hurt, is recognized for 5 minutes.

Mr. HURT. Thank you, Madam Chairwoman.

Mr. Bartlett, I had a couple of mechanical questions. We have talked a little bit about the fact that—and you have stated in your testimony that the losses would ultimately be paid back to the government. I guess the first question is, under the current TRIA program—and forgive me for not knowing this—there are no premiums that are paid up front into the program, like with flood insurance, are there?

Mr. BARTLETT. There are premiums but they are paid as part of your regular commercial insurance, and they are used to pay the deductible that an insurance company would pay—the 20 percent deductible, which is a large number, and also the co-insurance. It is only in the event that you surpass that, then the government would pay the backstop, so it is included in the premium—

Mr. HURT. How does the recoupment work and what are the circumstances in which it would not be paid back?

Mr. BARTLETT. My understanding is that it would be paid back. As I understand it, the Secretary of the Treasury would certify it is a terrorist attack, certify that it meets the threshold, it is above the $100 million, and that the deductibles have been exceeded, and then would, as I understand it—at that time would have the preestablished authority to assess commercial policyholders universally until the government is repaid. That is my—

Mr. HURT. It could take years—so $100 million—industry loss of $100 million, we just heard testimony that the—is the threshold, and then—and then my understanding is that above that, and we just heard testimony that the 9/11 attacks cost the insurance industry approximately $40 billion in current dollars—$100 million to $40 billion is—so it does get confusing to me real fast.

$100 million is the trigger, so it is not—unless the total losses are $100 million. And then after that every company would pay their own policies up to 20 percent, or roughly $1 billion for a large company. And only after that would the government come in.

So one would suppose, with a large attack, that private money would front the first—and this is rough justice—the first, say, $20 billion or $30 billion, and only after that the government would step in as a backstop. Anything the government pays as the backstop would then be recouped by a tax on all policyholders.

And it could take years?

Mr. BARTLETT. It would be whatever the Secretary of the Treasury decided it would take, frankly.

Mr. HURT. Okay.

I was intrigued by Mr. Lewis' testimony. I guess the first question I would ask is what do we know now that we didn't know 10 years ago when we enacted this program as a temporary program? What is it that we know now that we didn't know then? I would imagine that we now know a whole lot more.

Mr. LEWIS. Yes. It is a challenge, and I think you heard some of the sentiment earlier that we had hoped 10 years ago that we would know a lot more now that would enable a better management of the science, but the terrorists' tactics and weapons continue to evolve. What we do know more now is when we look at some of the more conventional attack modes—truck bombs, car bombings, you see some of these overseas—the potential impact of those may help us model losses from a severity perspective.

We have done a lot of work to try to manage aggregations. As you have seen, the industry, even though it has very high retention, so a ground-up loss is, per company, $100 billion-plus is a lot. And we bear that risk ourselves and we try to manage that.

So we have been able to develop the tools to manage within the current retentions, but when you start getting to events larger—

Mr. HURT. So how do you do that?

Mr. LEWIS. What we basically do is we limit our exposure—the potential ground-up loss has to be no more than a certain amount of capital. I will go back to the comment to make sure we can't put the rest of our policy—

Mr. HURT. But what do you say to the insured in terms of how they manage risk? Because obviously you—I would think that an insurance company can require as a condition of a policy that the insured take certain actions to minimize losses. So, can it?

Mr. LEWIS. That is a good question. When we are talking about our exposure, it is typically not one policy. At The Hartford, for example, we provide a lot of insurance to small businesses. So it is aggregations of policies. It is not limiting the amount of coverage on any one policy; it is making sure you don't write too many policies in one area.

There has been a kind of a redistribution of policies in general, and in the industry we have reached a balance. If TRIA goes away, companies are going to be faced with the decision about how do we bring the overall exposure down, and that is the problem that you are hearing in terms of people dropping coverage.

Mr. HURT. Last question really quickly—I have 5 seconds—I would assume, though, that while we have not had a massive attack like we had on September 11th, I would think that you could still—there are a lot of terrorist attacks that take place all across the world. You all could use those in trying to figure out modeling, can't you?

Mr. LEWIS. The issue is frequency—not really, because those are different locations, different tactics, and then when you start getting into attacks with the potential for nuclear, biological, chemical, and radiological weapons, there is no precedent. And we have heard that terrorists say that their intention is to try to deploy those weapons. We have no basis to try to price for them.

Mr. HURT. Thank you.

Chairwoman BIGGERT. Thank you.

Mr. Green, you are recognized for 5 minutes.

Mr. GREEN. Thank you again, Madam Chairwoman.

Mr. Cleaver has covered this, but I would like to make sure I have it for the record. Are you, indeed, all of the opinion that TRIA should be extended? If someone differs, will you kindly speak up just so that I will have a record that reflects that you are all in agreement?

If you are in agreement and you believe that it should be tweaked to some extent, would you kindly extend a hand into the air, because I would like to know what your opinion is about tweaking? What would you have us do to make it better than it is? Anyone?

Am I to assume that you all think it is fine as it is and that—let's just sort of stay the course, is that what I am hearing?

Mr. LANZA. I think it is we understand what TRIA does and so we understand that. We are covered for an uninsurable risk and we understand what TRIA does for us, and that is why we like it.

Mr. RYAN. Representative Green, if I could offer—

Mr. GREEN. Yes, sir?

Mr. RYAN. The insurance and reinsurance industry has had 10 years to grow accustomed to the current backstop and the program and the way the insurance industry responds to that. It is not too hard to envision a situation that was better for the insurance industry. I think any tweaking would reduce the benefit of the Federal program and introduce some uncertainty into the insurance industry and be to the detriment of insureds and insurers.

Mr. GREEN. Mr. Bartlett, I read your testimony and I am appreciative of what you said on pages three and four. You sort of explain how the system works. Thank you very much for the way you have codified this and explained it.

The 3 percent is especially important because it helps us to recoup after, God forbid, some devastating incident occurs. But I do want to ask this, Mr. Bartlett: Are we putting the insurance companies in a position wherein they can make a bad bet but they won't ever suffer the ultimate loss—meaning companies now that they don't assess risk properly, they can possibly go out of business. Will the companies—are they—are we putting them in a position now such that they are insured, or are we insuring them to the extent that they will always be in business?

Mr. BARTLETT. It is actually quite the reverse. TRIA, as it was finally authorized in the last round, was quite—was—at least proposes to be quite expensive to insurance companies should there be a terrorist event, as it should be. But I have to say, it is—had you asked if there were any tweaks that we should make—if you had asked me 5 years ago, I might have hesitantly put up my hand and said it is too expensive.

But it is a very expensive program—the 3 percent surcharge, the 20 percent deductible, the 15 percent copay, in fact, put the burden where it should be, and that is squarely on the private sector, both insurers, but also developers, property owners, and lenders. So there is full and adequate and very overwhelming incentive to mitigate against terrorism risk, to ensure properly, and to—and there is a large amount of payment that insurance companies would pay if it were to.

Would companies go out of business if a terrorist attack happened? Perhaps. This is a—if a terrorist attack happens it would be very expensive for the insurance industry, and it should be, because they are in the insurance business. But it would be achievable for the overall economy, and that, of course, is the goal.

Mr. COPEMAN. Congressman, as a small mutual insurance company—and I emphasize mutual because we exist for our policyholder; we have no stockholders; we have no one who invests in us—we certainly take very seriously the fact that we put, as I mentioned earlier in this particular example in New York, 16 percent of our policyholders' surplus on the line just for the risk of terrorism. There is still fire, there are still other catastrophic losses that can take place and we have to align our capital against those particular exposures.

So as a small company, TRIA makes a huge difference in whether or not we are able to make a marketplace for our mutual insurance company policyholders.

Mr. GREEN. Thank you.

Mr. Lanza, I believe you indicated that we should do this by 2013. Was that you who made the comment that we should extend it by 2013?

Mr. LANZA. No. The issue is that in 2013, as we go about renewing policies or issuing quotes on new policies, we will be advising insureds that the TRIA would be subject to sunset, and that would have issues for us and our ability to provide terrorism coverage.

Mr. GREEN. So is your request that we do whatever we are going to do by 2013—the end of 2013—

Mr. LANZA. By the end of 2013.

Mr. GREEN. —just so that—to help the market to build in the necessary risk factors and take the uncertainty out of it. Is that what you are saying?

Mr. LANZA. Correct.

Mr. GREEN. Okay.

Mr. RYAN. Congressman Green, I might have been the person who made that reference. I think it is vitally important for the reinsurance industry, too, to know where they stand in terms of what reinsurance they will be required to give for terrorism.

Mr. GREEN. Thank you, Madam Chairwoman.

And I would like to thank all of you for appearing. I truly don't want to see anybody go out of business. My questions have more to do with how much we do to—

Chairwoman BIGGERT. The gentleman's time has expired.

Mr. GREEN. Thank you, Madam Chairwoman.

Chairwoman BIGGERT. Mr. Sherman, you are recognized for 5 minutes.

Mr. SHERMAN. Propitious time.

Mr. Lanza, without TRIA would the private sector offer more terrorism coverage or less, and how would that affect the availability of commercial insurance overall?

Mr. LANZA. Without TRIA, there would be no terrorism coverage, and so availability would be limited. And for the reasons we spoke of earlier, there is no way to underwrite the risk, and that is why we won't be able to extend the coverage without TRIA.

Mr. SHERMAN. I assure you, there is simply no way to predict that risk. You could put the whole Foreign Affairs Committee together and try to guess what the risk is and none of us would be able to do it.

Mr. RYAN. Congressman Sherman, may I interject? Sorry.

Mr. SHERMAN. Yes.

Mr. RYAN. Aon Corporation, in advance of the last two pending terminations of the TRIA legislation, surveyed insurance carriers, and we determined that we would lose about 80 percent of the insurance capacity that was currently devoted to terrorism were TRIA to lapse.

Mr. SHERMAN. And while it is getting more difficult to predict the weather and hurricanes, that is easy compared to predicting a major terrorist attack.

What are the take-up rates of your company, Mr. Lanza, and for the industry as a whole?

Mr. LANZA. We are slightly above the industry average, which is around 64 percent. We are at about 86 percent for the commercial lines that are not mandatory, so that is not workers' comp. Workers' comp is 100 percent.

Mr. SHERMAN. So you are saying 86 percent of your customers choose to buy terrorism insurance?

Mr. LANZA. Correct.

Mr. SHERMAN. And so terrorism insurance isn't just for La Guardia, LAX, and the Empire State Building, who I assume are not your clients. It is for medium-sized businesses from cities that terrorists have heard of and some they don't know about or they haven't focused on.

Mr. LANZA. Correct. Terrorism doesn't have any boundaries.

We primarily write for small businesses that have an average of 3 commercial policies and about $10,000 in total premium, and they elect 86 percent of the time when they have the choice to have TRIA. And we distribute—

Mr. SHERMAN. Mr. Lewis, did you have a comment on that?

Mr. LEWIS. I think you raise an important point. After 9/11, one of the great lessons that we learned is a lot of attention was paid on the large buildings and the large companies. Horrible losses, but they shifted production to other areas.

We also are a large provider of small business insurance and the critical thing was there are a lot of small businesses in Lower Manhattan that were just down because they closed down Lower Manhattan. If the claim checks did not keep coming to keep them in business then those would have all been out of business—

Mr. SHERMAN. So even if you are not in an iconic location, you could be half a mile away and be affected.

Mr. LEWIS. Absolutely.

Mr. SHERMAN. But even—for Mr. Lanza's 86 percent, I am sure the vast majority of his clients are not within walking distance of one of the 500 most notable sites in America. But they want and need the terrorism insurance.

Do you find that your clients are taking—are getting the terrorism insurance because they need to do it in order to satisfy their creditors, or they simply think they want to do it for their own business, or is it a combination?

Mr. LANZA. I believe it is a combination. Also, we distribute exclusively through independent agents, such as Mr. Jensen, who do a lot of consulting with the clients.

Mr. JENSEN. Mr. Sherman, if I may?

Mr. SHERMAN. Yes.

Mr. JENSEN. As I testified before, most of my clients and my agencies are in smaller rural and suburban communities. An awful lot of my clients do purchase coverage because they still have the need even though we are not in one of these highly visible properties.

As a note, I insure an awful lot of volunteer fire departments, as an example. These are folks who need to have claims payments quickly if something were to arise. They are also, as our Nation is, and they are the ones that respond to the bad things and they are running to the circumstances rather than away from them, and they may very well respond to a larger city to help in other communities, so it is very important for those communities as well.

Mr. RYAN. Congressman Sherman, if I may, in addition to some of the other studies we have done, we have analyzed the take-up rate by segment of the economy, and I would like to introduce with my written testimony, if I have not already, some—

Mr. SHERMAN. I would ask unanimous consent to allow this document into the record.

Chairwoman BIGGERT. Without objection, it is so ordered.

Mr. SHERMAN. I think the testimony has been very interesting today. I know my time has expired, and I think a lot of us have learned that terrorism insurance is something that the vast majority of medium-sized businesses need and want, and that these are risks that cannot be priced by the private sector.

I yield back.

Chairwoman BIGGERT. Thank you.

Let me—just some food for thought, maybe, from Mr. Ryan for the reinsurance, and maybe some of you, but just thinking about this, in science and some other areas of the government there are public-private partnerships and classified information is shared. It does cause concern about intelligence, but could such a partnership be developed to model for terrorism risk, and then pricing for reinsurance and then ultimately for insurance?

So maybe if you could think about this, Mr. Ryan, and get back to us. I don't know that you want to answer right now.

And any of you—

Mr. RYAN. Actually, could I make one comment along those lines?

Chairwoman BIGGERT. Sure.

Mr. RYAN. There has been a lot of concern expressed regarding the severity of terrorist attacks, and while that is certainly true, there is a lot of science that has been shared regarding the impact, physically, of terrorist attacks, but fundamentally it is the frequency issue, and I think everyone on this panel has said and most of the people on the previous panel, unless there is some hard science behind the frequency of it I don't know that that will be addressed.

But certainly in terms of the severity issue, I think we have a head start on that portion of it, yes.

Chairwoman BIGGERT. All right. Thank you.

I ask unanimous consent to insert the following material into the record: a September 11, 2012, statement by Congressman Peter King from New York.

Without objection, it is so ordered.

With that, I would like to thank the panel for a really good discussion. The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses, and to place their responses in the record.

Again, I would like to thank all of you. You have been a wonderful panel. And we will be having some more hearings, too.

So thank you so much for being here, and with that, this hearing is adjourned.

[Whereupon, at 1:24 p.m., the subcommittee was adjourned.]

A P P E N D I X

September 11, 2012

Rep. Peter King: Statement for the Record on TRIA
Insurance & Housing Subcommittee Hearing: "TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program," Sept. 11, 2012

Eleven years ago today, our nation was rocked by the horrific terrorist attacks that hit the World Trade Center and the Pentagon. The staggering loss of innocent lives was the greatest tragedy. But in addition to this loss, the U.S. economy went into a tailspin following the attacks, with American businesses and workers left struggling financially.

Following 9/11, the insurance industry paid out and an unprecedented $31.6 billion in terrorism-related claims. After an attack of that magnitude, insurance companies did not know how to model for or project future terrorism-related costs. The private sector stopped offering terrorism insurance. Since all commercial borrowers had to have terrorism risk insurance in place, efforts to rebuild after 9/11 were stymied by the inability to insure against the threat of future attacks. According to a Real Estate Roundtable study, over $15 billion in real estate-related transactions were stalled or cancelled because terrorism risk insurance wasn't available. This translated into tens of thousands of construction jobs lost. My state of New York was hardest hit by this market failure.

The enactment of the Terrorism Risk Insurance Act in 2002 -- which I strongly supported and worked to extend -- filled this significant coverage gap. TRIA has been a tremendous success. This program provides the stability needed to keep our economy going in the face of continued terrorist threats, with businesses able to secure the insurance needed to operate. It is a sound policy that helped reestablish the economies of New York and our Nation's Capital City following the attacks. It will also enable the U.S. to quickly recover should another terrorist attack occur on our soil.

This Committee has rightly placed emphasis in finding private market-based solutions to reduce the role the federal government has played in housing, finance and insurance. TRIA has been successful because it allows the private sector to partner with the public sector in managing risk, with the private sector having significant "skin in the game." With our economy still struggling to recover from the financial crisis, it makes no sense to remove a successful federal backstop that aids market stability and has not cost taxpayers a dime in insurance claims. In fact, TRIA likely saves taxpayer money. If a future catastrophic attack were to occur and a federal backstop didn't exist, the same market failures that we saw in 2001 would occur, and Congress would be left appropriating huge sums in disaster assistance and again stepping up to the plate to provide insurance guarantees. Maintaining TRIA prevents us from repeating the past.

Finally, TRIA is not just an economic issue but also a homeland security issue. As Chairman of the Homeland Security Committee I regularly see intelligence reports of potential plots to attack the U.S. It is essential to provide the necessary stability to areas that have been and are at risk of being attacked by terrorists. We should not allow our enemies to decide which American cities will be insured and which sites can be redeveloped. TRIA has unquestionably made our economy stronger.

Statement of the

Honorable Steve Bartlett

President and Chief Executive Officer

The Financial Services Roundtable

before the

Committee on Financial Services

Subcommittee on Insurance and Housing and Community Opportunity

U.S. House of Representatives

September 11, 2012

Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify today – appropriately and humbly as we meet on September 11th.

I am Steve Bartlett, the President and CEO of the Financial Services Roundtable. The Roundtable is a national trade association composed of 100 of the nation's largest banking, securities and insurance firms. Our members provide a full range of financial products and services to consumers and businesses. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

TRIA IS A NEEDED PUBLIC-PRIVATE PARTNERSHIP

The property & casualty insurance sector is an important part of the country's physical and economic infrastructure. Insurance helps protect the U.S. economy from the adverse effects of the risks inherent in economic growth and development. Insurance also provides the resources necessary to rebuild physical and economic infrastructure in the event of catastrophic losses to persons or property. Insurance provides a safety net that is critical to healthy economic activity.

The Financial Services Roundtable supports the Terrorism Risk Insurance Act (TRIA), which provides an absolutely essential federal backstop in the face of catastrophic losses arising from a terrorist attack. Importantly, any federal outlay may, under the statute, be recouped by assessments on policyholders. In addition, it is imperative that the program be reauthorized to avoid disruptions in coverage.

TRIA, and the Terrorism Risk Insurance Program it created, provides stability in the market by making an uninsurable risk insurable. Originally signed into law on November 26, 2002, TRIA was amended by the Terrorism Risk Insurance Extension Act of 2005 and the Terrorism Risk Insurance Program Reauthorization Act of 2007, and is now set to expire on December 31, 2014.

TRIA must be reauthorized because it makes terrorism risk insurance accessible. It provides an orderly mechanism through which terrorism losses are absorbed by the private sector, and because it helps support the economy when we as a country are attacked.

TERRORISM RISK PRESENTS UNIQUE CHALLENGES

Effective insurance underwriting requires the ability to predict with some accuracy frequency, location and severity (amount of loss). Though normal insurance risks can be unpredictable, when those events are assessed over a large enough area and timeline, the randomness of those events provide a pattern which informs underwriting decisions and allows insurance companies to cover the appropriate level of risks.

Terrorism changes that equation because it is not random; it is purposeful. Neither the frequency nor severity of the attack can be predicted or modeled. A terrorist may not act for years and then strike multiple times in multiple different ways, none of which is predictable. This dynamic risk, driven by free will and unlimited in scope, makes managing the risk by the private sector near impossible. Terrorism knows no geographic, seasonal, or other objectively verifiable pattern. It can happen anywhere, any time and in any way imagined by the mind of the terrorist.

Modeling methodologies for terrorism are also nascent. While insurers continue to refine modeling methodologies, underwriters have yet to identify a model that can account for the erratic and purposeful behavior of a terrorist. These difficulties are substantially compounded by the very nature of terrorist activity – terrorists seek to disguise intent and their planned actions – and the highly secure nature of government intelligence sources. Similarly, there is no way to predict the severity of an event. Depending on the type of attack, thousands of dollars, millions of dollars or billions of dollars in insured commercial activity can be at risk.

Absent TRIA, the insurance industry's ability to absorb another terrorist attack, whether on the magnitude of September 11, 2001, or worse, is compromised. State legislatures and insurance regulators limit the industry's ability to manage or limit terrorism exposure and, since catastrophic terrorism is unpredictable, insurers cannot adequately price the exposure and are subject to a significant degree of adverse selection. TRIA is essential to ensure that the risk spreading mechanism that is the foundation of the insurance industry, works. We acknowledge that even with TRIA, the insurance industry remains vulnerable to significant financial disruption in the event of another catastrophic terrorism attack given the substantial insurer retentions TRIA requires.

