



STATEMENT OF THE
NEW YORK STATE INSURANCE DEPARTMENT

BEFORE

U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE
ON CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT SPONSORED ENTERPRISES

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I. Introduction

Thank you Chairman Baker and members of the subcommittee for the opportunity to discuss a very important issue for New York and the nation, the future of terrorism insurance.

The global war on terror is being fought on many fronts, and rightly so. The insidious nature of the terrorist enemy today; an enemy with no defined nation, borders, ideology, or structure; an amorphous enemy whose misguided foot soldiers come from all walks of life and backgrounds and are recruited from, and reside in, nations around the globe, require us to develop new defense paradigms to protect our national interests. These diverse individuals are united only in their hatred toward what we value the most - our freedom, and their zeal to destroy our way of life, in wanton disregard for the lives of our citizens and property. While the courageous men and women of the United States Military protect us from this enemy worldwide, the existence of a federal backstop for terrorism insurance in the form of The Terrorism Risk Insurance Act of 2002 (TRIA) has protected our economy from the destabilizing economic effect of the terrorist threat right here at home.

As vividly demonstrated by the recent cowardly attacks in London and Egypt, the terrorist threat has in no way subsided and continues to be an immediate and significant risk to our nation's physical and economic wellbeing. Reminders of this threat are omnipresent in our daily lives as evidenced by barricaded office buildings in urban centers, the necessity to search the bags of entrants to our mass transit systems, the increasing presence of security personnel on our streets, and news headlines about another bomb explosion or evacuation somewhere grabbing our attention. Just as the

terrorism threat has not subsided, our response to this threat, both physical and economic, cannot be allowed to diminish or abate.

Given the vital role that TRIA has played in ensuring the affordability and availability of terrorism insurance in the market, and by extension the overall US economy, we cannot and should not lower our economic preparedness by allowing TRIA to expire without an appropriate federal backstop being in place on January 1, 2006.

II. The Post September 11th Market and the Effects of TRIA

In the months following September 11th, the insurance marketplace experienced significant disruptions. Coverage for terrorist acts became either unavailable or priced beyond the reach of businesses. Large businesses and institutional concerns were compelled to cobble together coverage from various sources in order to reach barely adequate limits of insurance. Trophy properties and businesses in close proximity to those properties, particularly in major cities, found it especially difficult to secure adequate coverage in all lines. Many businesses in the post-September 11th market were faced with the unenviable choice of paying suddenly higher premiums for less coverage or going without insurance altogether for the terrorist risk. Some insureds were compelled to consider lowering the amount of insurance they carried in order to afford the premium increases or engage in other cost-cutting activities such as reevaluating expansion plans in the works on September 11th or reducing employee benefits. Others adopted the risk management technique of “avoidance” by disengaging themselves from otherwise economically sound activities that could be subject to the peril of terrorism. The inability of insureds to satisfy lenders’ “all risk” insurance coverage requirements

resulted in billions of dollars in stalled construction projects. We also saw a substantial migration of insurance writings to the excess and surplus lines markets, where rates and forms are not regulated.

In enacting TRIA, Congress and President Bush took the right step to address these market conditions. TRIA, as acknowledged in the recent Treasury report on its effectiveness, has been successful in stabilizing the insurance marketplace. The presence of this federal backstop has provided an appropriate means for the insurance industry to make vital terrorism coverage widely available to American businesses. By requiring insurers through the "make available" mechanism to offer coverage for acts of terrorism they otherwise might not have offered in the wake of September 11th, TRIA brought certainty and stability to the insurance marketplace. American businesses - both large and small - have been offered choices they might not otherwise have had and those businesses that needed the coverage most were able to obtain it. Thus, TRIA worked exactly as intended by Congress.

If a federal backstop is not in place on January 1, 2006, we may revisit some of the same market disruptions and economic uncertainties that we faced in the aftermath of September 11th - especially since the private market currently does not have the means to appropriately address this exposure. In particular, businesses viewed by insurers as having a greater risk of terrorism losses, such as those located in America's financial and commercial centers, may have great difficulty in finding terrorism insurance.

