

Testimony of the  
Property Casualty Insurers Association of America

Before the  
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Sponsored Enterprises

Committee on Financial Services  
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“The Future of Terrorism Insurance”

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Ernst Csiszar  
President and CEO

## **Testimony of Ernst Csiszar**

### **President and CEO Property Casualty Insurers Association of America**

My name is Ernie Csiszar and I am President of the Property Casualty Insurers Association of America. PCI is a trade association representing over 1,000 property/casualty insurers that write almost 40 percent of all the insurance policies in the United States. PCI was founded on the philosophy that consumers are best served by free, fair, and well-regulated insurance markets in which a wide variety of financially healthy companies compete for business on the basis of price, product innovation and quality, and customer service.

Terrorism insurance is a national economic security issue and I would like to commend the members of this Committee for understanding the critical role of the federal government in development of a long-term solution to this problem. I am here today to give you our views of this issue. I am also here to commit to you that PCI will work with you to explore all aspects of this problem and all possible solutions in order find a program that will protect our nation's economic security and our policyholders.

#### **The Importance of a Federal Role in Terrorism Insurance**

Our members believe in the power of free markets and support competition-driven solutions to public policy problems. We think consumers are best served, wherever possible, by markets that are free, fair, and well regulated. That being said, there are some instances – terrorism insurance clearly being one of them – where we are all better served by some limited federal intervention in the market.

This fundamental point was underscored earlier this year when Federal Reserve Board Chairman Alan Greenspan noted, "There are instances in which markets do not or cannot work, and....I have not been persuaded that a private market for terrorism insurance works terribly well." This view was reinforced last week when Chairman Greenspan told this committee that "...so long as we have terrorism that has the capability of a very substantial scope of damage, there is no way you can expect [the] private insurance system to handle that."

We all know that the ongoing threat of a terrorist attack on our nation and our economy is real. CIA Director Porter Goss has repeatedly told Congress that an attack on our nation is "only a matter of time" and that our enemies continue searching for ways to make future attacks much more devastating than September 11, including the use of nuclear, biological, chemical, or radiological weapons.

We believe our nation must fight terrorism on all fronts, using military action, homeland security measures, and programs that protect our economic security. We believe that a public/private partnership, coupling the power and security of the Federal government with the innovation and agility of private markets, is the best way to protect our economy.

## **The Impact of TRIA**

I want to offer several comments on the Terrorism Risk Insurance Act of 2002. TRIA was adopted in November 2002, more than a year after the September 11 attacks. It was debated significantly in the House and the Senate and emerged from long and thoughtful consideration of the issues involved, observation of the response of private markets to terrorism risk, and evaluation of alternative approaches. It was not done in haste and reflects the well-considered wisdom of the Congress and the Administration. We believe it was a tremendous achievement by the 107<sup>th</sup> Congress.

TRIA provides essential support and confidence to private insurance markets. The program has created a degree of certainty about the maximum losses that any individual company or the entire insurance industry could suffer and, in doing so, has helped foster what market there is for terrorism insurance. According to the latest statistics, roughly 44 percent of all business insurance consumers buy terrorism coverage. Some have feared that TRIA would “crowd out” the development of a meaningful private market for terrorism reinsurance. On the contrary, we believe it gave the support needed to allow such a market to begin to develop. Without TRIA, we don’t believe we would have seen the limited development that has occurred.

Our members write insurance policies for individuals and businesses in every state and virtually every community in our nation. Their commercial insurance policyholders – real estate developers, builders, manufacturers, retail stores, malls, apartment complexes, churches, mosques and synagogues, schools, and universities - have benefited enormously from TRIA. They know the threat of a terrorist attack is real and many have made a deliberate and considered decision to protect themselves from the economic risks of future attacks.

As you know, TRIA will expire at the end of this year. Given the many benefits it has provided, I am here to tell you that all of us – Members of Congress, insurers, and policyholders – must act now to develop a long-term solution to the problem of insuring terrorism risk. I commit to you today the resources of PCI to work with members of Congress and the business community to develop an effective, market-driven system that establishes a long-term, public/private partnership to address the issue of terrorism insurance once and for all.