Similarly, in the absence of an effective backstop for terrorism losses, another terrorist attack, especially if the impact is concentrated on a small group of primary insurers, may very well be enough to render the industry unable to absorb a second catastrophic loss, such as from a hurricane, earthquake or other natural catastrophe.

We have insufficient experience, significant modeling uncertainty, incomplete data, and a huge loss potential that may exceed the insurance industry's claims paying ability. It is, therefore, critical that the U.S. continues to have a backstop for the largest events.

TRIA IS DESIGNED TO KEEP THE WHEELS OF COMMERCE MOVING

Prior to 9/11, insurance companies included insurance for terrorism risk in their general policies with no additional premium assessed for this risk. Following that tragic day, insurers were left with little option but to exclude terrorism coverage as an uninsurable risk from policies. There was little or no market for commercial policyholders who sought coverage.

In the absence of all-peril coverage, banks and other investors were less willing to lend or invest money in construction projects and businesses without terrorism coverage; this ultimately hampered construction and jobs. During the fourteen-month period between 9/11 and the passage of TRIA, approximately $15 billion in real estate-related transactions were delayed or cancelled, according to the Real Estate Roundtable. During that same period, the White House Council of Economic Advisors estimated that 300,000 jobs were lost.

TRIA was designed to mitigate the negative economic impact from the stalled real-estate development and investment. First and foremost, TRIA includes a "make available" provision, which means that insurers must offer terrorism insurance to commercial clients. With coverage available, banks looking to lend and investors looking to deploy their capital can do so while protecting their investments from the threat of a terrorist attack.

With TRIA in place, the number of business that purchased terrorism insurance has risen dramatically. In 2003, the take-up rate was 27 percent; by 2009, the take-up rate rose to 61 percent, according to a 2010 Marsh Report.

TRIA ENSURES PRIVATE SECTOR PROTECTION OF TERRORISM RISK

TRIA ensures that private insurance and reinsurance pays the first losses in the event of a terrorist attack. The current version of TRIA has a "program trigger" of $100 million for certified acts of terrorism, under which the private sector takes all the loss. If losses exceed $100 million, each individual insurance company with losses will realize the entire loss up to 20 percent of its direct written premium the prior year – for some companies this would be over $1 billion in money being paid out before one dollar of government money is spent.

Following the 20 percent deductible, private insurers begin to share losses with the federal government; the government absorbs 85percent of additional losses and the private sector absorbs the remaining 15 percent with a program cap of $100 billion.

Importantly, if the government backstop is called upon, the law requires that government payments will be recouped by increasing future policyholders' premiums by up to 3 percent a year. Government funding for events that occur after January 1, 2012, must be collected by September 30, 2017.

FAILURE TO EXTEND TRIA WOULD HAVE ECONOMIC CONSEQUENCES

Without federal support, insurers' limited ability to manage terrorism risk would become unstable and they would withdraw or reduce their offerings. This is neither supposition nor hyperbole – we know how the market reacts in the absence of this program. In the absence of TRIA, limited insurance and reinsurance for terrorism risk will be available, and what is available will be offered at largely cost-prohibitive prices. Lending, especially for large-scale development in high-risk areas will be significantly restricted as credit is not extended to businesses unable to obtain terrorism risk insurance.

According to a 2010 President's Working Group report, marketplace terrorism risk insurance capacity has increased. Nevertheless, capacity is constrained and commercial insurance policyholders have difficulty obtaining coverage with sufficient limits. Essentially, market capacity is improving, but it is not sufficient. TRIA requires that terrorism coverage is available and provides the market the tools to grow.

THE ALTERNATIVE TO TRIA IS NO PROTECTION AT ALL

While some have argued TRIA exposes U.S. taxpayers to losses that will increase an already high debt and deficit, the opposite is actually true. As detailed above, losses from a terrorist act must reach a substantial total before the federal government becomes involved by loaning funds to pay claims. And once that level is reached, the insurer shares those losses with the federal government and then uses future premium charges to repay federal funds.

In fact, TRIA puts in a place an orderly system to make sure that the private sector absorbs most if not all of the losses. Without TRIA, terrorism insurance will be available only in limited quantities. This not only deters investments and costs jobs, but it also means that little to no coverage is in place if another attack occurs. It is difficult to imagine a situation in which the federal government will not be forced to absorb the loss from such an attack – when businesses are left with no protection from physical and financial disaster.

The risk of such an attack is not limited to a geographic region, industry or target. It can happen anywhere. And no matter where it happens, its impact goes far beyond that specific target. High-density areas and high-value properties have more difficulty obtaining coverage, but commerce is interconnected. What happens in one region or to one location has ramifications across the country. If a port or transportation hub is disabled by an attack, businesses that rely on that center in their supply chain are damaged and may face business continuity challenges.

But it is important to remember, the ultimate target of a terrorist attack is likely not a business or particular building. Rather, it is the government and population of the United States. If future attacks do occur, we, as a country, must respond to support our citizens and businesses. TRIA acknowledges this by ensuring that the U.S. response is one that supports its people and its economy by providing a mechanism in which such unpredictable losses can be underwritten and absorbed by the private sector.

CONCLUSION

The Roundtable applauds the Subcommittee for its attention to this topic at such an early date. Although expiration seems a long way off, business decisions that involve terrorism risk coverage are continually being made; if uncertainty is allowed to persist around renewal of the program, we will see an increasingly negative impact on the economy.

The Roundtable strongly believes TRIA should be reauthorized. Doing so will make our economy and country stronger. We look forward to working with you on this important issue. I am happy to answer any questions.

NAMIC®
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Subcommittee on Insurance, Housing and Community Opportunity

Hearing on

TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program

September 11, 2012

Introduction

Chairman Biggert, Ranking Member Guiterrez, and members of the House Financial Services Subcommittee on Insurance, Housing and Community Opportunity, thank you for the opportunity to provide testimony on the Terrorism Risk Insurance Act (TRIA) and its vital role in helping protect our country and our economy as we continue to consider how to best handle the threat of terrorism.

My name is Darwin Copeman and I am president and chief executive officer of Jewelers Mutual Insurance Company. A mid-sized company founded in 1913 and headquartered in Neenah, Wisconsin. Jewelers Mutual is licensed in all 50 states and is the only insurance company in the U.S. that specializes exclusively in protecting the jewelry industry and individuals' jewelry. Our company participates in the TRIA program and understands first-hand its importance of this unique partnership between the private insurance industry and the federal government.

Jewelers Mutual is proud to be a member of the National Association of Mutual Insurance Companies (NAMIC) made up of 1,400 property/casualty insurance companies serving more than 135 million auto, home and business policyholders, with more than $196 billion in premiums accounting for 50 percent of the automobile/homeowners market and 31 percent of the commercial insurance market. NAMIC is the largest and most diverse property/casualty trade association in the country, with regional and local mutual insurance companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. More than 200,000 people are employed by NAMIC members.

It is our firm belief that the threat of terrorism is not an insurable risk. As such, no self-sustaining private market for terrorism risk coverage is likely to develop. However, the presence of a robust private/public partnership that has provided stability and predictability has allowed insurers to actively participate in the market in a meaningful way. Without a program such as TRIA, many of our citizens who want and need terrorism coverage to operate their businesses all across the nation would be either unable to get insurance or unable to afford the little coverage that would be available. The result when the next terrorist attack occurs, will be more – not less – federal exposure as the government will be under extreme pressure to pay for *all* of the losses.

Therefore, we believe it is vitally important to our nation's finances, security, and economic strength that we maintain a long-term private/public partnership for terrorism risk insurance.

The Nature of Terrorism Risk

Before the events of September 11, the abstract possibility of a major terrorist attack on the U.S. was known, but largely dismissed by most people. At the time, terrorism was typically included in "all-risk" policies because the risk was deemed so small as to be incalculable. Overnight, the insurance industry's understanding of the nature of terrorism risk fundamentally changed.

What became immediately clear is that managing terrorism risk defies the normal underwriting practices of insurers. First, it was apparent that there was an absence of meaningful actuarial data that insurers normally rely on when considering whether coverage can be offered and, if so, at what price. In the case of natural catastrophe risk for example, a company can rely on decades of relevant event data that can be plugged into mathematical models to quantify risk – there is no comparable historical record on which to draw for large-scale terrorist events. Further, much of the relevant data that might be used by an insurance company is appropriately kept secret by the federal government for national security reasons. Without access to this type of information insurers cannot meaningfully calculate the likelihood, nature, or extent of a potential event, making pricing and reserving virtually impossible.

Second, like the risk from flooding, the risk is too highly concentrated to effectively pool across geographical locations and policyholder type, particularly in an age of mass-casualty terror. Acts of terrorism on the scale of 9/11 are what are known as a "clash events" meaning they cause significant losses across multiple lines of insurance. In the case of the attack on the World Trade Center, there were enormous insured losses in the property, liability, life, and workers compensation lines, among others. Naturally, these types of events directly threaten the solvency of both insurers and reinsurers and are not typically covered risks. In a fully free market, it would likely be the case that highly concentrated urban areas in particular would find it difficult to find or afford coverage for terrorism.

Third, there is no clear way to determine the possible severity of a given attack, particularly those using nuclear, chemical, biological, or radiological (NCBR) weapons. There is no real loss data to rely on to understand the extent of damage from such weapons. That said, several years ago, the Rand Corporation found that "a radiological attack in an urban core would likely lead to catastrophic levels of uninsured business interruption and property losses." The American Academy of Actuaries estimated potential losses from a NCBR attack in New York City at $778 billion, which is more than *three times* the commercial property/casualty industry's claims-paying capacity.[1] These estimates underscore the uninsurability of such an event.

Fourth, the existence of interdependencies in local, national, and global systems further complicates any effort to accurately price terrorism risk insurance. At the very highest level, the nation's foreign policy decisions and the effectiveness of its homeland defense have a direct impact on the likelihood and success of an attack. At the policyholder

[1] Insurance Information Institute, "Terrorism Risk: A Reemergent Threat." April, 2011, p. 15.

level, the vulnerability of one organization is not simply dependent on its own security decisions, but also on the decisions of other organizations and agents beyond its control. Further, interdependence does not require geographical proximity – one need only consider the 2001 anthrax scare utilizing the U.S. Postal Service to grasp that breakdowns in systems far away can have a serious impact on potential losses.

Finally, and most importantly, is the human element. The fact that human beings plan and strategically execute terrorist events means that these events are not fortuitous; they are caused deliberately and do not occur randomly. Because of this, there is no way to determine the probability that a particular property or asset will experience a terrorism-related loss. Part of the difficulty in assessing terrorism risk stems from the fact that, because of response measures taken in the wake of an attack, the next event is unlikely to follow a similar pattern. Unlike criminal acts such as robbery where the goals are predictably targeted, the goal of maximizing death and destruction can be accomplished in countless ways, anywhere, and at any time.

All of the above factors lead us to conclude that it is unlikely that insurers will ever have the necessary tools to predict when, where, and how terrorist events will occur. Immediately following 9/11, there was hope that, given time, more accurate modeling could be developed and utilized to help insurers manage this type of risk. And indeed, much has been done to develop tools to manage aggregate loss exposures that are based on a predetermined event of a certain magnitude in a given area. However, models that attempt to predict the frequency or severity of an attack are not considered reliable. Given that modeling is typically effective only in determining the likelihood that particular events will occur and the fact that the data inputs will always be extremely limited, improved modeling will not solve the fundamental challenges of offering terrorism coverage.

Similarly, the nature of terrorism risk does not allow insurers and risk managers to create effective mechanisms to mitigate the risk of loss due to terrorism. Unlike in other types of coverage where a policyholder might get a premium discount for storm-proofing her home, it is not at all clear how a commercial property-owner could reduce the probability of experiencing a terrorism-related loss. With the interdependencies mentioned above the possible scenarios are endless – a company might spend a significant sum of money to secure a facility while a neighboring company does not and is then used as a staging area for an attack. Additionally, the presence of human volition drastically reduces the value of preventative measures, given that a terrorist usually will plan an attack with those measures in mind. Again, terrorism is not comparable to a random event – a hurricane cannot study wind-damage mitigation efforts and then think up new ways to get around them. The only truly effective mitigation tools – if there are any -- reside within the government's national security apparatus, and as noted above, these are understandably kept secret.

No amount of innovation in catastrophe modeling and risk mitigation will change the factors that fundamentally distinguish catastrophic events randomly caused by natural forces, from catastrophic events caused by the calculated machinations of human beings. In any discussion about terrorism risk or the TRIA program, we must be clear about the unique nature of the terrorist threat.

The difficulty facing risk managers who wish to purchase private insurance coverage for terrorism-related events can be seen in the recent experience of the city of Chicago. To manage the liability risk associated with hosting a two-day NATO summit in mid-May, the city sought, and was able to easily acquire from domestic insurers, liability coverage for slip-and-fall accidents, automobile damage, and medical coverage. But city officials also feared that this important international gathering could be the target of a terrorist attack. They therefore attempted to purchase additional coverage for any liability the city might incur specifically related to terrorism. Insurance brokers acting on the city's behalf were unable to find a single standard commercial insurer that was willing to provide the needed coverage at any price. The city was finally able to purchase a policy from Lloyd's of London, which is known for insuring unusual risks. According to a report in the Chicago Tribune, the policy, which provided $100 million in terrorism liability coverage for just two days, cost the city $1.3 million. That premium represented more than 10 percent of the total cost of hosting the NATO summit.

It should be noted that the $100 million liability limit under the city's Lloyd's policy is equal to event "trigger" under TRIA, so that in effect, the TRIA backstop for losses in excess of that amount was irrelevant to this transaction. Yet the city's $100 million policy limit would not even begin to cover the potential property losses from a large-scale terrorist attack launched in downtown Chicago. Based on Chicago's NATO summit experience, it seems reasonable to conclude that in the absence of TRIA, few if any private insurers would be willing to provide the much larger amount of property coverage that would be needed to insure a large office building or hotel. Indeed, Chicago's experience suggests that, if anything, Congress should consider lowering the event trigger when it begins the work of extending the TRIA program beyond its 2014 expiration date. If the current trigger had been set at, say, $50 million, Chicago would probably have found numerous domestic insurers willing to offer the coverage it needed, and at a much lower premium.

The story of Chicago's search for terrorism liability insurance is noteworthy because it forcefully illustrates that the real beneficiaries of TRIA are not insurance companies, but the many entities that need the financial protection from terrorism that can only be provided by terrorism insurance that is both available and affordable. These beneficiaries consist not only of commercial enterprises, but include America's cities and other government entities as well.

The TRIA Program

The 9/11 attacks caused roughly $40 billion in insured losses. Soon after the events, reinsurers and insurers moved to exclude terrorism coverage from their new and renewing policies. There were certain at-risk areas of the country that saw extremely hard markets in property and workers compensation coverage. In states like New York which prohibited carriers from excluding coverage for terrorism and with reinsurance companies universally excluding terrorist acts in property/casualty treaties, most carriers' only alternative was to offer less coverage or not write the business at all.

The few companies willing to provide coverage increased their prices because of the significant terrorism exposure. However, many of those companies began to cut back when concentrations of values and employees became too large. Again using New York as an example, the lack of adequate insurance capacity and significant increases in pricing of commercial multi-peril business resulted in the postponement of many construction projects. It was estimated at the time to have delayed or cancelled $15.5[2] billion in real estate transactions and cost 300,000 construction workers their jobs.[3]

Given this economic uncertainty and the insurance industry's uncertainty about its ability to properly manage terrorism risk, Congress passed and President George W. Bush signed into law the Terrorism Risk Insurance Act of 2002. The bill established TRIA as a temporary federal government program that created a private-public partnership to share in the compensation for privately insured commercial property/casualty losses resulting from acts of terrorism. The program was designed to guard against further economic dislocation and to allow the insurance industry a transition period to develop the capacity to adequately provide terrorism insurance without government involvement. At the time, some analysts thought that it might be possible to develop a truly private market for terrorism given time to build capacity and to study the risk. However, it was soon realized – for the reasons discussed above – that without the program American businesses would be hard pressed to find or afford the coverage they needed and so TRIA was extended for two years in 2005 and again in 2007 for seven years. Both extensions included modifications that required a greater share of the potential losses be borne by the private sector.

Essentially, the program is a federal backstop for commercial property/casualty insurance that acts as reinsurance in the event of a certified terrorist event. A private insurance company pays for losses up to a certain level and then the government covers the majority of the losses up to a ceiling of $100 billion, after which neither the government nor the company is required to pay further. The private sector insurers' share of the losses is made up of several components:

1. A deductible – currently 20% of the prior year's direct earned premium on all lines of business covered in the TRIA program – up from 7% when the program first began.
2. Share of the losses above the deductible – the insurer still pays 15% of all losses above the deductible – up from 10%.
3. Industry aggregate retention – Federal government is required to recoup any losses from private industry up to $27.5 billion – up from $10 billion.

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[2] Real Estate Roundtable, "Survey Confirms Economic Toll of Terrorism Insurance Gap: Over $10 Billion of Real Estate Projects Affected Across U.S.," September 4, 2002.
[3] President George W. Bush, "President Reiterates Need for Terrorism Insurance Agreement," October 3, 2002.

Further, an event must hit a certain "trigger level" in order for there to be any Federal involvement. The trigger is currently set at $100 million which is up from $5 million when the program was first started. Insurers are required to offer coverage for acts of terrorism on the same terms and conditions as other coverages, although this does not include coverage for NBCR attacks.

With the passage of TRIA, the fear that a worst-case terrorist event could render companies insolvent was somewhat reduced, making it possible these companies to continue to do business in higher-risk, urban areas. TRIA placed a ceiling on individual company terrorism losses, which permitted them to quantify their terrorism exposure and find a way to write the coverage.

TRIA Is Needed to Increase Private Industry Participation in Terrorism Insurance Market

In its 2010 report, the President's Working Group on Financial Markets concluded that the availability and affordability of terrorism risk insurance has improved over the last several years. The marketplace has increased capacity and prices have in general declined. However, the report also concluded that only about 60 percent of commercial insurance policyholders are buying terrorism coverage, a take-up rate that has remained flat for six years. Also, despite the fact that marketplace capacity has increased in general, it has remained very constrained in certain markets where policyholders have difficulty obtaining sufficient coverage.

Clearly private industry has at least a limited capacity to offer coverage for terrorism. However, we must recognize that the entire marketplace as it stands today has grown up in the presence of the TRIA program. We cannot hastily conclude that because the private sector can handle a portion of the risk, it could figure out a way to handle all of it. For one, capital is the key to availability, and insurance industry capital remains insufficient to absorb the cost of a large-scale terrorist attack. Further, capacity could disappear altogether for subsequent attacks. Simply put, the private sector's capacity is dwarfed for most modeled terrorism events and cannot be exposed beyond a reasonable level without failing in its primary purpose - supporting the economy by protecting against non-terrorism related losses and events. For example, in the case of workers compensation, in 2010 Marsh & McLennan have cited industry-wide capacity at only $30 billion, while the "worst case scenario" single loss is $90 billion.

Additional capital is needed in order to address this problem effectively. The private market is unable to absorb terrorism risk without a federal component. Even without a federal component, the government would bear the ultimate risk of uninsured losses as businesses and citizens turn to the federal government for assistance – the presence of a well-managed partnership program between the government and private insurers serves to ultimately *reduce*, not increase, federal liability for terrorism losses. The purpose of the partnership is not to protect insurers, but to make sure that the economy can recover in as orderly a fashion as possible from a terrorist event.

We would add that an effective public-private partnership also depends on participation by insurers of all sizes and structures. Any discussion of increasing private sector involvement in the TRIA program must be had with an eye toward ensuring participation by smaller and mid-sized insurers. Event trigger and deductible levels are key to the ability of these insurers to continue to provide coverage. Large increases in the trigger, company deductibles, or insurer co-payments could drive medium and small insurers out the market, reducing competition and further constraining availability of terrorism risk coverage. There have been no changes in the market that would change this calculus.

Difficulties in measuring risk, raising sufficient capital, and the limits on ability to constrain risk exposure, all point to the continuing need for a public-private partnership. Given that we cannot predict the severity or frequency of terrorist events, having a cap on what a company knows that it will have to pay allows it to at least begin to manage its risk exposures. Without a program, we would see a drastic reduction in both the availability and affordability of terrorism risk insurance like we did in the aftermath of 9/11.