III. A Need for Immediate Action

Given the looming expiration of TRIA, the current lack of a free market solution to the terrorism exposure, and the negative economic consequences that will ensue without the existence of a federal backstop, both my fellow regulators at the National Association of Insurance Commissioners and I believe that immediate action must be taken to ensure that this essential economic protection remains in place without any gap in coverage. Congress may wish to consider modifications to the existing program that strike an appropriate balance between protecting taxpayers' funds and providing sufficient levels of coverage to ensure the continued availability and affordability of terrorism coverage. Alternatively, Congress may wish to take a more comprehensive approach by establishing mechanisms for increasing private market participation coupled with diminishing federal involvement, recoupment of taxpayers' expenditures, and developing dedicated capacity.

Developing a pool of private capital specifically designed to support terrorism writings will be a crucial component to any long-term solution. Federal participation on a mega-catastrophe level, however, will also be a necessary piece to any successful long-term solution. The objective would be to increase the capacity at the private market level while at the same time limiting federal involvement to truly extreme catastrophic events. Federal Reserve Board Chairman Greenspan, in his recent testimony before the House Financial Services Committee, recognized private market limitations with respect to extreme terrorist events stating 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.”

While industry capacity, measured by the capital and surplus available to insurers to support their policy writings, has increased over the last few years, there are competing demands on this resource. It is important to note that, in general, less than half of those funds are available to support commercial products in all lines of insurance, including terrorism coverage. Insurers have demonstrated their continued reluctance to expose this capacity to the terrorism peril in the absence of a backstop by filing conditional terrorism endorsements with regulators that, in the event that TRIA expires, reinstate terrorism exclusions and limitations which were in effect after September 11th. If triggered by the expiration of TRIA, these limitations will greatly reduce the terrorism coverage in the states that have approved these endorsements. In those states that have rejected these endorsements - like New York - insurers will have to make the difficult choice of writing the coverage and accepting the potentially catastrophic terrorism exposure or not writing it at all. This will leave the insurance marketplace in much the same position that it was in the post-September 11th and pre-TRIA environment with respect to the availability and affordability of terrorism coverage. These contingent endorsements also suggest that there is a need for maintaining the "make available" requirement or similar offer mechanism in any successor backstop.

The industry's reluctance to provide coverage for this exposure is also a function of their inability to accurately price terrorism coverage – a task that will be made all the more difficult in the absence of some form of backstop. While advances have been made through modeling to estimate potential losses that may arise as a result of a terrorist

attack, the frequency of such attacks can not be accurately predicted. Unlike natural disasters, which are random and where historical data forms the basis to predict future events, the intentional acts of terrorists are all but impossible to predict with any degree of accuracy. The challenge of accurately predicting attacks is made more difficult because terrorism is a shifting threat where the culprits modify their tactics and targets in response to security and loss mitigation efforts.

Finally, I'd like to briefly mention workers compensation coverage which is an area of particular concern for insurers in the context of industry capacity. A single, mid-sized employer with 250 employees at one location can represent a potential exposure to an insurer of tens of millions of dollars in the event of a terrorist attack. Moreover, insurers cannot utilize exclusions or limitations to reduce this aggregation of risk as they have done in other commercial lines because state laws do not permit exclusions or limitations to be applied to workers compensation coverage. One method of treating aggregation of risk concerns in the workers' compensation line would be to syndicate coverage through layering and diversification amongst different entities. Syndication involves structuring a layered program, vertically and/or horizontally, to cover insureds, locations, or lines of businesses that present a catastrophic exposure. Each layer of the syndicated program could be covered by a different entity, including insureds, through retentions and coinsurance, primary insurers, and reinsurers.

IV. Conclusion

Regardless of whether a short-term or long-term approach is taken with respect to the terrorism issue, the most important point is that a successor program be in place on January 1, 2006 to avoid any gaps in coverage. We urge Congress and the Administration to take the appropriate steps to ensure continuation of this vital economic protection. Of course, any solution to this issue will require the insurance industry to assume its appropriate role in the development of a long-awaited, free-market response to the threat of terrorism.

I stand ready to work with this Committee, Congress, the Administration, my fellow regulators and the insurance industry in achieving the goal of making terrorism coverage affordable and available.

Thank you.