## **The Unique Challenge of Underwriting Terrorism Insurance**

Our members are in the business of assessing, pricing, and underwriting risk. They work closely with their policyholders to reduce their exposure to all types of loss, including terrorism. Insurers have always risen to the challenge of underwriting and paying for catastrophic losses. Our industry paid nearly \$33 billion in claims from the September 11 attacks, not to mention the enormous payments we have continued to make, as always, from “normal” natural disasters such as hurricanes and earthquakes.

When we tell you that terrorism risk is different from other catastrophes, we do so for several reasons. The differences arise mostly from differences in severity and predictability. The size of the potential losses from a terrorist attack dwarfs the financial resources of the insurance industry. The September 11 attack was by far the largest insured loss in U.S. history. The amount of insurance industry capital devoted to insuring

the lines of business most likely to be affected by terrorist attacks (commercial property, workers compensation, etc.) amounts today to approximately \$148 billion or 40 percent of the total capital of the industry. Since September 11, 2001, insurers and catastrophe modeling experts have modeled many potential terrorist attack scenarios – these experiments convince us that there are many potential attacks, especially those involving the use of nuclear, biological, chemical, or radiological weapons that are well beyond the financial capacity of our industry to withstand. Continuing statements by Department of Homeland Security officials underscore our concerns.

Second, this risk is impossible for insurers to assess and price based on our current knowledge. Weather-related catastrophes are much more predictable. We have years of experience with sophisticated models that tell us not only where these losses are likely to occur, but on average how large they might be and how often they are likely to happen. We know none of this about terrorism. Without a distribution of either the ultimate cost or the probability of loss, we don't have a method to develop the appropriate charge for the coverage nor do we know what losses to expect.

These problems are the reasons that a vibrant, substantial, and healthy private market for terrorism reinsurance has not emerged since September 11. While we can agree with many of the points made in the recent Department of the Treasury report, there appears to be a belief in some quarters that allowing TRIA to expire with nothing in its place will automatically spur the development of such a private market for terrorism risk. We see no reason to expect that will happen without market-based reforms, coupled with a public/private partnership.

### **Limits on the Private Sector Role**

We have spoken above of our support for the greater use of private sector responses to this risk. At the same time, it is critical that policymakers also recognize the limits of the private sector response and why a federal role is essential. As already noted, insurers face significant problems underwriting this risk because of the enormous potential losses and because we don't know size or frequency distributions for the risk.

In addition, private markets require that buyers and sellers are able to determine for themselves whether a product will be offered and under what terms and conditions. If there is to be a greater private role in solving the terrorism insurance problem, there must also be federal support for giving insurers and insurance markets more freedom to negotiate these terms and conditions. Let me offer some examples of the problems we face:

- In certain states, insurers writing commercial property insurance are still required to cover losses from a "fire following" a terrorist attack, due to restrictions in 1940s-era laws enacted for a very different world. This is true even if insurers and policyholders would prefer to alter coverage.
- State regulators in three key states (New York, Florida and Georgia) continue to refuse to allow insurers to exclude or limit coverage for terrorist attacks after the expiration of TRIA this year. This refusal continues even if the insurer and the policyholder both might want the flexibility of a free market.
- TRIA itself provides state oversight and control of the rates insurers can charge for terrorism coverage, with the result that insurers cannot truly experiment with the

appropriate price for this coverage and, if they try, must fear potential future requirements that they return supposedly “excessive” rates.

- No state allows an insurer writing workers compensation to exclude or limit coverage for losses caused by terrorism. The only way workers compensation insurers can avoid this risk is to stop writing certain insureds – i.e., to walk away from policies they think may pose excessive risk. However, even when they do so, they face exposure in many states to losses from those same policies through mandatory residual market pools and guaranty funds.

We understand the desire for consumer protection behind many of these requirements, but we must emphasize that it is inconsistent to urge a more robust private sector response without giving the private sector the tools it must have to build that response.