Conclusion

It is much easier to argue the feasibility of a fully private market for terrorism insurance when no losses have been incurred since TRIA was enacted. Suffice it to say, the memory of the market immediately following 9/11 ought to give pause to anyone pushing to end the private/public partnership that has worked to provide commercial policyholders with the coverage they need. The result when the next terrorist attack occurs will be more – not less – federal exposure. In order to encourage private sector involvement in the terrorism insurance marketplace – and thereby protect and promote our nation's finances, security, and economic strength – we must maintain a long-term private/public partnership for terrorism risk insurance.

TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program

House Financial Services Subcommittee on Insurance, Housing and Community Opportunity

Testimony of
Robert P. Hartwig, Ph.D., CPCU
President & Economist
Insurance Information Institute
New York, NY

September 11, 2012

Washington, DC

Thank you, Representative Biggert, Ranking Member Gutierrez and members of the Committee.

Good morning. My name is Robert Hartwig and I am President and Economist for the Insurance Information Institute, an international property/casualty insurance trade association based in New York City.[1] I am also a Chartered Property Casualty Underwriter (CPCU) and have worked on a wide variety of insurance issues during my 19 years in the property/casualty insurance and reinsurance industries, including many related to the industry's exposure to catastrophic loss, including acts or terrorism. The Institute's members account for nearly 70 percent of all property/casualty insurance premiums written in the United States. Its primary mission is to improve understanding of the insurance industry and the key role it plays in the global economy.

I have been asked by the Committee to provide testimony on the status of the market for terrorism insurance in the United States. For the purposes of my testimony, I will divide my testimony into the following major sections:

(i) Review of the impacts of the September 11, 2001 attacks on the insurance industry;
(ii) A brief summary of changes in the terrorism threat landscape since the enact of the original TRIA legislation in 2002;
(iii) A discussion of why most terrorism risk remains fundamentally uninsurable in the private insurance and reinsurance markets;
(iv) The impact of the Terrorism Risk Insurance Program in maintaining market stability;
(v) Obstacles to insuring and reinsuring losses arising from acts of terrorism;
(vi) The success of the Terrorism Risk Insurance Program and the current state of the market for terrorism coverage, and;
(vii) Possible options for expanding private sector terrorism coverage.

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Summary of Impacts on the September 11, 2001 Terrorist Attack on Insurers and Insurance Markets

The terrorist attacks of September 11, 2001, produced insured losses larger than any natural or man-made event in history. Claims paid by insurers to their policyholders eventually totaled some $32.5 billion dollars--$40.0 billion in 2011 dollars **(Exhibit 1)** and to this day remain the second most costly insurance event in United States history **(Exhibit 2)**.[2] The losses sustained by the insurance industry that fateful day were unprecedented in virtually every respect, producing catastrophic losses not only in property coverages, but also for the first time in life insurance, disability and workers compensation lines. Aviation insurers also suffered their worst-ever losses stemming from a single event. The sheer enormity of the loss—coming from an entirely unforeseen peril for which no premium had been collected—combined with the possibility of future attacks and uncertainty arising from the United States' rapid military response to the threat, produced financial shockwaves that shook insurance markets worldwide and provoked an extraordinarily swift and severe underwriting and pricing reaction by insurers and reinsurers.

Terrorism Exclusions and Price Shocks in the Wake of the 9/11 Attack

The shock of the September 11 attack led insurers and reinsurers to exclude coverage arising from acts of terrorism from virtually all commercial property and liability policies. Before 9/11 terrorism exclusions were virtually nonexistent in commercial insurance contracts sold in the United States. The economic consequences of such exclusions were quick to manifest themselves. Major commercial property construction projects around the country, unable to secure coverage against the now very real risk of terrorist attack, were in jeopardy of being tabled, hurting job growth at a time of rapidly rising unemployment and when much of the country was in recession. Banks, in turn, threatened to choke off lending to businesses if borrowers failed to secure coverage against terrorist acts. The problem was not confined to high profile "trophy" properties located in major metropolitan areas. Shopping malls, office complexes, factories, sports

[2] The loss totals do not include the March 2010 settlement of up to $657.5 million announced by New York City officials and plaintiffs' lawyers to compensate about 10,000 workers whose health was damaged during the rescue and cleanup at the World Trade Center.

stadiums, hotels, utilities, airports, port facilities and other critical infrastructure all across the United States were impacted.

Even as exclusions proliferated, prices soared. The average rate increase for a business seeking to renew coverage in the fourth quarter of 2001 was nearly 30 percent. Reinsurance prices rose sharply as well. Very little private sector coverage for terrorism entered the market as a general consensus emerged that terrorism risk is fundamentally not insurable. Insurers, who are regulated by the states, therefore took the unprecedented step of seeking financial protection from the federal government in the event of future attacks. Only when the Terrorism Risk Insurance Act (TRIA) was enacted by Congress in November 2002—fourteen months after the attack—did stability finally return to the market and coverage for terrorist attacks resume.

Changes in the Terrorism Threat Landscape and Impacts on Terrorism Insurance Markets

In the immediate aftermath of 9/11 the ability of commercial policyholders to purchase adequate limits of terrorism coverage at affordable prices was severely constrained. Commercial property owners and businesses were faced with substantially reduced protection for terrorism-related risks, in addition to higher property/casualty rates overall. As a result, many were forced to go without coverage or only partly insure their assets.

Today, reports of property owners having problems securing terrorism coverage due to a lack of capacity in the market are no longer making headline news. Indeed, it is therefore tempting to conclude that in the ten years since TRIA was first implemented that insurance markets have fully adjusted to the post-9/11 environment and that insurers and reinsurers have concluded that terrorism is a fully insurance risk.

The reality is quite different. The fact of the matter is that terrorism risk today is almost every bit as uninsurable as it was a decade ago. Recent major successes in the war on terror, including the killing of al-Qaida leader Osama bin Laden in 2011, do not alter this conclusion. This is because the current stability in the terrorism insurance market in the United States is due almost entirely to two factors:

(i) There has been no successful terrorist attack on U.S. soil since 2001, and

(ii) TRIA remains in place.

The influence of both of these factors is discussed in the sections that follow.

Absence of Successful Attacks Does Not Imply Terrorism Risk is Inconsequential

The fact that there has been no successful terrorist attack in the United States in eleven years is a remarkable achievement. It is a testimony to the hard work and dedication of this nation's counterterrorism agencies and the bravery of the men and women in uniform who fought and continue to fight battles abroad to keep us safe here at home.

Unfortunately, the threat from terrorist attack in the United States is both real and substantial and will remain as such for the foreseeable future. Indeed, the U.S. State Department warned in a recent report that despite the death of bin Laden and other key al-Qaida figures, the terrorist network's affiliates and adherents remain adaptable and resilient, and constitute "an enduring and serious threat to our national security."[3]

Table 1 below shows that interest in attacking targets within the United States remains undiminished. Indeed, it is clear from Table 1 that in addition to an ongoing threat from foreign terrorist networks, the United States also faces homegrown (domestic) terrorist threats from radical individuals, who may be inspired by al-Qaida and others, but may have little or no actual connection to militant groups.

Catastrophe modeler Risk Management Solutions (RMS) points to an increase in the number of homegrown plots in the U.S. in recent years.[4] Many of these have been thwarted, such as the attempt by Najibullah Zazi to bomb the New York subway system and Mohamed Osman Mohamud who targeted a Portland, Oregon, Christmas tree lighting ceremony. Also among the more notable unsuccessful attacks was a 2010 attempted car bomb attack in New York City's Times Square. Other thwarted attacks

[3] *Country Reports on Terrorism 2011*, U.S. Department of State, July 31, 2012.
[4] RMS Terrorism Risk Briefing, July 2012.

against passenger and cargo aircraft, including the Christmas Day 2009 attempt to blow-up a jet over Detroit, are indicative of an ongoing risk to aviation infrastructure.

Table 1

RECENT TERRORIST ATTACK ATTEMPTS IN THE U.S.

Date	Location	Event
August, 2012	Ludowici, GA	Four U.S. soldiers charged in connection with murder and illegal gang activity, linked to foiled plot to commit domestic acts of terrorism, including overthrowing the government and assassinating the President
May, 2012	TBD	Foiled underwear bomb plot to bring down U.S.-bound commercial airliner around the anniversary of bin Laden's death
July 27, 2011	Fort Hood, TX	U.S. Army Pfc Naser Jason Abdo arrested and charged with plotting bomb attack on fellow soldiers at Fort Hood, TX
June 22, 2011	Seattle, WA	Two men arrested in plot to attack military recruiting station in Seattle
May 11, 2011	New York City, NY	Ahmed Ferhani and Mohamed Mamdouh arrested in plot to attack Manhattan synagogue
February 23, 2011	Lubbock, TX	Foiled plot to bomb military and political targets, including former President George W. Bush in New York, Colorado and California
December 8, 2010	Baltimore, MD	Attempted bombing of Armed Forces recruiting center by U.S. citizen Antonio Martinez, aka Muhammad Hussain
November 26, 2010	Portland, OR	Attempted bombing at Christmas tree lighting ceremony in downtown Portland by naturalized U.S. citizen Mohamed Osman Mohamud
October, 2010	Washington D.C.	Attempted plot to bomb D.C.-area metro stations
May 1, 2010	New York City, NY	Attempted SUV bombing in Times Square, New York City, by naturalized U.S. citizen Faisal Shahzad
December 25, 2009	Over Detroit, MI	Attempted bombing of Northwest Airlines passenger jet over Detroit by underwear bomber Umar Farouk Abdulmutallab
September, 2009	New York City, NY	U.S. resident Najibullah Zazi and others charged with conspiracy to use weapons of mass destruction in New York City
September, 2009	Springfield, IL	Attempted plot to detonate a vehicle bomb at the federal building in Springfield, IL
September, 2009	Dallas, TX	Attempted bombing of skyscraper in Dallas, TX
May, 2009	New York City, NY	Foiled plot to bomb Jewish synagogue and shoot down military planes in New York City
May, 2009	Various U.S. targets	Conviction of Liberty City six for conspiring to plan attacks on U.S. targets, including Sears Tower, Chicago.

Source: Federal Bureau of Investigation (FBI); various news reports; Insurance Information Institute.

Table 1 also demonstrates that the threat of terrorism is not confined to the country's largest cities such as New York and Washington. Recent attempted attacks have occurred in medium and small metropolitan areas including Portland, Oregon, in Lubbock, Texas and Springfield, Illinois.

Another evolving threat is cyber-terrorism. Recent high profile attacks, such as the sabotaging of Iran's nuclear program via the Stuxnet computer worm and malicious infiltration attempts here in the U.S. by foreign entities, underscore the growing threat to both national security and the economy.

All these factors suggest that terrorism risk will be a constant and evolving threat for the foreseeable future.

The Federal Role: Impact of TRIA in Maintaining Insurance Market Stability

Without question, TRIA and its successors are the principal reason for the continued stability in the insurance and reinsurance market for terrorism insurance today. As discussed previously, TRIA is credited with restoring terrorism coverage in commercial insurance policies upon its enactment in late 2002.

It is worth noting that in 2004, more than a year before the original Act's expiration at year-end 2005, terrorism exclusions once again emerged for policies with exposure extending into 2006. This was an unmistakable indication that insurance and reinsurance markets felt that terrorism risk, at least for larger scale attacks, remained uninsurable in the private sector. After Congress agreed to extend the program for another two years under the Terrorism Risk Insurance Extension Act of 2005 (TRIEA), terrorism coverage remained available and affordable in the market. However, with TRIEA's looming expiration in year-end 2006, terrorism exclusions once again appeared in the market, signaling the market's assessment that terrorism risk remained fundamentally uninsurable. These exclusions largely disappeared following passage of a 7-year extension of the program under the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA). With TRIPRA's expiration now a little more than two years away (year-end 2014), it is virtually certain that terrorism exclusions will reappear in the market in 2013. Indeed, insurance broker Aon estimates that at least 80 percent of the commercial property market will be impacted by these exclusions and other restrictions.

Studies by various organizations, including the University of Pennsylvania's Wharton School Risk Center, the RAND Corporation and the Organization for Economic Co-operation and Development (OECD), have supported the idea of a substantive federal role in terrorism insurance. In particular, the Wharton School found that TRIA has had a positive effect on availability of terrorism coverage and also has significantly contributed to reducing insurance premiums.[5] The OECD notes, however, that the financial (capital) markets have thus far shown little appetite for terrorism risk.

Evidence from Other Countries: Terrorism Risk Insurance Programs Abroad

Additional evidence that terrorism risk is fundamentally uninsurable comes from abroad. A number of countries have established their own terrorism risk insurance programs and these have operated successfully, often for many years. Australia, Austria, Belgium, France, Germany, the Netherlands, Spain, Switzerland and the United Kingdom have all created programs to cover terrorism in the event of an attack on their own soil.[6]

This begs the question as to why—eleven years after the 9/11 attack and a decade after the initial terrorism risk insurance program legislation was enacted—terrorism risk, particularly for large-scale attacks, is still viewed as uninsurable? The answer is surprisingly simple and explains why even the absence of a successful major attack on U.S. soil since 2001 does not alter this assessment.

Obstacles to Insuring Losses Arising from Acts of Terrorism

Simply put, acts of terror violate all four of the basic requirements traditionally associated with insurability of a risk. In situations where these requirements cannot be met, it is difficult or impossible to ascertain the premium to be charged and/or difficult or impossible to achieve the necessary spread of risk to avoid excessive exposure to

[5] *Evaluating the Effectiveness of Terrorism Risk Financing Solutions*, Howard C. Kunreuther and Erwann O. Michel-Kerjan, September 2007, National Bureau of Economic Research.

[6] In 1993, the British government formed a mutual reinsurance pool for terrorist coverage following acts of terrorism by the Irish Republican Army. Insurance companies pay premiums at rates set by the pool. The primary insurer pays the entire claim for terrorist damage but is reimbursed by the pool for losses in excess of a certain amount per event and per year based on its share of the total market. Following 9/11, coverage was extended to cover all risks, except war, including nuclear and biological contamination, aircraft impact and flooding, if caused by terrorist attacks. The British government acts as the reinsurer of last resort, guaranteeing payments above the industry retention.

catastrophic loss, thereby threatening the insurer's solvency. Consequently, such a risk would generally be deemed to be commercially *not* viable (i.e., insurable) in whole or in part.

The four basic requirements for insurability of a risk are detailed below (as well in Exhibits 3A and 3B), with a description of how terrorism risk violates each requirement:

1. **Estimable Frequency:** Insurers require a large number of observations to develop predictive, statistically sound rate-making models (an actuarial concept known as "credibility"). For example, insurers handle millions of auto, home, workers compensation and business property claims every year, providing them with vast amounts of data from which they can reliably estimate the frequency of such claims. For major catastrophic risks such as hurricanes and earthquakes that occur less frequently insurers still maintain databases with hundreds or even thousands of these events, supplemented by sophisticated catastrophe models, that help provide statistically reliable estimates of frequency. Terrorism risk is clearly different in this respect.

   Obstacle: There are very few data points on which to base frequency estimates for acts of terror in the United States, thus estimates lack any true actuarial credibility. The opinions of experts on the likelihood of terrorist attacks, which might be viewed by some as substitutes for actuarially credible data, are also highly subjective. At any given time, there is a wide range of viewpoints among national security experts on the likelihood, location and/or attack modality. Moreover, insurers have no access to data used internally by counterterrorism agencies. Given the paucity of historical data and diversity and shifting nature of expert opinions, catastrophe models used to estimate terrorism risk are relatively undeveloped compared to those used to assess natural hazard risks. The bottom line is that estimating the frequency of terror attacks with any degree of accuracy (credibility) is extraordinarily challenging, if not impossible in many circumstances.

2. **Estimable Severity:** Insurability requires that the maximum possible/probable loss be estimable in order to calculate the insurer's exposure (in dollar terms) and minimize its "probability of ruin." No insurer can expose itself to losses of a magnitude that present an unreasonable risk of insolvency.

   Obstacle: Potential losses arising from terrorist attacks are virtually unbounded. In this sense terrorism risk is akin to war risk, which is almost universally excluded from commercial insurance policies worldwide. Consequently, losses arising from acts of terror can easily exceed an insurer's claims paying capital resources. Workers compensation coverage, which does not permit any exclusions or limitation if injuries or deaths arise from terrorist acts, can lead to extreme losses that on their own could potentially bankrupt an insurer under some attack scenarios. In addition, when it comes to estimating losses from potential terrorist attacks there also appears to be significant variability in outcomes (i.e., disagreement on estimated severity impacts), underscoring the degree of uncertainty associated with potential terrorist attacks.

3. **Diversifiable Risk:** Insurability requires that the losses can be spread across a large number of risks. This is an application of the "Law of Large Numbers" and helps makes losses more manageable and less volatile. Failure to achieve an adequate spread of risk increases the risk of insolvency in the same way that an undiversified portfolio of stocks (or any asset) is riskier than a well-diversified portfolio.

   Obstacle: Terrorism attacks are likely to be highly concentrated geographically (e.g., World Trade Center site), concentrated within an industry (e.g., power plants, airports) or within a certain span of time (e.g., coordinated attack).

4. **Random Loss Distribution/Fortuity:** Insurability requires that the probability of a loss occurring be random or fortuitous. This implies that individual events must be unpredictable in terms of timing, location and magnitude.

Obstacle: Terrorism attacks are planned, coordinated and deliberate acts of destruction. Again, they are likely to be highly concentrated geographically (e.g., World Trade Center site) or concentrated within an industry (e.g., power plants). Terrorists engage in "dynamic target shifting" whereby terrorists shift from "hardened targets" to "soft targets" which implies that losses are not random or fortuitous in nature.

The Success of the Terrorism Risk Insurance Program

The Terrorism Risk Insurance Program, by all objective measures, is a success. The program not only succeeded in restoring stability to the country's vital insurance and reinsurance markets in the wake of the unprecedented market dislocations associated with the September 11, 2001 terrorist attack, but it continues to deliver substantive, direct benefits to businesses, workers, consumers and the economy overall—all at little or no cost to taxpayers.

Availability and Affordability

One measure of success is the "take-up rate" (i.e., share or businesses purchasing coverage) of insurance coverage among. Insurance brokers Marsh and Aon both estimate that take-up rates for terrorism coverage are in the 60% to 65% range over the past several years (ranging as high as 80% in some industries), up from approximately 27% in 2003—the first full year under TRIA. This suggests that coverage is widely available, is affordable and is routinely purchased in the market. It is important to note, however, that the take-up rate for workers compensation coverage is effectively 100%. This is because workers compensation is a compulsory (all employers must purchase coverage) combined with the fact that states do not allow exclusions for terrorism losses in workers compensation programs.

Affordable pricing is another measure of the program's success. While pricing varies across industries, reflecting differences in risk, the average commercial terrorism premium is equivalent to approximately 0.5% of a company's total insured value, according to brokers. Prices can also be stated as a share of the cost of the insured's total insurance program, in which case annual premiums account for approximately 5% to 6% of total costs, again varying by industry.

Capacity

One primary goal of TRIA and it successors has been to encourage private sector capacity to enter (and remain) in the marketplace so that an increasing share of losses from future terrorist attacks could be borne in the private sector.

Evidence of the program's success in this respect has been documented by a number of government entities and other organizations. In its latest report on terrorism risk insurance market conditions, the President's Working Group on Financial Markets noted that the program provides an incentive to property/casualty insurers and reinsurers who might not otherwise provide terrorism insurance at current capacity levels or prices.[7] The U.S. Government Accountability Office (GAO), commenting on the availability and affordability of terrorism coverage in large metropolitan areas, reported that with a few exceptions, commercial property terrorism insurance appears to be available nationwide at rates policyholders believe is reasonable, suggesting ample capacity.[8]

Note that this statement is very different from an assessment that such capacity would exist in the absence of a terrorism backstop. Again, it is important to emphasize that the majority of the coverage that exists in the market today exists because of the continued existence of the Terrorism Risk Insurance Program. As noted earlier, insurance broker Aon estimates that 70% to 80% of the market would encounter terrorism exclusions if the program were discontinued. Thus capacity in the market is largely contingent upon the continuation of the program.

The so-called market for "standalone" terrorism coverage also provides evidence that in the absence of a Terrorism Risk Insurance Program, coverage capacity (supply) will fall well short of demand. Insurance brokers Marsh and Aon both report that the "theoretical"

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[7] *Market Conditions for Terrorism Risk Insurance 2010*, Report of the President's Working Group on Financial Markets.

[8] *Initial Results on Availability of Terrorism Insurance in Specific Geographic Markets*, GAO-08-919R, July 2008.

maximum amount of coverage available per risk in the "standalone" market is approximately $2 billion with larger sums available under some circumstances. This is in contrast with limits of just $150 million or less available in early 2002 before TRIA was enacted. At the time, such coverage also was subject to high deductibles equal to 7 to 10 percent of the stated value of the coverage.[9] While the sums available in the market today may seem large, especially in comparison to 2002, there are many risks for which the coverage is inadequate. Consider, for example, that back in 2001 (prior to the introduction of terrorism exclusions) the twin towers at the World Trade Center site were insured for $3.55 billion—more than what is generally available in the market today. Multibillion dollars risks are now quite common in the United States, from office and shopping complexes to large manufacturing facilities, sports stadiums, transportation hubs and energy infrastructure not to mention infrastructure such as bridges, tunnels and dams.

Reinsurance capacity, which was extremely limited in the aftermath of 9/11, is up as well. A 2011 report from reinsurance broker Guy Carpenter noted that there is between $6 billion and $8 billion of terrorism reinsurance capacity available in the U.S. market, but cautions that the market remains vulnerable to a major terrorism loss. This caution is appropriate. Indeed, many modeled loss scenarios result in insured losses in the tens or even hundreds of billions of dollars—some even exceeding the claims paying capital of the entire industry. As noted previously, much of the capacity in the market today is predicated on the existence of the Terrorism Risk Insurance Program. In the absence of the program, reinsurance capacity would be greatly reduced.

Factors that Could Influence Greater Private Sector Participation in the Terrorism Insurance Marketplace

As discussed previously, the primary factor influencing private sector participation in the market for terrorism insurance, apart from the absence of a successful attack on U.S. soil since 2001, is the continued existence of the Terrorism Risk Insurance Program.

[9] *September 11, 2001: One Hundred Minutes of Terror that Changed the Global Insurance Industry Forever*, Robert P. Hartwig, John Liner Review, January 2002.

The program's success to date has stabilized insurance and reinsurance markets, enhanced availability and affordability of coverage and encouraged private sector capacity to enter the market, thereby helping businesses invest, grow and create jobs.

What follows are several options, based on international experience and U.S. experience to date, that could potentially further increase private sector participation in the markets for terrorism insurance and reinsurance.

Long-Term Extension or Permanence of a Terrorism Risk Insurance Program

The positive experience of other countries, some of which have had programs in place much longer than the United States, combined with favorable recent U.S. experience under the current 7-year extension of the program under TRIPRA, suggests that a long-term extension—or a decision to make the program permanent—could be an effective means to achieve increased private sector participation in the program. If insurers and reinsurers are assured that the program will be in place for the indefinite future, uncertainty is reduced. From an economic perspective, the reduction in uncertainty would likely be conducive for investment under the program.

Pooling Proposal

As Congress begins to explore alternatives to enhance private sector participation in the market for terrorism risk, it is instructive to recall that insurers began their effort to create a federal "backstop" very shortly after the September 11 attacks. By late September 2001, insurers had already drafted an outline describing their plan for a federal backstop and legislation was drafted in early October. Dubbed the "Insurance Stabilization and Availability Act of 2001," the bill proposed the establishment of a privately run and financed terrorism reinsurance pool, organized as a federally-chartered mutual insurance company, that would reinsure the terrorism risks of U.S. licensed insurers and reinsurers and purchase reinsurance from the federal government in exchange for a premium. The organizational structure of the pool would have been similar to that of Pool Reinsurance Company Ltd. (often referred to as "Pool Re"), a mutual insurer established in Great Britain in 1993 after several bombings attributed to the Irish Republican Army (IRA) made insurers reluctant to offer coverage for terrorist acts (Pool Re now provides coverage against a broad range of terrorism risks). While no doubt adjustments would need to be made given the passage of more than a decade since the industry's initial pooling proposal, the concept of a pool has worked successfully in the U.K. for 20 years.

Summary

In the eleven years since the tragedy of the September 11, 2001 terrorist attack on the United States, much has been learned about the nature of terrorism risk and its insurability. There is no question that the Terrorism Risk Insurance Act and its successors brought much needed stability to the market in the aftermath of the most costly insurance loss in global history. In the decade since, private sector insurers, reinsurers and the federal government have successfully partnered with one another in order to maintain that stability, providing tangible benefits for businesses large and small—and their employees—all across America.

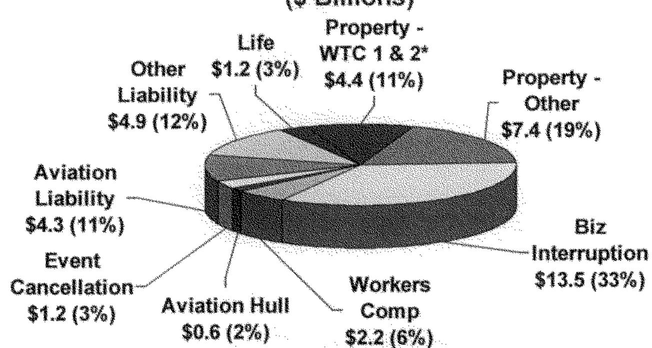
The looming expiration of the TRIPRA at the end of 2014 brings to a head the question of whether terrorism risk is now, or ever will be, a risk that can be managed entirely within the private sector. The evidence, both in the United States and from similar programs abroad, is that market stability in terms of both pricing and availability of terrorism coverage, as well as the ability to maintain adequate and expanding levels of capacity over time, are contingent on the continued existence of the Terrorism Risk Insurance Program.

Thank you for you for the opportunity to testify before the Committee today. I would be happy to respond to any questions you may have.

Exhibit 1

Loss Distribution by Type of Insurance from Sept. 11 Terrorist Attack ($ 2011)

($ Billions)



Total Insured Losses Estimate: $40.0B**

*Loss total does not include March 2010 New York City settlement of up to $657.5 million to compensate approximately 10,000 Ground Zero workers or any subsequent settlements.

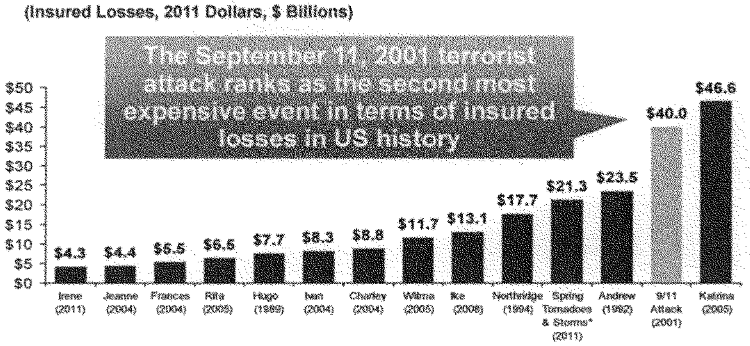
**$32.5 billion in 2001 dollars.

Source: Insurance Information Institute.

Exhibit 2

Top 14 Most Costly Disasters in U.S. History

(Insured Losses, 2011 Dollars, $ Billions)



Note: Property losses only except in the case of 9/11, which includes all impacted lines. 9/11 property losses totaled $23.5 billion.

Sources: PCS; Insurance Information Institute inflation adjustments.

2

Exhibit 3A

Terrorism Violates Traditional Requirements for Insurability

Requirement	Definition	Violation
Estimable Frequency	•Insurance requires large number of observations to develop predictive rate-making models (an actuarial concept known as credibility)	•Very few data points •Terror modeling still in infancy, untested. •Inconsistent assessment of threat
Estimable Severity	•Maximum possible/ probable loss must be at least estimable in order to minimize "risk of ruin" (insurer cannot run an unreasonable risk of insolvency though assumption of the risk)	•Potential loss is virtually unbounded. •Losses can easily exceed insurer capital resources for paying claims. •Extreme risk in workers compensation and statute forbids exclusions.

Source: Insurance Information Institute

Exhibit 3B

Terrorism Violates Traditional Requirements for Insurability (cont'd)

Requirement	Definition	Violation
Diversifiable Risk	•Must be able to spread/distribute risk across large number of risks •"Law of Large Numbers" helps makes losses manageable and less volatile	•Losses likely highly concentrated geographically or by industry (e.g., WTC, power plants)
Random Loss Distribution/ Fortuity	•Probability of loss occurring must be purely random and fortuitous •Events are individually unpredictable in terms of time, location and magnitude	•Terrorism attacks are planned, coordinated and deliberate acts of destruction •Dynamic target shifting from "hardened targets" to "soft targets" •Terrorist adjust tactics to circumvent new security measures •Actions of US and foreign govts. may affect likelihood, nature and timing of attack

Source: Insurance Information Institute

STATEMENT OF JON JENSEN
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

HOUSE COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 11, 2012

Good morning Chairman Biggert, Ranking Member Gutierrez, and members of the Subcommittee. My name is Jon Jensen and I thank you for inviting me to testify today on behalf of the Independent Insurance Agents & Brokers of America (IIABA or the Big "I") in order to provide our association's perspective on the topic of terrorism insurance. I began my insurance career over 35 years ago and now serve as President of Correll Insurance Group, a South Carolina-based insurance agency with 12 offices and 132 associates. In addition, I have served as Chairman of the Government Affairs Committee for the Big "I" since 2011 and also represent my home state on IIABA's Board of Directors.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, representing a network of more than a quarter of a million agents, brokers, and employees nationwide. Big "I" member small businesses possess the unique ability to offer consumers a wide array of insurance products – property, casualty, health and life – from many different insurance companies. Independent agents sell nearly 80% of all commercial lines policies in the country, and our expertise and experience with businesses and the commercial marketplace affords our membership a one-of-a-kind perspective with which to speak to the topic of terrorism insurance.

The scheduled expiration of the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) at the end of 2014 is quickly approaching, and I applaud the Committee for scheduling this hearing now and for proactively initiating its important review of the Terrorism Risk Insurance Program (TRIP). Although the threat of unprovoked, unpredictable, and possibly devastating attacks continues to loom large and creates complex and unique challenges for insurance providers, the existence of the TRIP has successfully helped preserve a stable and viable market for terrorism insurance. Continuing this stability and maintaining this narrow and limited public-private partnership is vitally important, and the Big "I" looks forward to working with members of the Committee to develop long-term solutions to the unique challenges created by the continued threat of terrorist attacks.

The Terrorism Risk Insurance Program

The enactment of the Terrorism Risk Insurance Act (TRIA) in November 2002 and the subsequent establishment of TRIP were key elements of our government's response to the heinous, unprecedented, and unforgettable attacks of September 11, 2001.

America had never endured a terrorist attack of such magnitude, and the attacks quickly produced severe disruptions in the insurance marketplace and in our national economy. Insurers were forced to confront the reality that large terrorism events could indeed occur and that they posed very unique risks. The underwriting and pricing of these exposures proved nearly impossible due to the inability of carriers to assess and measure the likelihood and magnitude of future terrorism events, and many insurers simply stopped providing terrorism coverage to commercial policyholders as a result. The inability of businesses to secure adequate terrorism coverage also had significant and negative repercussions across broad sectors of the national economy. The commercial real estate market, for example, was acutely affected as insurance for new construction projects could not be obtained and therefore funding from lenders could not be secured.

The original enactment of TRIA and its extension in 2005 and again in 2007 successfully stabilized the insurance marketplace and helped eliminate the market disruptions and uncertainties that followed the September 11th attacks. Congress wisely structured the program so as to involve the private sector as much as possible and created a successful and limited public-private partnership that has operated at virtually no cost to taxpayers. The private sector remains solely responsible for terrorism-related losses related to personal insurance (auto and homeowners), group life, reinsurance, and numerous other lines of coverage, and less than one-half of property-casualty premiums are written in lines covered by the terrorism risk insurance program.

TRIP also has numerous cost sharing provisions that limit the exposure of the federal government should the worst happen and a need for the backstop arise, and the portion of terrorism-related losses that are the responsibility of the private sector has increased over time. The program now has a "trigger" of $100 million in aggregate industry insured losses that must be incurred before any federal dollars are spent (a significant increase from the $5 million trigger incorporated in the original law), which limits the application of the existing program to only severe events. If a terrorist attack of this size and scope did occur, each insurance company would have a deductible equal to 20% of its commercial property-casualty premium volume and would also be responsible for a 15% share of relevant losses above its retention level. The insurance marketplace retention of losses (i.e. the amount covered by deductibles and the copayment mechanism) must add up to at least $27.5 billion (an amount that has also increased significantly over time), or the federal government may recoup the difference through a surcharge on commercial policies. Lastly, there is an annual $100 billion cap on the program.

Ongoing Need for Limited Federal Role

The Big "I" believes the continued operation of TRIP or a similar public-private partnership is essential given the continued threat of terrorism and the unique and unpredictable nature of this devastating risk.

The factors and marketplace realities that caused Congress to enact and reauthorize TRIA remain in place today. It is widely believed that the size and severity of a terrorist attack could threaten the capacity of the insurance market, and such risks still cannot be assessed by traditional methods. Insurers do not have access to the data and information to perform proper underwriting, as much of the information that does exist is available only to governmental agencies that fiercely guard it for security and law enforcement reasons.

Despite the significant and meaningful progress that has been made in protecting our country from terrorists, the threat of terrorism remains with us daily. Those government officials most directly involved in protecting us from such threats – from the Secretary of Homeland Security to the Director of the National Counterterrorism Center – regularly remind us that such threats continue to evolve and have become more decentralized and diverse in recent years. The evolving nature of terrorist threats makes it even more difficult for insurers to assess and make meaningful judgments about possible terrorist events, and this unfortunate reality is why it is so important to have a thoughtful terrorism risk insurance program in place.

TRIP has had an incredibly beneficial impact on the nation's economy, but terrorism coverage will once again become extremely difficult – or impossible – for many businesses to obtain if the program is allowed to expire with no policy solution in its place. The private sector simply lacks the ability and capacity to fill the considerable void that would be created if the program expires, and such an outcome would be especially troubling for the countless small and medium-sized businesses that already struggle to remain profitable in a challenging economic environment and are unable to self-insure. The vast majority of businesses in this country are of this size, and these commercial enterprises will be unable to properly protect their assets, property, and investments against the threat of terrorism without such a partnership. This problem is particularly acute in urban and suburban areas. In short, we believe the termination of TRIP would have destabilizing effects on the economy in many regions of the country.

Conclusion

It has been eleven years since the terrorist attacks of September 11, 2001, and I am certain the memory of those events and the ensuing weeks and months remain vivid to all those in this room. Although our nation has thankfully been spared from further events in recent years, the threat of terrorist attack is as great as ever, and our country must take the steps necessary to protect itself from a similar future event. We must also take the steps necessary to protect our national economy against such events and ensure that terrorism insurance is available in a meaningful way to our nation's businesses and job-creators.

The Big "I" believes that TRIP has worked well and that some form of limited federal involvement is still needed to maintain a stabilized and viable market for terrorism insurance. We applaud the Committee for the foresight to delve into this subject matter this Congress and look forward to working with you as you consider solutions to address the unique nature of the risk presented by terrorist attacks.

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CONGRESSIONAL TESTIMONY

TRIA: Time to End the Program

Testimony before
Subcommittee on Insurance, Housing and Community Opportunity,
Committee on Financial Services,
United States House of Representatives

September 11, 2012

David C. John
Senior Research Fellow
The Heritage Foundation

Chairman Biggert and Ranking Member Gutierrez, thank you for inviting me to participate in this hearing. I am David C. John, the Senior Research Fellow in Retirement Security and Financial Institutions at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

The Terrorism Risk Insurance Act (TRIA) served a very real purpose in the days after 9/11 when insurance companies and their customers feared the cost of providing coverage for acts of terrorism would be prohibitive. However, we have now reached a point where the private sector is increasingly capable of providing that coverage at appropriate prices without government support. In fact, the continued existence of TRIA may keep the industry from further progress. However, the industry will need time to make the transition to a fully private terrorism system, and it is greatly to the Subcommittee's credit that you are beginning to discuss this issue now instead of waiting until closer to the program's 2014 expiration date.

Back in 2001, TRIA served a real purpose. Without swift but well-considered action from Congress, thousands of American businesses might have been unable to continue purchasing affordable terrorism insurance. The massive losses from the September 11, 2001 attacks made property and casualty insurers understandably reluctant to continue to issue property insurance policies that included terrorism coverage until they could evaluate their exposure to potential terrorist attacks. They were equally reluctant to issue stand-alone policies that only covered acts of terrorism.

Before TRIA, property and casualty insurers faced a serious dilemma. Many of their corporate policies issued before the 9/11 attacks insured against terrorist attacks in much the same way they covered natural disasters or more conventional accidents. Then and now, insurance premiums on most types of loss were based on sophisticated estimates of the likelihood that a particular claim will have to be paid. Until September 11, insurers never expected the scale of damage inflicted in those attacks. Thus before 9/11, terrorism coverage often carried a very low price tag and often was included without much additional though in more comprehensive coverage.

Then the world changed. Insurers and the rest of us discovered that such attacks were possible and could cause catastrophic damage. At the time, none of us had any firm idea whether those attacks were isolated incidents or not. As a result, they were unable to price terrorism coverage quickly and accurately, and unwilling to expose their companies to claims that could run in the tens of billions of dollars.

Losses from the World Trade Center attacks were spread among many foreign and domestic insurers and "reinsurers." This is standard practice for large policies; insurers essentially spread the risk among many other companies in return for a share of the premiums generated by the policies. Some of the risk is sold to reinsurers, who generally insure the insurance companies against huge losses. In this way, no one company is left facing ruin when there is a huge claim on a policy. This method enabled the industry to absorb the roughly $35 billion in claims from the attacks on the World Trade Center. However, in the days after 9/11, many insurers and reinsurers that would have had great difficulty paying another such loss were unwilling to renew policies that include terrorism coverage.

As we knew at the time, the wrong government response could prevent the market from taking the necessary actions. Any program that essentially transferred the risk from companies to the government by promising that tax dollars would pay most of the losses would only make it more difficult for private insurers to establish the real market price for terrorism coverage. Because the industry would be collecting premiums without facing the true value of potential losses, such coverage would be underpriced. Those who bought this insurance would not have any incentive to reduce their risk, but every incentive to support extending the federal program indefinitely.

While the problem in 2001 was real, it should have been temporary. By now, normal insurance industry processes should have already been able to resolve it. The industry should have developed ways to price terrorism coverage properly, which could include upper limits on company liability. And reinsurers should have found ways to involve sophisticated investors who, for a price, could face the type of losses that could occur.

Recent industry data indicates that there has been a great deal of progress towards making terrorism coverage both widely available and affordable. While coverage varies according to geographic area and industry, some industries show that over three-quarters of larger firms have purchased some form of terrorism coverage. In addition, the cost appears to be declining, with one major report suggesting that the cost dropped by almost a third between 2008 and 2009 alone. Clearly, the process is well underway, and Congress should remove the last barriers to restoring full private coverage for acts of terrorism by ending TRIA.

The recession has had a negative effect on the number of firms that have been able to renew their coverage, but this is to be expected. Faced with cash flow problems, firms will cut wherever that can. What is concerning is that industry sources suggest that the risk models used for terrorism insurance are still more primitive than those used for other types of catastrophic coverage. This may well be due to the continued presence of TRIA, which limits a firms risk exposure and may cause them to focus more on the risk that the firm retains than on the potential losses that the government would cover.

TRIA was not intended to be a permanent program. As the original bill stated, TRIA would "provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance." Returning this coverage to the private sector is an important goal, because there is no reason why taxpayers should continue to have the ultimate financial responsibility for paying insurance losses on private property. The insurance crisis has passed, and the insurance industry now has enough information about terrorist attacks to again provide this coverage. As a result, there is no reason to extend TRIA beyond its scheduled 2014 expiration date.

Some insurance industry associations and others argue that without TRIA, terrorism coverage will revert to some level of problems, but this should not be the case. By 2014, the industry should have over 12 years of data that would allow it to appropriately price its coverage. If, and let me stress the *if*, the industry cannot assume total responsibility, Congress should start the process in early 2013 by implementing proposals such as increasing the deductible to be paid by insurers, increasing the insurer co-participation, increasing the event trigger, removing coverage for acts of domestic terrorism; and reducing the recoupment percentage from 133 percent to 100 percent. These changes should take effect almost as soon as they can be passed

That should be followed by a full phase-out of TRIA so that the entire program has ended no more than two years after the current 2014 expiration date. *If* these steps are necessary, Congress should also strongly indicate to the industry that further extensions will not come, and that it should expect to offer terrorism coverage after that without any further taxpayer subsidies.

Let It Expire

Congress should neither extend nor expand TRIA without a firm and short phase-out, and if Congress passes any longer extension, whoever is in the White House after January 20 should reject such legislation. Continuing to pass the risk of property insurance losses caused by terrorist attacks to taxpayers does nothing to increase security. Rather, programs like TRIA encourage insurance companies to avoid the proper pricing of coverage, with the expectation that federal reinsurance under TRIA will enable them to pass on significant losses to taxpayers. TRIA is thus a pre-approved bailout for insurance companies, the essence of corporate welfare. There was a good reason to establish TRIA, but those days are over. TRIA has served its purpose and should now be allowed to expire.