### **Guiding Principles for a Long Term Solution to the Terrorism Insurance Problem**

As you consider how to proceed, we believe there are several important principles for you to consider when evaluating long term solutions to the terrorism insurance problem:

- Terrorism is the most significant risk facing our nation’s economic security today. It is critical that it be addressed. It requires uniform protection and a nation-wide response (not state by state). The fight against terrorism is a long-term battle and we should now build on the steps initially taken by Congress to provide a long-term solution.
- The insurance industry does not have the financial capacity to bear the total risk of terrorism losses due to the nature of the exposure and the scale of the risk. Addressing this risk to our nation’s economic security requires a partnership between the private sector (and its infrastructure) and the Federal government. This partnership must protect the public, the nation’s economy and insurers’ ability to meet their many obligations to their policyholders.
- A long-term solution should minimize cross-subsidies by line of insurance and by insurer, maximize incentives for sound economic underwriting and pricing, and cover exposures most seriously threatened by terrorism. There should be an equitable distribution of costs based on geographical location and risk of loss, including potential losses to life, property, agriculture, and critical economic infrastructure.
- The program should cover losses from both domestic and foreign terrorism events.
- A long-term solution should encompass group life coverages and address terrorism exposure for homeowners and automobile insurance arising principally from potential “weapons of mass destruction” attacks, given the catastrophic potential losses it poses for our industry and for the American public.
- The program should be consumer friendly and implementation costs should be kept reasonable by following standard industry business practices.

## **Components of an Alternative Solution**

I want to emphasize the need for us to develop a long-term solution to the terrorism insurance problem. PCI recognizes the goal of increasing the reliance on the private insurance market and reducing the role of the federal government over time. We believe that all reasonable ideas should be considered and, to that end, I'd like to offer several thoughts on such a design.

### **Greater Reliance on Private Insurance Markets**

In order for the private insurance market to assume a greater relative share of the risk insurers need greater freedom to respond and innovate, the ability to share losses and seek capital in the marketplace, and encourage build-up of catastrophe reserves.

### **Market Reform**

In order to assume a larger role, insurance companies need to be able to experiment and innovate, as well as respond quickly to opportunities and developments. Unfortunately, a patchwork of state laws and regulations, enacted or adopted before Sept. 11, impose counterproductive barriers and obstacles. Recognizing the national scope of the risk, PCI urges Congress to modernize and streamline the handling and treatment of insurance relative to terrorism. Specifically, we believe a long-term solution should:

- Provide greater rating freedom to encourage the market to respond by allowing insurers to charge an appropriate price for the degree of risk assumed.
- Repeal or scale-back antiquated Standard Fire Policy (SFP) laws. The SFP was created in 1943, before the detonation of the first atomic bomb. This area cries-out for modernization and a more level playing field across the country.
- Clarify that no state can unilaterally mandate terrorism coverage in the absence of the federal Program.

### **Loss Sharing and Capital Creation**

As federal involvement diminishes, private insurers need the ability to safely and predictably share risks and spread losses on a limited basis among themselves, over and above individual company retention levels. To facilitate loss sharing, insurers need the ability to band-together and fill the gap or layer between individual company exposures and the federal backstop. This mechanism is analogous to many state catastrophe funds or pools already in existence and is essential as the level of the federal backstop diminishes.

The creation of a reinsurance facility would provide participating insurers, particularly smaller insurers, the ability and flexibility to "buy-down" to lower retention levels, with the cost and terms of doing so determined by the governing board of the facility.

We envision mostly "post-event" funding, through the use of revenue bonds and policyholder assessments, although there would be a "pre-event" component as well, to cover start-up and administrative costs. The facility would accumulate reserves on a tax-free basis and have the ability to purchase private reinsurance.

In order to attract capital from the private market (not just insurers), we also believe a facility should be authorized to issue tax-free “pre-event” bonds. The facility could be the reinsurance facility noted above or another entity created for this more limited purpose, but would serve to attract private market capital.

### **Reserve Accumulation**

In order to encourage private insurers to voluntarily experiment with accepting increased risk in the free market environment, we believe the government should provide them with the ability to voluntarily accumulate tax-free reserves on a pre-event basis, and to retain and manage such reserves themselves.