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Testimony of Michael H. Lanza
Executive Vice President and General Counsel
Selective Insurance Group, Inc.
On Behalf of the Property Casualty Insurers Association of America (PCI)

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives
September 11, 2012

Chairman Biggert, Ranking Member Gutierrez, Members of the Subcommittee:

Thank you for the opportunity to testify today on terrorism insurance issues. I am Michael Lanza, Executive Vice President and General Counsel of Selective Insurance Group, Inc. Selective is the 49^{th} largest property and casualty insurance group in the country. I am testifying today on behalf of our national trade association, the Property Casualty Insurers Association of America (PCI), which represents approximately 40 percent of the nation's home, auto, and business insurance market.

Today we memorialize the anniversary of the tragic 9-11terrorist attack that killed thousands and resulted in economic devastation greater than any insured loss in history. With economic investment freezing, President Bush asked Congress to immediately enact legislation to protect our country's security. This Committee responded swiftly and passed the Terrorism Reinsurance Act, or TRIA, in just 2 months. In September 2002, the House adopted the TRIA conference report by voice vote. In 2005, and 2007, the House voted overwhelmingly to renew this important national security program. These three House votes passed by wide margins under different majorities – and reflect TRIA's historic bipartisan support.

In the last 11 years, the threat of terrorism has not receded. Dozens of terrorist attacks against our nation are attempted annually, with terrorists evolving new strategies to circumvent federal security. TRIA is a low-cost, fiscally prudent terrorism safety net that protects our nation's economic security. Absent its extension, insurance policies will begin in 2013 to exclude terrorism coverage or, to the extent permitted under state law, not be renewed for major underlying risks.

PCI and Selective strongly believe in the private insurance market. We also believe that the private insurance market can adequately cover risks that are fully insurable. Fully insurable risks are those for which a private insurer can adequately predict the likelihood and severity of a loss. We know terrorism when we see it, but it is difficult to define. Is it a crime or an act of war? Neither, however, is generally insurable – let alone fully insurable – in the private insurance market.

Some Committee Members who have philosophical concerns about government programs that support or displace private markets may have some philosophical doubts about TRIA. TRIA, however, is essential to the private insurance market because terrorism is not a fully insurable event. The likelihood and severity of terrorist attacks cannot be adequately predicted. Terrorism in the 9/11 form, which is what TRIA was designed to address, is an inherently unpredictable political act designed to frighten the nation's security and public through death, mutilation, and the destruction of public and private property. We know that after 9-11 the federal government set up costly victims' protection funds where private coverage was inadequate. TRIA has been the government's best security protection to keep the private sector largely responsible – and avoid future federal post-event bailouts.

National security is the primary responsibility of the federal government – not the private insurance market. Our national security apparatus is focused on anticipating and preventing terrorist acts and assessing the probability and severity of such events against major economic centers and public and private symbols of our country. These government agencies gather and have access to classified intelligence information not available to the private insurance market. Insurers analyze exposure to hypothetical terrorist events, but insurers don't have access to this sort of intelligence information necessary to predict the acts of terrorists. Our policyholders who purchase TRIA coverage (and in Selective's case that is 86% of our Commercial Lines policyholders and the mandated 100% of our workers compensation policyholders) also do not.

The pool of potential terrorists and the risk of terrorism are not static. They change based on U.S. domestic and foreign policy – which is constantly evolving. These policy changes, coupled with technological developments, can also lead to new forms of attack. The scope and breadth of these policy changes cannot be adequately predicted or tracked by the private insurance industry. Companies such as Selective, which writes primarily in 22 states east of the Mississippi and has approximately $1.6 billion in premium, certainly don't have the resources to do so. And Selective's small business clients, who pay an average of $10,000 for 3 commercial policies, certainly do not. This is why they need TRIA.

Let me elaborate on this. To be insurable, events must be predictable in frequency and severity. Property casualty insurers can estimate, based on experience, roughly how many car accidents, house fires, and industrial accidents will occur in a year and what their costs will be. With over a hundred years of weather history and free access to weather pattern science, the industry can also model storm paths and predict weather losses. This experience, and access to factual evidence and trends, however, does not exist for terrorism. In fact, only one data point exists for a catastrophic terrorist event – and that happened 11 years ago today.

Another difference between fully insurable events and terrorist acts is that insurable events are generally not correlated. That means they are random and independent of each other. For example, the likelihood of a hurricane in Florida is not correlated with the likelihood of an earthquake in California. The likelihood of correlated terrorist events is known and was demonstrated 11 years ago. Coordinated attacks can cause more terror, thus simultaneous attacks on New York City and Washington. Correlation of occurrence is another reason why we believe TRIA is required.

While *some* terrorism coverage is available in the private market now, it is not widely available for the reasons I have discussed – and because the potential losses are so large. Industry models have shown potential losses for another major terrorist event to be up to $250 billion. That figure is more than half the surplus for the entire property casualty insurance industry. Without TRIA, the private insurance market would have significant difficulty handling a loss of that magnitude.

There are three additional points about TRIA that I would like to make:

1. **TRIA Is Fiscally Responsible.** To date, TRIA has not cost taxpayers one cent in direct payments. If losses were to occur, the private insurance market would repay any government assistance up to $27.5 billion. According to the CBO, TRIA's net cost to taxpayers through 2017 is roughly zero. That's not bad for a program that helps ensure hundreds of billions of dollars in annual insurance coverage. In the absence of TRIA, taxpayers would face much more exposure. Without private insurance, the Federal government will step in to assist in a disaster. That means the demand for government assistance will be greater without the possibility of any TRIA recoupment.

2. **TRIA Protects Private Sector Growth.** The impetus behind TRIA was to prevent severe terrorism-related economic disruptions. Insurance is a substitute form of capital that supports balance sheets and permits businesses to own properties and engage in activities, such as hiring and business expansion, they might not otherwise do in its absence. Moreover, insurance permits immediate rebuilding after a loss. Without TRIA, insurers may simply exclude terrorism coverage or not renew policies covering major commercial risks to the extent permitted under state law. That means if there was a terrorist act, there would be less private capital to rebuild, which is key to the economy, economic development efforts, and public morale.

3. **TRIA Is Vital to Keeping the Cost of Workers Compensation Down**. State workers compensation laws mandate coverage for terrorist acts that occur in the workplace. Without TRIA, it will be very difficult to obtain reinsurance in the private market. This could lead insurers, where possible, to exit the workers compensation market. For those that remain in the market, the extent of losses could impair the ability to pay the claims of injured workers. Just as insurance is substitute capital for business, reinsurance is substitute capital for insurers. Without it, more capital would be required to support workers compensation writings. This would certainly drive up the costs of workers compensation insurance. This could be a significant impediment to economic recovery, particularly as it impacts small businesses.

Given what terrorism is, the private insurance markets cannot provide terrorism coverage without TRIA. TRIA is a critical national security and economic development program in which the private insurance market is proud to participate. PCI stands ready to assist you as you continue your deliberations. Thank you very much.

TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program
September 11, 2012
Testimony before the Subcommittee on Insurance, Housing and Community Opportunity of the House Financial Services Committee
U.S. House of Representatives

Christopher M. Lewis
Senior Vice President and Chief Insurance Risk Officer
The Hartford Financial Services Group

Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of The Hartford Financial Services Group (The Hartford) and our property-casualty insurance trade association, the American Insurance Association (AIA), to discuss the important issue of terrorism risk insurance. My name is Christopher Lewis and I am Senior Vice President and Chief Insurance Risk Officer for The Hartford. Founded over 200 years ago, The Hartford is one of our nation's oldest insurance companies, among the largest commercial property-casualty insurers, and an insurance partner to over one million small businesses across the United States.

In my capacity as a chief risk officer, I believe that I can offer an important perspective on why terrorism risk remains a unique and uninsurable risk, describe the limited tools available to insurers to manage that risk, explain the market stabilizing value of the program established by the Terrorism Risk Insurance Act of 2002 (TRIA) and its successors, and underscore the importance of maintaining this essential program into the foreseeable future to protect our economy in the event of another major terrorist attack on U.S. soil.

The Insurance Industry's Response to September 11, 2001
Today marks the 11th anniversary of the tragic attack on September 11, 2001. That event forced all Americans to confront directly the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil – quite literally, to face a new form of war. Despite the unanticipated nature of the event, The Hartford and other insurers responded to September 11 claims in an unwavering manner and without a single dollar of federal assistance.

However, the devastating economic consequences of the attack forced insurers and other businesses to re-examine the nature of terrorism-related risks, as well as to review how such risks were being spread and managed.

In today's dollars, the September 11th attack is estimated to have resulted in almost 3,000 deaths, as well as over $23 billion in insured property loss and $40 billion in total insured loss[1] The Hartford's share of this loss was approximately 3 to 3.5%, as we helped our policyholders recover from the tragic loss. Of course, a large portion of the insured industry loss was effectively reinsured, and the reinsurance industry honored its obligations.

Unfortunately, in the aftermath of the attack, the reinsurance markets withdrew new capacity and the reinsurance market for terrorism evaporated. Without the ability to spread and diversify these risks globally through reinsurance and with no ability to price the risk of terrorism, insurance companies were unable to provide adequate terrorism coverage to commercial

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[1] Source: Insurance Information Institute, 2010 dollars excluding Victims Compensation Fund

policyholders. The effects of this chain of events trickled down to lenders and the construction industry, putting a significant drag on the economy. To support the economy and allow private markets to stabilize, Congress stepped forward in bipartisan collaboration and passed the Terrorism Risk Insurance Act of 2002 (TRIA).

TRIA provides a federal backstop to insurance companies for large certified terrorism events - above a $100 million loss - while requiring insurers to "make available" (offer) terrorism insurance to commercial policyholders for such coverage as business interruption and property insurance. Under the current program, insurers would need to absorb an estimated $25 to $30 billion of insured losses before the federal government begins to share the losses. Put another way, a terrorism loss would have to be larger than $25 to $30 billion before the federal government would be called on to make any payment. Even then, TRIA requires each insurer to pay 15 cents on every dollar of loss above its deductible, and then provides a recoupment mechanism to recover federal dollars that are expended.

By creating a post-event pooling mechanism that preserves significant industry "skin in the game" and only accesses federal dollars for extremely large-scale terrorism losses, the Act allows insurance companies to understand and manage their potential exposure to losses attributable to terrorism attacks while providing a cap on the potential loss to capital from such an attack. As a result, insurers are able to offer terrorism coverage to commercial policyholders while TRIA provides the all-important market stability.

In the event of a future terrorist attack, TRIA ensures that private insurance payments flow to those affected businesses that have purchased coverage, as well as to their employees, which in turn helps businesses and the economy recover. These payments will be crucial to minimizing the economic, psychological, and social fallout from an attack. At the same time, if an attack is so massive that it triggers the federal protection established by TRIA, government payments are ultimately recaptured through a recoupment mechanism that was established in the legislation. This greatly mitigates any costs of this federal program.

It is important to emphasize that taxpayers are protected at every step under TRIA. First, they benefit from the economic security that insurance coverage provides before an attack. Second, after an attack occurs, the immediate flow of claims payments provides stability and minimizes economic disruptions to those who suffer from the attack directly as well as to all Americans. And finally, in the event of a catastrophic terrorist attack that triggers the government program, any dispersed federal funds are ultimately repaid through TRIA's recoupment mechanism. Thus, TRIA is both a sensible and indispensable component of national economic security.

Terrorism Risk is a Unique, Uninsurable Risk

A public-private solution is necessary for the risk of terrorism because, from an insurance perspective, terrorism does not meet the core characteristics of a privately "insurable peril." Private insurance markets are founded on the ability to (a) measure the likelihood and potential severity of loss to a policyholder for any specific peril and then (b) to effectively pool the loss experience across many policyholders exposed to relatively *homogeneous*, *random* and *independent* risks. Quite the opposite, terrorism involves an intentional act carried out at the direction of individual actors and groups with the explicit intention of maximizing overall loss of life, property, and economic disruption across as many insureds as feasible. Terrorists can pick the target, change the target at will to bypass security, and coordinate an attack on multiple targets in diverse locations. As result, terrorism, like war risks, fails the basic requirements for "ex ante" (before the event) pooling in the private insurance markets.

- Insurers lack any basis for assessing the likelihood or probability of a major terrorist attack, especially given the limited information that is publicly available. While insurers can price insurance when the nature of the risk is estimable but highly uncertain, ex ante insurance mechanisms fail when there is no credible basis for assessing the likelihood of an event.
- The potential magnitude or severity of large scale terrorist attacks, particularly those that involve the use of unconventional weapons involving nuclear, biological, chemical, and radiological (NBCR) agents, is largely unknown given the fortunate dearth of prior experience. While insurers can manage loss aggregations for "conventional" attack modes, the industry has limited information on managing exposures to wide-area loss event scenarios that would be the hallmark of NBCR attacks.
- Given the concentration of insured lives and property values in business centers, the risk of wide-area terrorism attacks poses a real solvency threat to insurers -- a threat that can easily eclipse that of natural disasters given the stated intention of a terrorist to exact maximal economic disruption.
- The interdependent nature of terrorism risks limits the markets' ability to rely on mitigation to manage exposures. Hardening a potential target may simply cause a terrorist to shift to a softer target or shift the manner of attack. Moreover, since a portion of a terrorist objective is to wage psychological war, the terrorist attacks can be directed throughout the U.S. – from New York City, to Chicago, to San Francisco and to the main streets of any town in between.

Limited Risk Management Tools are Available
Even with the existence of TRIA, insurers' ability to manage terrorism risk is limited. From a coverage perspective, while TRIA requires a mandatory "offer" as a condition for participation, state laws actually mandate coverage for terrorism for certain lines of insurance. For example, in the 49 states that require workers' compensation insurance, on-the-job injuries are covered without exclusion, whatever the cause. Further, a number of states (including those with significant business centers) mandate that insurers cover terrorism-created fire losses, even if a policyholder does not purchase terrorism coverage. As a result, while an insurer may exclude NBCR terrorism coverage in some states, losses caused by the fire following an explosion from one of these perils would be covered.

Second, as noted above, the industry's lack of credible methods for assessing the likelihood of an attack limits our ability to determine an actuarially fair premium. As noted by the most recent report on terrorism risk insurance market conditions from the President's Working Group on Financial Markets (PWG Report), "despite the reported improvements in modeling to measure an insurer's aggregate loss exposure, the industry remains uncertain about the reliability of probabilistic models to predict frequency and severity of terrorist attacks."

Third, reinsurance capacity for terrorism losses is minimal. Citing many of the same issues identified above for primary insurance companies, reinsurance companies offer extremely limited capacity for terrorism risk and generally do not offer coverage for terrorist attacks committed with NBCR weapons. According to the PWG report, reinsurance capacity available for terrorism risk remains in the $6 billion to $10 billion range, an amount that is well below the estimated industry-wide retention figure under TRIA.

To provide some perspective, The Hartford's 2011 retention under the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) is approximately $1.1 billion in company losses. With respect to property, terrorism reinsurance of any material amount within this retention is effectively non-existent. In contrast, for natural catastrophe losses, The Hartford's principal corporate catastrophe treaty provides just under $700 million in reinsurance protection in excess of a $350 million deductible. The Hartford has an additional $400 million in reinsurance protection above $1.1 billion financed through non-traditional reinsurance markets (e.g., catastrophe bonds). As the person in the company responsible for purchasing reinsurance protection for The Hartford, I can attest that I wish that the reinsurance markets were willing to provide the same capacity for terrorism within our TRIA retention as is available for natural catastrophes. But the reinsurance capacity is simply not available. The recent PWG report is interesting in that it indicates that the total amount of reinsurance capacity is up slightly from prior studies. The small increase in reinsurance capacity, undoubtedly available to smaller companies, actually demonstrates the value of the TRIA program to "crowd in" additional reinsurance capacity – that is, it provides reinsurers some assurance that the reinsured companies can manage through a large scale event and remain viable trading partners after a loss.

Given these challenges, how do insurance companies manage the risk of terrorism today? The main tool available to manage the risk of terrorism is to limit exposure concentrations in potential "high target areas." If terrorism exposure concentrations get too high relative to surplus, an insurance company could non-renew entire commercial policies to reduce the terrorism exposure – often creating hardships for the underlying policyholders. These exposure concentrations are especially difficult for certain lines of business like workers' compensation and fire following coverage in certain states where exclusions for NBCR attacks are not recognized. Over the past 11 years, with the benefit of TRIA, the insurance industry has successfully managed these concentrations of exposure within the TRIA retentions. Policies shed by one company have generally been absorbed by a competitor.

Without TRIA, however, individual insurers would face large uncapped exposure and would face difficult choices about how to manage down exposures relative to capital, including facing decisions on whether or not to non-renew large portions of their commercial policyholder portfolios, especially given the fact that they cannot exclude the peril of terrorism from workers compensation coverage and fire following coverage in a number of states. For the record, we do not believe that this outcome would be in the best interests of our policyholders or the overall economy.

Bottom Line: TRIA Has Worked
Almost ten years into TRIA, there should be no doubt that the program has brought stability to the private market and has enabled insurers to provide capacity despite the unique characteristics of terrorism risk. As the President's Working Group concluded at the end of 2010, "the Program provides incentive to property and casualty insurers and reinsurers who might not otherwise provide terrorism risk insurance at current capacity levels, or at current prices, absent Federal support or State law mandates. It does this by providing some degree of certainty of an insurers' maximum loss exposure." TRIA has been shown thus far to be a successful partnership among the federal government, insurers and policyholders to protect the economy in the event of an attack. Thanks to TRIA and its successors, The Hartford has been able to manage our terrorism exposure within acceptable limits while supporting our policyholders' need for terrorism coverage. In 2011, The Hartford's take-up rates for terrorism insurance were over 98%.

As a nation, we can take some comfort in the fact that since 9/11 and despite numerous attempts, terrorists have not succeeded in attacking U.S. interests on our soil. Other countries in the world have been less fortunate. The inescapable conclusion is that as long as this terrible risk threatens our way of life, we must fortify our economy against the potential consequences. TRIA and its successor programs have been very successful and continue to make terrorism coverage widely available. It is essential that the program is maintained so that the United States can enjoy national economic security for years to come.

CIAT COALITION TO INSURE AGAINST TERRORISM
insure against terrorism.org

STATEMENT

OF

ROLF LUNDBERG, JR.

SENIOR VICE PRESIDENT, CONGRESSIONAL & PUBLIC AFFAIRS
U.S. CHAMBER OF COMMERCE

ON BEHALF OF

THE COALITION TO INSURE AGAINST TERRORISM

BEFORE A HEARING OF

THE SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY OF THE HOUSE COMMITTEE ON FINANCIAL SERVICES

ENTITLED

"TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM"

SEPTEMBER 11, 2012

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Good morning, Chairwoman Biggert, Ranking Member Gutierrez, and members of the Subcommittee. I appreciate the opportunity to testify today regarding the important issue of terrorism risk insurance and its importance to the economy. My name is Rolf Lundberg, and I am the Senior Vice President for Congressional and Public Affairs at the U.S. Chamber of Commerce. The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

I am appearing today on behalf of the Coalition to Insure Against Terrorism (CIAT), of which the U.S. Chamber is a member. CIAT is a broad coalition of commercial insurance consumers formed immediately after 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. CIAT's membership of 79 major trade and membership associations, representing virtually every sector of the economy, has remained resolute from the original proposal through the 2005 and 2007 reauthorizations and now, in recognizing, as did Congress and the Administration, that only the Federal government could provide the framework to make this coverage available to all those who required it to invest on new construction and to carry on commerce. The diverse CIAT membership represents commercial real estate, banking, energy, construction, hotel and hospitality, entertainment, manufacturing, transportation, the major league sports, as well as public sector buyers of insurance. CIAT is the true consumer voice on terrorism risk insurance, as we are comprised of the principal policyholders of commercial property and casualty lines of insurance in the United States.

I am pleased today to offer the policyholder perspective on terrorism risk insurance, and to highlight why the TRIA program continues to be vital to our economy. As we saw in the months following the 9/11 terrorist attacks, the lack of terrorism risk insurance contributed to a paralysis in the economy, especially in construction, tourism, business travel and real estate finance. Enactment of TRIA changed that by making terrorism risk coverage widely available to commercial policyholders, and delivering it through a private insurance mechanism that keeps the private industry's skin in the game through the insurer deductible and co-share layers. It also protects taxpayers by providing recoupment -- from us the commercial policyholders -- of any federal share paid out in the wake of a large-scale terrorist event. While private insurance capacity apparently has grown slightly in the past decade, these years have also taught us that a continuing federal role in this unique risk remains vital. The terrorism peril is simply too intrinsically linked to government policy and intelligence to be solely handled by the private sector alone. TRIA needs to be reauthorized, and we therefore commend you, Chairwoman Biggert and the Subcommittee, for your leadership on this issue and for convening this important hearing.

The 26 foot tall banner that stretches across the front of the U.S. Chamber of Commerce headquarters in Washington, D.C., spells out our nation's biggest challenge and our highest priority in one word—J-O-B-S. That banner has served as a reminder to us and to all of Washington of where our focus must be.

The Chamber believes that stronger and faster economic growth is the best way to successfully put Americans back to work. We must not only affirmatively clear away impediments to job creation, but we must avoid taking steps that would create more uncertainty and strangle businesses, stifling our economy's ability to grow, and also negatively affect job creation.

At the same time as we seek to remove barriers that will allow businesses to invest and grow, we also have to recognize what policies work – policies that allow business to continue to invest and look ahead and have confidence in the future.

We know from previous experience following 9/11 that the impact on jobs of the absence of terrorism insurance was widespread and growing. Our economy today is more than 20% larger than it was a decade ago. There is every reason to expect that the jobs impact would be greater and more widespread today were the certainty of the terrorism insurance program to be pulled out from under our economy.

America has strong demographics, abundant natural resources, the world's most productive workers, and a long history of picking ourselves up when we are down. We should not self-inflict additional and unnecessary damage to our fragile economy, and possibility extinguish the prospect of economic recovery and new jobs for Americans.

With this in mind, I would like to focus my remarks today on three main areas: (1) the importance of terrorism risk insurance to the broader economy; (2) how and why the TRIA program continues to serve an important purpose; and (3) the current state of the terrorism risk insurance market.

The Importance of Terrorism Insurance to the Economy

On today's solemn anniversary we remember the thousands of innocent lives lost on that tragic day eleven years ago, and offer our thoughts and prayers to the families and loved ones left behind. The terrorists who perpetrated that terrible attack intended to paralyze us with fear -- but the best of America shone through that day, and in the weeks and months that followed.

It is incumbent upon us to remember the lessons of 9/11. Among those lessons is the importance of maintaining safeguards to ensure that such catastrophic events do not cause lasting harm to our economy. As we saw in the months that followed 9/11, managing the risk of terrorism is an imperative. It was a critical situation: it was difficult, if not impossible, for commercial policyholders to secure coverage against terrorism risk, yet banks and other capital providers would not provide financing without it. In 14 months between the 9/11 attack and enactment of TRIA, over $15 billion in real estate related transactions were stalled or even cancelled because of a lack of terrorism risk insurance, according to a Real Estate Roundtable study. Furthermore, the White House Council of Economic Advisors found that there was an immediate and direct loss of 300,000 jobs in that period from deferred construction investment.

The simple fact is that our recovery from 9/11 was slowed due to a lack of any realistic solution for the private sector to manage terrorism risk. Furthermore, our ability to recover from a further attack was also severely weakened by the situation. The months following 9/11 made clear that a strong, resilient economy requires a plan to deal with potentially devastating terrorism losses. Indeed, several other nations have terrorism insurance programs, including several that pre-date TRIA. Undoubtedly, we would face the same post-9/11 danger to our economy if Congress were to let the TRIA backstop expire without replacing it with a permanent solution.

The Terrorism Risk Insurance Act

In recognition of the critical post-9/11 situation, Congress and the Bush Administration worked together in 2002 to enact TRIA -- a public-private partnership to deal with terrorism risk that has served our nation and its economy well for nearly 10 years. The TRIA program has a dual purpose: (1) to keep our economy functioning smoothly by requiring private insurers to make terrorism coverage available to commercial policyholders; and (2) to provide an efficient mechanism for managing terrorism losses in a way that maximizes private sector involvement and provides strong protection for taxpayers.

As commercial policyholders, we are well versed in the benefits of TRIA's first purpose, i.e., the "make available" provision. We have no interest in seeing a return to the standard terrorism exclusions became the norm in the months following 9/11. In fact, when TRIA was originally set to expire in 2005, and again in 2007, we saw policy renewals with "springing exclusions" that would have voided terrorism coverage upon expiration of the program. Having TRIA in place, quite simply, has been difference between being able to manage terrorism risk or holding one's breath.

Policyholders understand that the reason terrorism coverage is available is because of the TRIA backstop. However, to view the TRIA program as simply a federal backstop is to miss key components of the program. In truth, the TRIA program is a public-private partnership where all parties participate in managing risk. Private insurers take a large share of losses through both the insurer deductible and through the 15% co-share of any losses exceeding the deductible. The federal government steps in only in certain, severe cases, where losses from the terrorist event exceed $100 million, and only then if an insurer has losses that exceed its statutory deductible. We policyholders also bear substantial costs, in the form of the premiums we pay for terrorism coverage, and through the responsibility for paying post-event surcharges so that taxpayers may recoup federal assistance provided through the backstop.

The simple reality is that having TRIA in place actually saves the taxpayers money. As currently structured, the program is only likely to trigger federal compensation in truly massive, catastrophic terrorism events. In the absence of TRIA, such an event would likely cause Congress to appropriate millions, if not billions, in ad hoc disaster assistance, with no strings attached. Under TRIA, however, there is a pre-existing mechanism to ensure economic recovery -- a mechanism that maximizes which private sector involvement, and protects taxpayers through the recoupment provision.

Current Market Conditions

Because of TRIA, today terrorism risk insurance (with one exception) is generally available for commercial policyholders. It would not be available without TRIA. CIAT members have generally seen a decline in pricing for terrorism insurance, which we attribute not just to the normal ebb and flow of the insurance market, but rather to the continued availability of the TRIA backstop and the fact that there have been no certified acts of terrorism since the enactment of TRIA.

Even with TRIA, however, we note that coverage for nuclear, biological, chemical and radiological ("NBCR") events remains extremely limited in terms of availability and affordability. Where insurers do offer such coverage, it may be limited in terms of geographic area (*i.e.*, coverage is harder to procure in perceived "target" cities such as New York or Washington), and it may also be limited to certain perils (*i.e.*, biological and chemical events may be covered, but not nuclear or radiological). Coverage limits for NBCR insurance that is available tend to be relatively low and expensive.

We understand that the principal factor in insurers' decisions not to cover NBCR is their lack of sufficient data to properly model their exposure to such losses with any degree of certainty. On this point, we would point out that this Committee has previously considered measures intended to encourage greater availability and affordability of NBCR coverage, though they were not ultimately included in the TRIA reauthorization legislation. We believe that policymakers may need to revisit this issue given that the market for NBCR terrorism coverage has generally not improved.

Conclusion

The TRIA program has worked extremely well over the past ten years -- albeit with no ultimate test on losses and claims -- by providing access for commercial policyholders to insurance against terrorism risk. It has done so through a meaningful public-private partnership that requires and arguably maximizes private sector involvement and unquestionably protects taxpayers in the event of any future act of terrorism. Fortunately, we have yet to see this pay-out and recoupment mechanism in practice, but it nevertheless remains clear that our economic recovery from any such event depends upon having such a plan in place. The terrorism peril is simply too intrinsically linked to government policy and intelligence to be solely handled by the private sector. We therefore commend this Subcommittee for its continued consideration of this important issue, and we urge you to consider a permanent solution that would extend beyond TRIA's current expiration date in 2014. Our CIAT coalition looks forward to working with the Subcommittee on reauthorization.

Thank you again for the opportunity to testify here today, and I am pleased to respond to any questions you may have.

Wharton
UNIVERSITY *of* PENNSYLVANIA

Written Testimony
prepared for a hearing of the

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
U.S. House of Representatives

on

"TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program."

by

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September 11, 2012

Chairman Biggert, Ranking Member Gutierrez, distinguished members of the Subcommittee on Insurance, Housing and Community Opportunity, thank you for inviting me to testify today on "TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program." My name is Erwann Michel-Kerjan. I teach at the Wharton School of the University of Pennsylvania and I am Managing Director of the Wharton Risk Management and Decision Processes Center.

For nearly three decades, the Wharton Risk Center has been at the forefront of basic and applied research to promote effective corporate and public policies for low-probability events with potentially catastrophic consequences (i.e., extreme events) based on an understanding of the decision processes of consumers, firms and public sector agencies.

Since 2008 I have also served as chairman of the OECD Board on Financial Management of Catastrophes, established by Secretary-General Angel Gurría to advance knowledge on these issues and collaborate closely with the governments and the private sector of the now 34 member countries (including the United States).

The question of how best to manage and finance catastrophes is now high on the agenda of top decision makers around the world given the series of unprecedented disasters and crises that have occurred since 2001. Among all countries, the United States has faced the largest number of untoward events of many different kinds in this short period of time: starting with the 9/11 terrorist attacks, followed by the anthrax attacks, then several major corporate scandals, the Columbia Shuttle accident, followed by the massive blackout, the BP oil spill in the Gulf, the 2004/2005 hurricane seasons (and other significant natural disasters in the ensuing years), and of course the financial crisis from which our economy has yet to fully recover.

America has proved to be a resilient nation. But if this series of events are predictive of what the near future will look like, we as a country have to start a serious discussion about our ability to better prepare for and recover from future catastrophes physically and financially. My Wharton colleague Howard Kunreuther and I made this point explicitly when we jointly testified before the U.S. Senate last year.[i]

Thanks to the leadership provided by Congress, this Subcommittee and especially by you, Chairman Biggert and Congresswoman Maxine Waters, the long overdue reform of the National Flood Insurance Program was passed by Congress at the end of June and signed by the President in early July of this year. This bi-partisan reform was the outcome of over two years of hard work, hearings, and public debates. The Biggert-Waters Flood Insurance Reform Act of 2012 is also based on sound evidence from empirical research produced by leading institutions across the country, including our own team at the Wharton Risk Center.[ii]

For those reasons, I want to express my deep respect and gratitude for the extraordinary service you have provided to this nation.[iii] Your leadership in reopening the national debate about the future of terrorism risk insurance now, more than two years before the expiration of the temporary Terrorism Risk Insurance Program (TRIP) on December 31, 2014, is very much needed. Today we remember all the victims of the 9/11 tragedy and share our support with their families.

My testimony today will focus on three questions:

1) **How has the terrorism risk-sharing between the federal government, the private (re)insurance industry (supply side) and exposed businesses (demand side) changed with 9/11 and the passage of TRIA 10 years ago?** Our team at the Wharton Risk Center has been conducting research on this topic continuously since 2001 so my response to this question will be based on empirical evidence (take up rates, pricing, effects of government intervention).

2) **How does a world without TRIA look post 2014?** Here, it is critical to imagine the economic consequences of a future attack on U.S. soil. Because we cannot predict when such a catastrophe will occur (if ever again) it is difficult for us to fully evaluate the effectiveness of any program to finance low-probability extreme-impact events. Paradoxically, if the recent increases in federal disaster relief and bailouts serve as evidence, a world without TRIA does not necessarily mean less financial exposure of the federal government to the economic consequences of terrorism. It might very well mean, *de facto*, increased financial liability for all of us as American taxpayers. I will explain why.

3) **Finally, how have other OECD countries addressed the terrorism risk coverage challenge?** I will briefly highlight the different solutions currently in place in five other countries that have suffered from terrorist attacks on their soil: Israel, Spain, France, the U.K. and Germany. This will build on ongoing work undertaken by the OECD Board I have the honor of chairing and in partnership with the heads of all terrorism risk insurance programs around the world.

I. Terrorism Risk-Sharing in the U.S. from 2001 to Today

Terror Insurance Markets Before and Immediately After 9/11

It is important to remind ourselves of the context in which TRIA was established. Before 9/11, major insurance losses from terrorism were viewed as so improbable that the risk was not explicitly mentioned in standard policies (outside of transportation insurance) and hence the cost for providing such coverage to firms was never calculated. Terrorism was covered *de facto* in most commercial insurance contracts.[iv] One of the first attacks to significantly impact the insurance industry occurred in the U.K. in 1992 and cost insurers nearly $700 million (indexed to 2001). Then in 1993, three other major terrorist attacks occurred. The first was the bombing of the World Trade Center in New York City in February 1993, perpetrated in one of the garages of the Towers. The bombing killed six people and injured one thousand, and caused $725 million in insured damages. The second was a series of 13 bomb attacks in India that killed 300 and injured 1,100 others. Given the lack of insurance coverage there, these attacks had no major impact on insurers, though. The third major attack occurred with a bomb exploding near NatWest Tower in April 1993 in London. This attack triggered $900 million in insured losses.

Notably, the British insurers recognized the significance of these earlier attacks for the future of their industry and created a dedicated terrorism insurance program that same year, Pool Re. Surprisingly, insurers in the U.S. – and those international insurers and reinsurers covering activities in the U.S. – continued to cover this peril without explicitly pricing it in their commercial insurance policies. Two years later, the Oklahoma City bombing killed 168 people, but the largest losses were to federal property and employees, and were covered by the government. In 1998, bomb attacks on the U.S. embassy complex in Nairobi, Kenya killed more than 250 people and injured 5,000 others. Still, U.S. insurers and international reinsurers operating here continued to cover terrorism.

As Berkshire Chairman Warren Buffett said in his November 9, 2001 letter to shareholders:

> *"We did not price for manmade mega-cats, and we were foolish in not doing so. In effect, we, and the rest of the industry, included coverage for terrorist acts in policies covering other risks-and received no additional premium for doing so. That was a huge mistake"* [v]

Things radically changed on September 11, 2001. The Al Qaeda attacks killed more than 3,000 people from over 90 countries and injured more than 2250 others (victims of the attacks in New York City, Washington, DC, and aboard Flight 93 which crashed in Stony Creek Township, Pennsylvania, as well as among teams of those providing emergency service). The attacks also inflicted damage estimated at nearly $80 billion, about $32.5 billion (2001 prices, or $42 billion in today's prices) of which was covered by nearly 150 insurers and reinsurers worldwide, many of them in Europe (including $21 billion for damage and business interruption alone).[vi] This illustrates the power of international diversification of these markets.

Private reinsurers, who covered the large portion of these losses, then decided to exit the U.S. market, which they could do, as they are unregulated vis-a-vis the risks they decide to cover. Insurers were thus left without protection for future terrorism catastrophes. By early 2002, insurers had excluded terrorism from their policies in 45 states.[vii] Commercial enterprises thus found themselves in a very difficult situation, with insurance capacity extremely limited and, when offered, very highly priced.

September 11, 2002

One year after 9/11, when national security had become the number one priority on the agenda of the United States and other countries, our commercial enterprises remained largely uninsured at home. If another large-scale attack had occurred, the impact on the economy could have been much more serious than it was on 9/11. Indeed, the economic losses would not have been spread over a large number of insurers and reinsurers worldwide. In the absence of massive post-disaster federal relief, these direct and indirect losses such as business interruption, would have been sustained by the firms themselves.

Terrorism Insurance under the Current Public–Private TRIA Arrangement

The lack of availability of terrorism insurance shortly after the 9/11 attacks led to a call from some private sector groups for federal intervention. For example, the U.S. Government Accountability Office reported in 2002 that the construction and real estate industries complained that the lack of available terrorism coverage delayed or prevented several projects from going forward because of concerns by lenders or investors.

In response to such concerns, the Terrorism Risk Insurance Act of 2002 (TRIA) was passed by Congress and signed into law by President Bush on November 26, 2002.[viii] This program was originally aimed at providing a three-year temporary measure to increase the availability of risk coverage, but the program has been renewed twice since, in 2005 and 2007. TRIA is now extended up to the end of 2014.

This Subcommittee is familiar with the current design of TRIA so I will not discuss it in detail here. In brief, TRIA requires insurers to offer terrorism coverage to all their commercial clients (a legal "make available" requirement). (Note that residential coverage is not included in this program). These firms have the right to refuse this coverage unless it is mandated by state law, as in the case of workers' compensation in most states.

Loss sharing under TRIA is organized as follows: The first layer is provided by insurers through a deductible. That deductible is calculated as a percentage of the direct earned premiums each insurer received in the preceding year from its policyholders for all lines of business covered under TRIA. In order to increase the role of the private market over time, this percentage has increased sharply from 7% in 2003, to 10% in 2004, 15% in 2005, and it has been 20% since 2007. For some insurers this represents billions of dollars before they receive any federal assistance. The second layer up to $100 billion is the joint responsibility of the federal government and insurers. Specifically, the federal government is responsible for paying 85% of each insurer's primary losses during a given year above the applicable insurer deductible; the insurer covers the remaining 15%.

Contrary to what is done in other countries (see the review in Section III), the U.S. federal government does not collect any premiums for covering 85% of the insurer's losses above the deductible. In essence, the government intervened to provide insurers with free up-front reinsurance for exposure that would ordinarily require a substantial amount of (costly) capital should the insurers seek protection from the private reinsurance market. The "up front" is important here since the U.S. Treasury can recoup part of its payment from insurers over time, in charge for them to recoup this amount against their own policyholders (whether they have suffered from the attack or not, which poses equity issues that have not been discussed at any length in analyses of TRIA).

Has TRIA Worked as Intended?

The main policy goal of TRIA was to ensure that commercial firms across the nation could access subsidized coverage, and as a result, more companies should purchase this coverage.

Market Penetration Has Increased Substantially. The empirical evidence reveals that this strategy has worked. Market data from the two largest insurance brokers, Aon and Marsh, on their own clients (which tend to be larger firms), indicate that commercial take-up rates for terrorism insurance have more than doubled from 27% in 2003 to 60% in 2006, a level that has remained stable since (62% today). These figures have been cited in a number of publications and by my fellow panelists today.

Three important points should be noted about this 60% figure. First, this is not a TRIA take-up rate but combines *all* types of terrorism coverage used by businesses in the United States: U.S. risks only (TRIA only), U.S. risks and non-U.S. risks (clients with foreign values; referred as "TRIA and non-certified"), high risks not covered by the market (referred to as "standalone coverage"), and programs structured as a combination of standalone and TRIA coverage (often done through a captive). Second, these are based on the portfolio of clients of the above two brokers (in other words, these are samples only, not the full market). Third, there is a lot of heterogeneity across industries (e.g., the take-up rate for financial institutions and real estate is around 80% but only 40% in the energy sector).

While we should certainly feel good about the increase observed in 2003-2006, nevertheless, probably about 4 out of 10 large corporations in the United States don't have coverage against terrorism today. Whether they will be able to sustain a large loss with internal or external capital is an open question Congress might want to analyze further. We need to better understand the demand side of this market. Let's remember that on 9/11 the coverage was virtually 100%.

Decrease in Insurance Cost. The increase in coverage is partly due to the fact that terrorism insurance prices have continuously decreased since 2003. The median premium rate for terrorism insurance for middle-size and large firms was down from $57 per million of total insured value (0.0057%) in 2004, $42 per million (0.0042%) to $37 per million (0.0037%) in 2008, then to $25 per million (0.0025%) in 2009 (data from Marsh). A recent report by Aon provides similar information on take-up rates for the twelve months ending March 2012: $20 per million for TRIA coverage only (which translates into an average of about 3.5% of the premium charged for property coverage for TRIA only and about 5% for TRIA and non-certified).[ix] This decrease is largely explained by the absence of any new attack on U.S. soil, thanks to the hard work of our government services here and abroad. It is also explained by the natural effect of competition in insurance markets.

Effects of the Federal Intervention. The design of TRIA had another effect on the insurance supply. My colleague Paul Raschky and I recently performed an economic analysis to evaluate how the supply of an additional unit of coverage differed between terrorism insurance (with government intervention) and property insurance (without it). Partnering with Marsh, we were able to undertake a full demand-supply analysis by accessing data on contracts for hundreds of their clients supplied by twenty-six large insurance companies operating in the United States. We find evidence that insurers in the U.S. are much less diversified for terrorism coverage than they are for property lines of coverage, and to some extend for other types of catastrophe risks (e.g., wind and flood); meaning that they would more easily provide additional coverage to a client for terrorism risk than for these other risks.[x]

This result can be interpreted in two ways. On the one hand, and as some have argued, there could be gaming here (*President's Working Group on Financial Markets, Market Conditions for Terrorism Risk Insurance, 2010*): some insurers might be taking on much more terrorism risk with the current free up-front reinsurance from the federal government than they would otherwise, knowing that under TRIA they collect all the terrorism insurance premiums but are responsible for only a portion of the loss. On the other hand, this also means that insurers have provided much more capacity to this market that they would have done otherwise, which was the intent when TRIA was designed.