Current tax law permits insurance companies to establish tax-deferred reserves only against losses that have already occurred. The establishment of tax-deferred reserves for future catastrophic losses from terrorism events would incentivize U.S.-based property and casualty insurers to build capacity and properly manage catastrophic loss exposures, and help protect the insurance market from insolvencies if a terrorist event occurs.

Based on a concept similar to individual IRA accounts, funds would be set aside and held in segregated accounts on a tax-deferred basis and would be included in taxable income in the year the funds are withdrawn. There is a long history of bipartisan support for a similar concept for catastrophic losses from natural disasters.

### **More Limited Federal Role**

Recent events in London serve to remind us that the threat of terrorism is real. Treasury Secretary John Snow and Federal Reserve Chairman Greenspan have acknowledged the need for a continuing and significant federal role in terrorism insurance. However, PCI recognizes that this role also needs to evolve in the next phase of our public/private partnership.

As we have noted, given a free market, the private insurance market is willing to assume a larger share of the risk. Nevertheless, a long-term continuing federal role is integral to encouraging this evolution. We support extension of the federal program for an additional ten years and reducing federal financial involvement over time via gradual increases in the industry aggregate and individual company retention levels. These reforms should be coupled with market-based reform.

PCI recognizes your role and obligation as stewards of the taxpayers' money. We pledge to work with you to balance this with the imperative need to protect the economy and avoid even larger potential outlays in the future.

### **Covered Lines**

The threat of terrorism is not limited to commercial property interests. We commend the Treasury Secretary for acknowledging the need for extending a federal role relative to commercial property and workers compensation insurance. Unfortunately, the suggestion has also been made that general liability and commercial automobile insurance be dropped from the TRIA program. We respectfully suggest that such a move

would be harmful to commercial insurance consumers, as well as the general public, for a variety of reasons.

Along with property and workers compensation, general liability and commercial automobile coverages are often written as part of a discounted “package” or “program” for a variety of large, mid-sized, and small businesses. Eliminating general liability and commercial auto from the program will make it harder for the most vulnerable employers to obtain affordable coverage tailored to their needs. As an example, many of our hospitals will be on the front line in the aftermath of the next terrorist event. Our medical and pharmaceutical research facilities serve a key role as well, particularly in the case of a biological or chemical event. These facilities need a broader array of affordable commercial coverages to remain open and viable.

Second, as with workers compensation, potential losses under group life insurance can be enormous, given the concentration of risk in some workplaces. Group life insurance products provide valuable protection to more than 150 million citizens and in many instances is their only life insurance. As we protect our nation’s assets we must not neglect protection of the economic security of its workers. PCI, therefore, strongly supports the addition of group life coverage to the program.

Third, until now, the debate over the elements of a long-term program have been focused on the needs of businesses and commercial property owners. However, many experts predict that the next mass terrorism attack could very well be a nuclear, biological, chemical or radiological (NBCR) event. By their nature, such events have the potential to destroy or neutralize not only businesses and commercial ventures, but also many homes and automobiles. Whole neighborhoods could be destroyed or rendered uninhabitable, and both local and national economies severely harmed, yet TRIA does not address this scenario. PCI suggests a thorough study of the potential losses faced by individual consumers and how the public/private partnership can best address the matter, with recommendations for any needed legislation.

## **Conclusions**

Our members again commend you and your colleagues for addressing this issue and for offering ideas for a solution. We believe terrorism is the most significant threat today to America’s economic security and we applaud your efforts to address this very serious problem.

We believe TRIA represents the considered will of the Congress and has worked well at very low cost to the government. It has been a success and has promoted the ongoing development of private markets for terrorism coverage. We understand and support the desire of many to encourage new private sector responses and an increased role for private solutions, we would be remiss if we did not tell you that we believe the current system works well.

Finally, we want you to know that our members are committed to addressing this issue. We have been working closely and diligently with them, and will continue to do so, to identify and formulate potential solutions to this problem. We look forward to continuing to work with you and your colleagues as we work toward a long-term, market-based solution.