II. A Paradox: Why Stopping TRIA Might Not Necessarily Lower the Federal Government's Exposure to Future Terrorism Economic Losses

TRIA is set to expire at the end of 2014. The question in front of us now is, what do we do next?

- Do we extend TRIA for another few years as is?
- Do we let it expire?
- Do we work to make TRIA more effective and equitable in a redesigned risk-sharing arrangement?

Most of the discussions about TRIA before the 2005 and 2007 renewals have been about whether or not to extend the program. This is likely to be a focal point again in the coming months. At the center of the debate is an argument that can be summarized as follows: if the federal government continues its pattern of renewing TRIA, this will continue to distort the market by displacing long-term private market activity that would have otherwise emerged. It is of course impossible to verify this logic unless one lets TRIA expire and then observe what happens over time, which can be a risky proposition for the federal government as I will show.

Indeed, if the goal behind terminating TRIA is to limit (or avoid any) additional financial exposure of the federal government given the already historical government deficit of $16 trillion today, then terminating

TRIA would seem to make sense. The unnoticed paradox, however, is that a world without TRIA (that is, with no federal backstop *and* no mandatory offer requirement) might not necessarily be one with less risk to the federal government and the American taxpayers.

If TRIA expires, and unless reinsurers reentered the U.S. market with much more capacity than they provide today and at a price considered reasonable by insurers, most primary carriers are going to exclude this risk from their portfolio everywhere they can. Those that provide it will charge much higher premiums than they currently do to take into account expensive capital they need to set aside to meet regulatory and/or rating agencies' requirements. As we have seen with the homeowners' hurricane risk insurance market in Florida after the 2004 and 2005 hurricane seasons, new poorly capitalized companies will emerge to take advantage of this situation and write terrorism coverage with a high degree of concentration.

What happens next depends on whether or not another large-scale attack is perpetrated on U.S. soil. If there are no future attacks, the new system will look good (as any would in the absence of claims). But the day after a large attack, we will realize that many firms are uninsured or poorly insured.

Under extreme pressure from the media and interest groups, the federal government will be asked to step in. Only a small portion of the losses will be paid by insurers and their reinsurers, and the large majority of it by all of us as taxpayers. This outcome is pretty certain as one looks at how much more involved the federal government has been in providing financial support after catastrophes and crises in the past decade than it used to be 50 or 60 years ago. If the attack occurs during an election year, this would be even more certain.

Overall, the number of Presidential disaster declarations has dramatically increased over time, from 191 declarations over the decade 1961-1970 to 597 for the period 2001-2010. As Figure 1 also reveals, many of the peak years correspond to presidential election years. In 1996 and 2008 (both presidential election years) there were 75 presidential declarations. This record number was exceeded in 2010 when there were 81 major disaster declarations, and again in 2011 with 99 declarations. Evidence also shows that the portion of economic losses paid by the federal government has been increasing steadily with recent disasters.

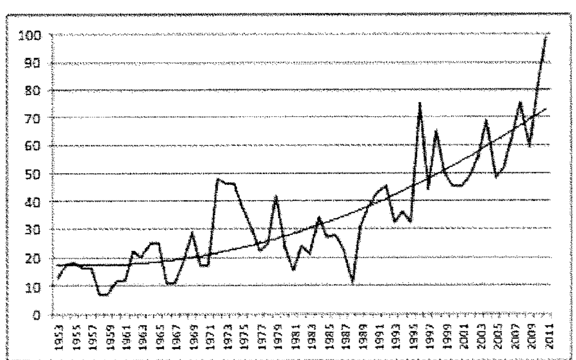

Figure 1. U.S. Disaster Presidential Declarations Per Year, 1953-2011 (data from FEMA)

Maybe we should rethink options before us as to what should be done post 2014, specifically on working to make TRIA more effective and equitable in a redesigned risk-sharing arrangement.

III. How Have Other OECD Countries Addressed The Terrorism Risk Coverage Challenge?[xi]

In this last section of my testimony I would like to provide some international perspective. This is important for three reasons: a) terrorism threat is international by nature; b) other countries are facing similar challenges as we are as to who should bear the risk of terrorism and how best use the strengths of the private and public sector in developing a robust compensation scheme; and c) in today's global business environment, a growing number of American corporations generate a significant part (if not the majority) of their revenues outside the United States.

I will briefly highlight the solutions currently in place in five other countries that have suffered from terrorist attacks on their soil: Israel, Spain, France, the U.K. and Germany (chronologically, as they developed their program). The material presented below is public information.

Israel: Government Coverage, No Involvement of Private Insurers

In this country with a long history of terrorist attacks, losses from attacks are compensated directly by the State according to a pre-defined formula. Any direct and indirect damage occurring within Israel due to war or hostilities will be covered by a *public compensation fund* legislated in 1961. The fund is built from the general property tax collected across the country, according to regulations. Insurers do not cover this risk. Both individual and business compensation is provided to those who suffer from an attack. Businesses can also receive claims payments for workers' compensation and loss of business revenues.

Spain: Government Coverage Sold by Private Insurers in its Behalf

Eligibility. Terrorism has been covered as part of the State-backed insurance compensation scheme for extraordinary risks (including also storms, floods, earthquakes, riots), *Consortio de Compensation de Seguros* fund, established in 1954. Coverage for these risks is included as an add-on to property insurance sold by private insurers who are not financially responsible for losses. The private sector has never expressed an interest in covering terrorism or these other extreme events.

Pricing. Commercial enterprises pay 0.21 euros per thousand of property coverage and another 0.25 euros for business interruption to benefit from this state insurance against extraordinary risks.

Loss History. In the aftermath of the March 11, 2004 terrorist attacks in Madrid, the Consortio paid 41 million euros in claims (railway vehicles were not insured). The December 2006 attacks against the Barajas Airport triggered another 46 million euros in claims. These claims were rapidly paid by the Spanish catastrophe fund which currently has over 4 billion euros in reserve and has never used the state guarantee in over 50 years of operation.

France: Public-Private Risk Sharing; Unlimited Government Reinsurance

From a legal perspective, the situation in France was especially acute in the aftermath of 9/11 because the 1986 law does not allow commercial property insurers to dissociate terrorism coverage from commercial property. To stop covering terrorism meant to stop covering commercial property at the 2002 renewals.

The *GAREAT*, a public-private partnership, was established in December 2001 as a co-reinsurance pool organized under a tier structure of risk sharing and shareholders. It operates on an aggregate annual excess of loss basis

Risk-Sharing Arrangement. The first layer presents an annual aggregate capacity of 400 million euros shared among all 105 members of the pool prorated to their share of ceded business. A second layer is provided by private insurers and reinsurers up to 2 billion euros. Above that, the State layer is an *unlimited* guarantee by the French government provided through the Caisse Centrale de Reassurance (CCR), a state-owned reinsurance company.

Premium Sharing. The premiums levied by insurers against policyholders are transferred to the GAREAT and shared as follows: members of the pool keep nearly 52%, the reinsurance layers 36%, and the CCR receives around 12% of the total annual premiums collected.

Eligibility. Terrorism insurance is mandatory in France, so the take up rate in 100%. The pool covers a large range of French commercial and industrial risks above 20 million euros for property damage and business interruption, including chemical, biological, radiological and nuclear (CBRN) attacks (GAREAT does not cover liability risks and personal lines). Moreover, the same deductible is applied for terrorism as for other property coverage risk pricing.

Pricing. Reinsurance rates by the GAREAT do not vary with location: they are identical across the country. They apply as a percentage of the property premiums and depend only on the total insured value, for which five segments are defined: free (for sums insured below 6 million euros); 6% of the property insurance premium (for sum insured between 6 and 20 million); 12% (between 20 and 50 million euros); 18% (sums insured higher than 50 million euros). Finally, for "special risks" (e.g., nuclear plants) the rate is 24%. This cost is much higher than those I have described for the United States, which are in the 3-to-8% range of the property insurance premium.

Renewal and Government Exit Strategy. The pool was first set up for a single year with the option of being renewed, as was done in 2003 until December 31, 2012. An agreement has been reached recently to renew it on January 1, 2013 for another 5 years.

U.K: Public-Private Risk Sharing; Unlimited Government Debt Issuance

In the wake of the terrorist bomb explosions in London in April 1992, which cost insurers nearly $700 million, and an announcement seven months later by British insurers that they would exclude terrorism coverage from their commercial policies, the U.K. established a mutual reinsurance organization, Pool Re, in 1993 for commercial property and business interruption to accommodate claims resulting from acts of terrorism.

Eligibility. The scale of 9/11 attacks in the United States led to a major revamping of Pool Re. Since the end of 2002, protection of companies operating in the U.K. under Pool Re has been extended to all risks, a category that now includes damage caused by chemical and biological as well as nuclear contamination (while war and related perils as well as computer hacking continue to be excluded).

Risk-Sharing Arrangement. Pool Re acts as a reinsurer for all insurers that wish to be a member of the pool; the U.K. Treasury in turn provides Pool Re with unlimited debt issuance that the pool will have to reimburse over time. Pool Re's right to draw funds under the retrocession agreement with the government is determined on a strict cash needs basis. That means that premium income earned by Pool Re during the time necessary for claims settlement, (i.e. after a terrorist attack), will also be used to pay these claims, if necessary.

All insurers authorized to insure losses arising from damage to commercial property in Great Britain are eligible to apply for membership of Pool Re, regardless of their domicile. Most insurers operating in the U.K. commercial property market are members. As of September 2012, Pool Re has 230 members (75 insurers incorporated in the U.K., 41 Lloyd's syndicates, and 114 insurers incorporated elsewhere). They have an individual retention before being reimbursed by the pool which is based on their proportion of participation in Pool Re, applied to the "industry retention" (£100 million per event, £200 million per year in 2012).

Pool Re has a current reserve of nearly £4.7 billion, which would have to be exhausted before the British Treasury pays anything. If the government needs to intervene for insured losses above this, it will get reimbursed for that payment by the pool over time; and at the end of the day, the members of Pool Re will have paid *all* insured losses due to the terrorist attack.

Premium Sharing. Pool Re shares 10% of its collected premiums with the U.K. government in order to receive this coverage.

Germany: Public-Private Risk Sharing; Limited Government Reinsurance

As in the United States, until the events of 9/11, coverage against terrorism risk was included in all commercial lines in Germany without an explicit extra premium. After 9/11, the extremely limited availability of terrorism coverage led to the founding of *Extremus AG*, a federal government-backed property insurance corporation that started operations on November 1, 2002. Unlike Pool Re, Extremus is not a reinsurance institution but a private insurance company.

Risk-Sharing Arrangement. The annual capacity to pay for claims is 10 billion euros. It is completely reinsured by national and international insurance and reinsurance companies (first layer limited to a total of 2 billion euros), as well as by the federal government (second layer of 8 billion euros). As of December 31, 2010, Extremus provided a total of 450 billion euros terrorism insurance coverage to 1,174 firms.

Premium Sharing. As is the case in France and the U.K., but not in the U.S., the reinsurance provided to Extremus by the federal government is not free of charge: the government receives approximately 12.5% of the 50 million euros in premiums collected by Extremus.

Eligibility. Extremus provides coverage for buildings, contents, and business interruption. But only risks with total insured value over 25 million euros are eligible for coverage. As in the U.S. and the U.K., companies operating in Germany are not required to purchase insurance against terrorism. The annual compensation by Extremus for any company is capped at a maximum of 1.5 billion euros. This means that a company with a total insured value of 25 billion euros it can purchase coverage for only 6% of its total insured value from Extremus. A number of risks are explicitly excluded, such as nuclear risks as well as biological and chemical contamination by terrorists, war and civil war, and insurrection. Losses due to computer viruses are also not covered.

This international review shows that different countries have responded to the question of terrorism risk financing differently, and that those responses were often modified after terrorist attacks on national soil. Some of these concepts may be relevant for the United States as we rethink the role that TRIA should play in the future.

For different governments to be able to compare notes, market developments and ongoing national debate about the future of terrorism risk insurance is important as well. The OECD has taken the lead in making this happen by organizing an unprecedented gathering of all the heads of terrorism risk insurance programs of member countries at its headquarters in Paris in 2010 along with representatives from the private sector and intelligence community;[xii] the next meeting of this group will take place on December 4, 2012.

IV. Conclusion

The threat of terrorism is still present in the United States even though there has been no successful attack on U.S. soil since 2001. TRIA provides federal reinsurance to insurers at no up-front cost which is unique worldwide. As a result, millions of businesses operating in the United States are able to purchase coverage at a price they judged reasonable. Despite its successes, TRIA can be criticized on several fronts and can certainly be improved. For example, a significant number of firms do not purchase that coverage.

Can the market operate in the absence of a federal backstop and a mandatory offer requirement? Yes, but there is likely to be a rather thin market except for lines that insurers cannot exclude (such as workers' compensation). Could this be sustainable? If there is no successful terrorist act on U.S. soil in the next 10 or 20 years, then yes. But when the next attack occurs, experience shows that Congress will be called to the rescue by businesses that went uninsured, as it has been so many times in recent years for other types of catastrophes and crises.

Instead, I believe we should try to work together at improving the current system, rather than relying on ad hoc response that will come at a time of great sadness and grief. As I showed early in my testimony, an improved TRIA could actually limit the financial liability of the American taxpayers, not increase it.

To make this happen will require leadership from Congress and the Office of the President. As we have done since 2001, my colleagues at the Wharton School and I look forward to working with both on *how* we do it.

I want to thank you again for the opportunity to testify here today. I would be happy to answer any questions you may have.

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[iii] Michel-Kerjan, E. and H. Kunreuther. Why We Should Not (Always) Blame Congress. *The Huffington Post*, August 8, 2012.

[iv] Kunreuther, H. and E. Michel-Kerjan. Policy Watch. Challenges of Terrorism Risk Insurance in the U.S. *Journal of Economic Perspectives*, 2004.

[v] Mr. Buffet's letter is available at: http://berkshirehathaway.com/qtrly/web1101.html

[vi] U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, U.S. Securities and Exchange Commission, Commodity Futures Trading Commission 2006. Terrorism Risk Insurance: Report of the President's Working Group on Financial Markets. Washington, D.C., September.

[vii] Large-scale terrorism is different than many other risks: difficulty to quantify the risk, thus to price it actuarially; dynamic nature of the threat, which partly depends on government actions; interdependencies (the vulnerability of one organization depends not only of its own actions but also on actions of other agents) asymmetry of information in favor of government services; potential for catastrophe losses, which would require a lot of costly capital for insurers to cover alone; potential for bankruptcy; and the fact that other risks present a more attractive return on investment insurers can then present their shareholders. See Wharton Risk Center (2005). TRIA and Beyond. The Future of Terrorism Risk Insurance in the U.S. Philadelphia, PA and Kunreuther, H. and E. Michel-Kerjan. Terrorism Insurance 2005. *Regulation*. The Cato Institute.

[viii] The complete version of the original Act can be downloaded at: http://www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/claims_process/program.shtml.

[ix] Aon. Property Terrorism Marketplace. Terrorism Insurance Update. March 15, 2012.

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[xi] I would like to thank the chairmen, secretary-generals and general managers of the programs discussed here for ongoing discussions and their insights. For more on international terrorism risk insurance markets, see:

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TESTIMONY OF JANICE OCHENKOWSKI

ON BEHALF OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS)

BEFORE THE

U.S HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

ON

"TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM"

TUESDAY, SEPTEMBER 11, 2012

2128 RAYBURN HOUSE OFFICE BUILDING

Good morning, Madame Chair Biggert and Ranking Member Gutierrez and members of the Subcommittees. My name is Janice Ochenkowski. I am a Managing Director with responsibility for global risk management for Jones Lang LaSalle, a global real estate and financial services company based in Chicago. I am pleased to be here this morning to testify on behalf of the Risk and Insurance Management Society, Inc. (RIMS). I also appreciate the Subcommittee's foresight and initiative to begin this very important policy debate regarding the reauthorization of the Terrorism Risk Insurance Act on the anniversary of September 11.

RIMS is a not-for-profit organization dedicated to advancing the theory and practice of risk management for the benefit of our member organizations. Our discipline is vital to the creation and protection of physical, financial, and human resources. A global organization and the largest organization of risk managers in the United States, RIMS is comprised of over 10,000 individuals from more than 3,500 entities. 81% of our members are Fortune 500 companies with approximately 1,000 members representing small businesses (less than 500 employees). Membership spans the entire economic spectrum from the high-tech sector, real estate, financial, healthcare, energy, transportation and defense. Members also include universities, hospitals, and public entities such as the City of San Francisco, Miami-Dade School District and Orange County, California.

However, as diverse as RIMS member organizations are, they share a common characteristic. That is, they are predominantly large consumers of property and casualty insurance and they have a abiding interest in the need for, and availability of, insurance to cover risk against acts of terror.

Application of the Risk Management Discipline to Terrorism Risk

Risk management is the practice of analyzing an entity's exposures to loss, selecting methods to mitigate the exposures, implementing the selected methods, and monitoring and adjusting the methods depending on the results. Applications for risk management cover all possible exposures to loss, ranging from estimating the number of employees who will be injured in a given period to how to effectively use arbitrage in a global business. The methods used to mitigate exposures are non-insurance transfers, insurance, control, retention, and avoidance. For terrorism exposure, most businesses use a combination of control, retention, and insurance as mitigation strategies.

For example, an owner of real property valued at $10 billion located in the central business districts of major cities, would have a risk management program that would include several different risk management methods to manage concerns about terrorism. Those efforts would include a security program with options such as guards, cameras, motion detectors and alarms, along with an employee and tenant identification program to control building access. Visitors would be limited to one entrance where security staff could log entry and departure. Redundancy and security would be built into all vital computer operations. If the size and potential risk to the property warranted it, the owner might also make physical improvements to the property as well as to the perimeter of the facility. In addition, the owner would purchase an all-risk commercial insurance policy to cover the property for physical damage risks, including terrorism. Property insurance policies have deductibles, and the owner will retain the risk of the deductible amount.

In my job at Jones Lang LaSalle, we purchase insurance for properties owned by our clients through several insurance programs. In total, for U.S. exposures, we purchase insurance for just under 70 million square feet of real estate with an aggregate insured value of under $9 billion. All are commercial properties, and include industrial, retail and residential, but most are office buildings. The locations vary from suburban to city center but are generally within major urban areas in populous states. Since the enactment of the first terrorism legislation, we have been able to purchase terrorism insurance at commercially reasonable limits and in forms acceptable to the properties' lenders. There are some limitations on high risk locations as well as some property types, but in general we are able to buy the coverage we need at premium that can be absorbed by our tenants or investors.

In the event that the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) is allowed to sunset on December 31, 20014, we believe that we will be unable to obtain the limits of coverage necessary to protect the properties and investors and to satisfy lenders. A more significant portion of the risk will be retained by owners, which would further impede the real estate market's financial recovery. I should also note that tenant leases now frequently require that the landlord maintain terrorism insurance and the inability to purchase the coverage could result in a default on the lease, renegotiation of terms, or loss of a tenant.

One of the basic functions of risk management is to identify potential risks for a company in areas such as property, health and safety, and environmental and financial risk, and to identify options to mitigate those risks. Insurance coverage is a critical and necessary part of the process of protecting our companies from risk, especially risk that can produce catastrophic losses. Terrorism is one of those risks that presents catastrophic exposure to companies. Accordingly, it is vital that terrorism insurance continues to be available to buyers of commercial insurance in a comprehensive and affordable manner when the program expires in 2014.

Stability in Insurance Markets Promotes Economic Stability

RIMS considers the availability of adequate insurance for acts of terrorism to be not simply an insurance problem, but also an economic issue. The inability to acquire sufficient insurance for terrorism coverage could result in the inability to secure financing for future construction projects as well as potential impacts on existing construction projects that require evidence of terrorism coverage. Without TRIA, many companies would not be able to comply with various lender covenants within mortgages, which would impede the ability to fund real estate transactions and further limit the normal functions of the real estate market. Additionally, other businesses and public entities face terror exposures critical to the economic well being of our county. Public and private transportation, schools and hospitals, special and sporting events, and certain manufacturing exposures need terrorism coverage as well. Furthermore, as a direct result of 9/11 losses, worker's compensation insurers have restricted coverage for employers with aggregations of workers within a single facility or in large metropolitan areas.

Many businesses and our members in the United States rely on global insurance companies for coverage. These insurers decide where to underwrite risk based on their assessment of overall profitability in return to their shareholders. If the risk to write coverage is perceived to be too great or uncertain, U.S. businesses will be left without the coverage they need. This could complicate the already fragile economic recovery.

Terrorism Risk Poses Unique Issues of Loss Predictability

Unpredictability of losses is many times greater for terrorism risk than for natural disasters, as there are no credible historical data on losses. It is impossible to predict frequency with any degree of accuracy, and it is extremely difficult to estimate both the frequency and severity of a potential terrorist event, as the timing, location and target cannot be identified in advance. Without some form of backstop like TRIA, RIMS believes insurance companies will review their portfolios of business and will refuse to continue covering certain risks in areas where exposure is greatest. This would be true for workers compensation, property, and even third-party liability lines of coverage. Both large and small businesses would be affected.

Congressional Action and its Impact on Terrorism Risk Insurance Availability/Affordability

The last ten years have demonstrated that the private insurance market alone will likely not be able to respond nor provide adequate coverage for acts of terrorism. Following the events of 9/11 and prior to the passage of TRIA in 2002, the first long-term authorization, the required supply of commercial insurance coverage for acts of terrorism was not available. RIMS members with large concentrations of employees had difficulty in purchasing workers' compensation insurance as well as difficulty in purchasing property insurance coverage, including coverage for terrorism on buildings and construction projects.

Since 9/11, RIMS has conducted a series of intermittent membership surveys (formal and informal) related to member organizations and their access to terrorism risk insurance. In 2006, prior to the passage of TRIPRA, the vast majority of members indicated their policy renewals were conditioned upon Congress' long-term extension of TRIA. As an indicator of what might be expected if a TRIA-type program were not in effect, 75 percent said that prior to the passage of TRIPRA in 2007, their policies contained terrorism coverage conditioned upon the extension of TRIA. Seventy-six percent stated that they believe their terrorism coverage limits would have been decreased had TRIA not been extended, and 82 percent felt their premiums would have increased if TRIA had not been extended. In this regard, one of our members reported that the premiums for coverage of a property in a large metropolitan area went from $200,000 in 2005 to $500,000 in 2006, for one half of the policy limits they had in 2005. Furthermore, the member's broker stated that carriers were unwilling to commit to insuring projects inclusive of TRIA if the completion dates went beyond December 31, 2007, TRIA's original sunset date.

Subsequent to passage of TRIPRA, a 2010 survey of RIMS members indicates that for the most part, capacity is generally not an issue, but continues to be a challenge for risks located in major metropolitan areas, including New York, San Francisco, Chicago, Boston, and Washington, D.C. Based on our members' experience in these densely populated urban areas, the typical situation is that when insurers monitor their aggregate liability in these particular areas, the purchase of adequate insurance can be difficult. Passage of TRIA in 2002 was followed by a demonstrable increase in the number of insurers willing to write the coverage and provide higher limits needed for these high-risk areas. However, this does not hold true for all areas, even today. The amount and cost of coverage available for high-risk locations continues to vary greatly based on the location of the insured and the aggregation of risk in that particular area. If the federal backstop were withdrawn altogether, these urban areas considered high risk, and those more susceptible to terrorist acts and most in need of terrorism risk insurance, would likely be most vulnerable and negatively impacted.

Elements of Legislation in the 113th Congress

As to an appropriate Federal role in terrorism reinsurance, RIMS strongly supported bipartisan efforts of this Subcommittee and others to create a Federal Insurance Office (FIO) and worked in coalition to secure its incorporation into the Dodd-Frank Wall Street Reform and Consumer Protection Act. RIMS support for an FIO was based on the belief in the need for federal coordination on international matters as well as the necessity for a Federal expertise on insurance issues which became apparent in the aftermath of the 9/11 attacks. As part of this growing recognition that the Federal government has an appropriate role in insurance matters, Congress gave the FIO and Treasury joint authority to administer the Terrorism Insurance Program.

A July 2012 survey of RIMS membership indicates, once again, the strong belief in the necessity of a federal backstop. Nearly 85% of RIMS respondents indicated that Congress needs to reauthorize TRIPRA and that without another long-term extension, issues of affordability and availability will resurface. As the Subcommittee and Congress move forward into the next Congress, RIMS supports the following principles in development of another long-term solution:

- A completely private market solution in the long term is probably not feasible because of the difficulty in predicting acts of terrorism and thus being able to price the risk properly. Businesses, as part of their corporate governance, need to be able to assess what the business risks are and how they can be quantified and treated. Without a TRIA-type program, many entities will simply be self-insured due to lack of availability or affordability of coverage or both—leaving their companies and their workers exposed to an event that could bankrupt the company.

- As risk managers, we believe that a program should always be in place to ensure an orderly and efficient response to minimize any market disruptions and ensure benefits are available to any victims—individuals or companies from a catastrophic loss scenario.
- A private/public partnership provides the best alternative to addressing the long-term needs of availability and affordability of insurance to cover acts of terrorism. Some form of risk pooling may be an appropriate approach. Regardless of the extent of private market involvement, the federal government will likely be required to continue to be involved in a reinsurance capacity at some level with the level of involvement decreasing over time.
- The solution needs to address the long-term availability and affordability of insurance coverage for nuclear, biological, chemical, and radiological (NBCR) events caused by terrorism. RIMS believes it is critical that a program be developed to insure continued coverage for acts of terrorism, including nuclear, biological, chemical, and radiological acts. The federal government has stated that potential acts of terrorism from these sources are likely. RIMS believes that NBCR represents some of the most problematic areas in the ongoing terrorism debate. The stand-alone terrorism insurance market continues to be extremely limited, in that it really only exists for the property line and is very limited in terms of capacity and price. Rating agencies are increasing the capital requirements for reinsurers, which means that they cannot write the same limit of

coverage as last year without increasing their capital reserves. The practical impact is that available limits of coverage will be reduced. RIMS believes that it is critical that a long-term solution be developed to insure that terrorism insurance will be available.

- All commercial property, workers' compensation, auto and general liability lines should be included in any new plan.
- Insurance companies writing commercial lines should be required to participate in the program and be required to make coverage available for acts of terrorism.
- Tax incentives and eligibility for participation in the program should be considered to encourage creation of private insurance capacity.

RIMS appreciates the opportunity to testify and thanks the Subcommittee for beginning this very important discussion in advance of TRIPRA's expiration. We stand ready to serve as a resource as you begin your work to develop legislation next Congress. Should you require additional information or have any questions regarding RIMS policy positions, please do not hesitate to contact Kathy Doddridge, RIMS Government Affairs Director, at kdoddridge@rims.org.

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TESTIMONY

OF

EDWARD B. RYAN
AON BENFIELD

TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM

BEFORE

UNITED STATES HOUSE FINANCIAL SERVICES SUBCOMMITTEE

ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

SEPTEMBER 11, 2012

Good Morning Chairwoman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee. I am Edward B. Ryan, Senior Managing Director at Aon Benfield, the world's leading reinsurance intermediary and full-service capital advisor. With more than 80 offices in 50 countries, our worldwide client base has access to the broadest portfolio of integrated capital solutions and services. I thank you for the opportunity to testify on behalf of the Reinsurance Association of America on the reinsurance perspective of this hearing entitled "TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program."

As we mark the 11th anniversary of the attacks on the US, we remember all the victims of 9/11. Aon Benfield, especially the 1,100 of us who worked in the World Trade Center, continues to mourn the 176 of our colleagues and friends whom we lost that day.

We know the commercial insurance market and know that reinsurance availability is a key component of our economy. We therefore urge Congress to act to extend the Terrorism Risk Insurance Act (TRIA).

Aon and the RAA supported the adoption of the Terrorism Risk Insurance Act in 2002, its reauthorization in 2005 (TRIEA) and the 2007 Extension Act (the current TRIPRA). The response to 9/11 by the insurance industry was to pay tens of billions of dollars in claims but also to exclude terrorism losses going forward. TRIA created an essential federal backstop that enabled the primary insurance industry to provide terrorism insurance coverage to our nation's businesses. The Program has enhanced the private market for such coverage and has had a stabilizing influence on the economy. Under TRIA and its extensions, the availability of terrorism risk insurance has increased.

Private Reinsurers' Role under the TRIPRA Program

There is a role for private reinsurers under the TRIPRA program. In an event certified by the Secretary of the Treasury as a terrorist attack, TRIPRA provides reinsurance-like protection for primary commercial insurance exposures. The program provides coverage for 85% of eligible loss up to an industry loss of $100 billion. Coverage is subject to an individual company retention of 20% of the prior year's direct earned premium (DEP) on covered lines. These individual company retentions, and the 15 percent co-pay for losses above the retention, require insurers to retain significant losses before TRIPRA funding is triggered.

Private reinsurance provides a vehicle for insurers to manage that retained loss.

Private Insurers and Reinsurers Still Face Significant Hurdles in Underwriting Terrorism Risk

Since the terrorist acts of 2001, insurers, modelers and reinsurers have worked to develop a better understanding of terrorism risk. Companies have consulted military and intelligence experts and hired specialty risk modeling firms.

At Aon Benfield, through our wholly-owned subsidiary Impact Forecasting, we developed the first terrorism model post 9/11 to analyze terrorism exposures. With a comprehensive list of 8,000 hard targets in the database, the Impact Forecasting Terrorism Model can produce deterministic and probabilistic losses for a full range of conventional and NBCR (nuclear, biological, chemical and radiological) scenarios.

Despite these efforts, terrorism risk poses great challenges as an insurable risk.

The main hurdle in assessing and underwriting terrorism risk is that the frequency of loss from terrorism is neither predictable nor random. Terrorists continually attempt to defeat loss prevention and mitigation strategies. In addition, the insurance industry does not have access to all existing information about terrorism, targets and potential attacks for obvious national security reasons.

Observations on Private Reinsurance Terrorism Market

Despite these issues, reinsurers have been willing to put capital at risk to manage terrorism losses. Reinsurers typically offer coverage for foreign acts of terrorism, i.e. acts committed by non-US agents, in stand-alone terrorism contracts, rather than within existing all-perils catastrophe contracts. The amount of stand-alone terrorism treaty reinsurance capacity available in the private market is estimated to be $6-$8 billion, a figure that has remained largely unchanged in recent years.

The bulk of terrorism reinsurance currently comes via existing reinsurance programs. Coverage for Personal Lines (which is not subject to the Program), for Workers Compensation, as well as for acts of terrorism committed by US agents is generally available in existing catastrophe programs. Insurers with exposures limited to rural or suburban areas have secured terrorism coverage within existing reinsurance programs, with limitations on the size of subject risks or events.

Regarding NBCR exposures, there is little reinsurance appetite for this risk. When it is available, pricing for NBCR coverage comes at a significant premium and coverage amounts are significantly less than those available for conventional terrorism.

For the foreseeable future, based on current demand, there will be an adequate supply of reinsurance capacity for coverage around the structure currently provided by the Federal Program. However, were the Program to terminate in 2014, we expect insurers to curtail the provision of terrorism insurance. U.S. businesses would be more exposed to the financial consequences from terrorist activities. To the extent that this additional risk forces businesses to seek insurance, insurers would offer meaningful but not unlimited insurance products. The private reinsurer marketplace would work productively with insurers to provide reinsurance coverage for terrorism, but capacity would be severely constricted. Moreover, absent a federal backstop for terrorism risk, expectations that the vast majority of the existing insurance market for terrorism risk would disappear is not merely speculative. Aon tracked property insurance market behavior prior to the previous expiration of the various iterations of TRIA and, in each instance, more than 80% of the existing capacity for terrorism risk would have been withdrawn from the market in the absence of TRIA and its mandatory offer of coverage provisions.

TRIPRA Renewal in 2014

TRIPRA has served an important role to our nation's economy. As TRIPRA expires in 2014, we urge this Committee and the Congress to reauthorize this program in 2013 to eliminate any uncertainty around reauthorization, and to meet the needs of insurers and insureds whose contracts will expire throughout the year. We commit the resources of Aon Benfield as well as the Reinsurance Association of America to work with the Committee to achieve this goal.

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TESTIMONY OF

LINDA ST. PETER
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NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

HEARING TITLED

TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM

SEPTEMBER 11, 2012

INTRODUCTION

Chairwoman Biggert, Ranking Member Gutierrez, and members of the Subcommittee, on behalf of more than 1.1 million REALTORS®, thank you for inviting me to testify today on the future of the terrorism risk insurance program. My name is Linda St. Peter. I am the 2012 Vice Chair of the Commercial Committee for the National Association of REALTORS® (NAR) and I am the current operations manager for Prudential Connecticut Realty in Wallingford, CT. I have specialized in commercial and investment real estate brokerage, since 1988. I am pleased to testify of behalf of the NAR and its commercial affiliates: CCIM Institute, Institute of Real Estate Management, REALTORS® Land Institute, and Society of Industrial and Office REALTORS®. Together, members of NAR and its affiliates are involved in all aspects of commercial real estate – from real estate brokerage to property management.

RECENT ATTACKS &THREATS

We still live in an uncertain world and continue to fight the war on terror. Though we have been safe at home since September 2001, we only need to look to the 2011 suicide bombing at Moscow's Domodevo airport for terrorism's devastating potential. Additionally, conflict in many countries across the Middle East and North Africa has increased political and social tensions, factors that suggest terrorism risk will be a constant and potentially growing threat for years to come. It is in the interest of America's economic security to ensure that as much of our commercial real estate industry is covered by terrorism insurance as possible.

Through my experience working on some of Connecticut's most significant commercial real estate projects over the past several years, I personally understand the vital importance of terrorism insurance to accomplishing the economic goals of Connecticut. I can tell you that if the terrorism insurance program were to expire, many of my firm's community development projects would not be possible.

IMPORTANCE OF TERRORISM INSURANCE

It is no secret that immediately after the horrific 9/11 terrorist attacks, terrorism insurance coverage was virtually non-existent for commercial property owners. Only when Congress enacted the Terrorism Risk Insurance Act (TRIA) in 2002 did coverage for terrorist attacks resume. TRIA established a public-private risk-sharing partnership that allows the federal government and private insurance companies to share losses in the event of a major terrorist attack. Originally enacted as a 3-year program, TRIA has been reauthorized by Congress twice. In 2005, Congress passed the Terrorism Risk Insurance Extension Act (TRIEA). The most recent extension – the Terrorism Risk Insurance Reauthorization Act of 2007 (TRIPRA) – extended the program through December 31, 2014.

Today, there is concern that the uncertain future of TRIA may cause insurance prices to fluctuate. Further, this uncertainty may prompt insurers to drop terrorism coverage if a reauthorization of the program is not in place by the end of 2014. This became evident in 2005 when private insurers became more reluctant to offer terrorism coverage due to uncertainty regarding the program's extension. Ultimately, the uncertainty of insurance pricing impacts our net operating income, and the value of our properties. The potential unavailability of this coverage at the end of 2014 will impact our financing agreements and potentially hurt the fragile commercial real estate market.

Affordable and available terrorism insurance is a vital component of most commercial real estate transactions. It is estimated that 84 percent of outstanding commercial mortgage balances require terrorism insurance. Thus, if TRIA were to expire, and insurers subsequently dropped terrorism coverage, those loans would be in technical default. While the commercial real estate finance market is starting to show signs of life, any disruption in the availability of terrorism insurance in this sector would have serious consequences on its fragile road to recovery.

NECESSITY OF THE TERRORISM RISK INSURANCE PROGRAM

The passage of TRIA in 2002 helped stabilize commercial real estate markets following the disruptions of the September 11, 2001, terrorist attacks by making terrorism coverage available and, over time, more affordable. According to a 2010 President's Working Group on Capital Markets (PWG)[1] and 2008 Government Accountability Office (GAO) study[2], TRIA and its subsequent extensions have generally kept terrorism insurance affordable and available nationwide. Owners of high-value properties in urban areas, such as Manhattan, however, still face challenges in obtaining coverage at a reasonable price. Improved access and lower premiums are due in part to the continued improvement in an insurer's ability to model and measure their aggregate loss exposure, and thereby manage terrorism risk.

However, despite improvements in these measurements, the frequency and severity of terrorism attacks cannot be reliably assessed by insurance companies. Primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses and continue to have limited availability to reinsurance. Reinsurance plays a critical role in insurance markets by allowing insurers to transfer some of the risks they assume in offering, permitting them to offer additional coverage. Similar to the challenges faced by primary insurance companies, reinsurers have limited ability to predict the frequency and magnitude of future terrorist attacks, which has hindered reinsurers from sufficiently managing the industry's current terrorism risk exposure.

Thus, without the federal backstop for potential insurance losses related to terrorism, we believe coverage availability could decline significantly. In fact, without TRIA providing reimbursement for insured losses that exceed the amount of an insurer's deductible, coverage could decline by more than 95 percent, according to one insurance company cited in the GAO report.

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[1] Market Conditions for Terrorism Risk Insurance 2010, Report of the President's Working Group on Financial Markets.
[2] GAO, Report to Congressional Committees, Terrorism Insurance – Status of Efforts by Policyholders to Obtain Coverage (GAO-08-1057, Sept. 2008).

Recent Modifications to TRIA

As mentioned earlier, since its enactment in 2002, TRIA has been modified and extended twice. We believe many of the changes made have enhanced the program by providing more access to affordable terrorism insurance for businesses, while lowering the potential cost to taxpayers in the event of a major terrorist attack.

This includes the removal of the foreign vs. domestic terrorism distinction. Without this change, the Treasury Secretary may be forced to make determinations that may not serve our national security needs, and more importantly, the distinction served no policy goal. As the 2005 London bombing demonstrated all too well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims.

Principles for a Long Term Solution

Quite simply, an effective homeland security strategy is central to the nation's economic security. American businesses must have adequate terrorism risk coverage. Without terrorism insurance, the nation's economic infrastructure is totally exposed to large-scale business disruptions after an attack, and to a retarded recovery from the damage that is caused by the attack. As our economic interests continue to be targeted by terrorists, it is appropriate, necessary, and vital that the federal government play a role in maintaining the security of our insurance system which helps provide for recovery of the economy.

Extension & Structure of Program

We believe the time has come for Congress to enact a long-term solution for insuring against terrorism – one that provides the needed market certainty to allow for continued economic growth and development. We envision a two-part structure that would finance both conventional terrorism risks and nuclear, biological, chemical, and radiological (NBCR) risks.

Conventional Terrorism Risk. For risk of conventional (i.e., non-NBCR) terrorism attacks, we believe the current TRIA backstop should be kept in place, with the insurance deductibles, industry retention, and program trigger all maintained at no higher than their current levels. This ensures policyholders will continue to have access to coverage through the "make available" provision.

While TRIA has been largely successful in making available private direct insurance coverage against conventional terrorism attacks, it has not been without some continuing problems of availability and affordability. There are still major markets today, particularly high-risk urban areas, where the combination of aggregation risk, high retention rates, and rating agency pressure are causing capacity problems for conventional terrorism coverage. Therefore, Congress and the federal government need to continue the statutory framework that is known as TRIA for conventional terrorism exposure, but this framework needs to be modernized to reflect the continuing market realities of capacity shortfalls in some areas.

NBCR Terrorism Risk. NBCR terrorism risk is a different matter. Even if the federal backstop exposure to conventional terrorism can be reduced over time to all but the most catastrophic attacks, the challenges are different for NBCR, according to all of the expert actuarial estimates. As it presently stands, TRIA covers NBCR perils; however, we have not seen any evidence that such coverage is being written except when mandated for workers compensation. Because TRIA only requires that terrorism insurance coverage be made available on the same terms, amounts, and limitations as non-terrorism perils, insurers are not required to make NBCR terrorism coverage available if NBCR coverage for non-terror events is not offered.

The GAO and the PWG reports have all recognized that markets simply cannot price the risks associated with NBCR perils. Accordingly, we believe that this is a crucial area that the long-term solution should address. NAR believes NBCR coverage and pricing can be improved if Congress adopts measures that would lower insurer deductibles and co-pays with respect to NBCR risks. It is also necessary for Congress to clarify that the federal government is solely liable for NBCR terrorism losses above insurers' individual NBCR retentions, thus encouraging insurers to provide more capacity. Finally, we urge Congress to add NBCR perils to the "make available" requirement under TRIA so that policyholders would have an optional endorsement giving them coverage for NBCR terrorism that would otherwise be excluded by the nuclear hazard or pollution exclusion contained in certain commercial lines policies.

CONCLUSION

Affordable and accessible terrorism insurance is an integral part of the health of the commercial real estate markets. Given that the reinsurance industry has not yet been able to develop a long-term solution that would eliminate the need for some form of federal assistance, NAR is concerned that the potential sunset of TRIA will result in a spike in terrorism coverage premiums, and cause coverage to become unavailable in numerous markets.

NAR believes the TRIA program has been a success because it provides for the sharing of risk between government, private insurers, and policyholders. Ultimately, it is critical for the U.S. economy that commercial policyholders be able to obtain coverage for terrorism risk. Therefore, TRIA must be extended beyond its current 2014 authorization.