Committee on Transportation & Infrastructure
Subcommittee on Railroads

Aon Risk Services

National Rail Transportation Practice

Testimony

June 13, 2006

Aon Risk Services
Rail Liability Insurance Market

James R. Beardsley and Deborah S. Bates are attending the hearing representing Aon Risk Services' Rail Practice. Aon Risk Services is a world leader in delivering integrated, innovative solutions in insurance and risk management, human capital consulting and specialty insurance underwriting. Our professionals are experts in their fields and possess specialized knowledge and skills. One of the specialties is a dedicated industry focus on railroads and rail related industries. Within that specialty, we are recognized as the industry leader.

As well as being the leading freight railroad insurance broker in the world Aon is the:

No. 1 global reinsurance broker
No. 1 global manager of captive insurance companies
No. 1 global retail insurance broker

As representatives of Aon's National Rail Practice, we currently design the excess programs for all but one of the five american Class 1 freight railroads. In addition, we have a substantial book of short line, transit and national passenger rail accounts.

Our purpose for being here today is to give the committee a snapshot of the current state of the rail liability market. Additionally, we will discuss how the transportation of hazardous materials impacts the capacity and pricing of insurance for the railroads.

Globally there are currently three geographic centers for railroad liability insurance, U.S., Europe and Bermuda.

Their combined capacity is almost one billion dollars. The smallest market is the U.S., with only about $75 million. The European markets have the capability to provide an additional $300 million. Finally, since 2002 Bermuda has come into the market with a further $575 million.

<u>American</u>

American Home	$50M
Lexington	$25M

European

Gerling	$75M
Liberty International	$50M
Lloyd's	$50M
SCOR	$25M
Swiss Re	$50M-$100M
XL Europe	$50M

Bermuda

ACE	$150M
Arch	$25M
Allied World	$50M
Chubb	$35M-$50M
Endurance	$25M
Max Re	$25M
Starr	$150M
XL Bermuda	$100M

In the overall global insurance market there is substantially more than $1B depicted above available, but we are dealing with a class that is considered to be very volatile and only a select few companies are willing to participate. In order to access this capacity the railroads are required to pay substantially more than most other industry groups at an equivalent attachment point, as the potential exposure to loss is deemed to be far higher.

Within the companies listed above there are four that are considered to be lead markets. The lead markets set the terms and conditions of the insurance. They set the pricing and the attachment point of the lowest layer of insurance. The expertise of these individuals is accepted in most cases by the rest of the market as the base on which to build the balance of the program to the level required by each railroad. The American domestic leaders are American Home and Lexington, both divisions of AIG. The European leaders are Gerling, headquartered in Cologne, Germany, and Lloyd's of London syndicate, Wellington.

Over the last several years the North American railroad liability insurance market has contracted substantially. Five years ago railroads were able to purchase in excess of $1.5 billion in coverage. The number of insurance companies and Lloyd's syndicates willing to write freight railroads has decreased, while the price charged for the capacity has increased. There are several events that have exacerbated this condition.

- September 11, 2001
- Large derailments with chemical releases
- Contraction of the worldwide insurance market
- Large passenger losses
- Hurricanes

As a result of September 11th a substantial amount of insurance capacity withdrew from the market. It was not as a direct result of large liability losses that occurred on that date, but the impact on the capital base of the insurance market as a whole.

Over the last 10 years freight railroads have sustained several catastrophic liability losses. The insurance markets have reserved these losses in excess of $600M against premiums paid of approximately $300 million. As a result of these events several insurance companies have ceased writing railroad insurance. Some of the companies that have exited the North American rail business include:

- CNA
- American Re
- California Union
- General Star
- TIG
- Anglo American
- Zurich London

In general, the insurance market, both foreign and domestic, has contracted. Over the last decade the number of active Lloyd's syndicates has substantially reduced. At one point Lloyd's marine syndicates could be counted on for a substantial participation in the higher layers on a railroad program. In recent years their capability has been substantially curtailed due to tighter internal regulations combined with decreased willingness to participate on accounts considered to be volatile.

Lastly, the losses incurred on passenger and transit systems adversely impact freight railroad insurance capacity and pricing. Freight and transits are usually written by the same underwriters; therefore any loss incurred by one adversely affects the other.

As you know, 2005 was a cataclysmic year for natural disasters. Insurance market losses for Katrina and Rita have been estimated to be in excess of $70 billion dollars. While there were no large liability losses for large freight railroads as a result, there were a few very large property claims. These losses are currently estimated to exceed $600 million. There is indirect effect on liability from property losses in a given class of business.

The recent bombings in both London and Madrid focused underwriters attention on the terrorist threat as it relates to the rail industry. This is in light of the fact that most of the participating liability underwriters provide full terrorism cover and a large percentage of the capacity not eligible for protection under TRIEA as it comes from foreign insurance companies. As a result, any further terrorist event on a transit, passenger or freight could have a disastrous impact on the available rail capacity and the breadth of coverage available. Underwriters' concern is emphasized by the attention paid during the renewal process to information provided in the Terrorism Questionnaire that is currently required in all market submissions. This information has a marked effect on all underwriter's willingness to provide coverage. In most cases, the more in-depth the information provided to underwriters as to the perceived exposures and the lengths to which the railroad has gone to mitigate them will only serve to enhance the terms that underwriters are prepared to offer.

We are concerned that further large liability losses involving hazardous chemicals, especially inhalants, will result in an additional contraction of the liability market capacity and a spike in price. We feel that if there is another chemical loss in excess of $50 million that the current insurance attachment point of $25 million dollars will likely disappear. It is expected that the self insured retention will increase to at least $50 million. This will not be a decision that the railroads make, it will be foisted upon them by the market, as there will be no underwriters willing to participate below $50 million of self insured retention.

When underwriters are examining a submission in order to evaluate the exposures on freight railroads, their attention is naturally drawn to the number and type of hazardous material carloads. This information will have a direct bearing on the premium charged. Underwriters focus on the hauling of hazardous materials because they have been the proximate cause of many of the largest rail industry losses to date. They will also pay considerable attention to the amount of investment committed by the railroad on maintenance of way and equipment in order to ensure that the infrastructure is of the highest possible standard.

We feel that we should emphasize that terrorism and hazardous chemical data must be looked at in conjunction with each other. These are the two major areas of concern for the participants on excess liability programs for freight railroads and thus are a major concern for the railroads themselves

In conclusion, as the professionals charged with the task of securing financially secure capacity for our railroad clients to cover catastrophic accidents or events, we must report that we are concerned. We are concerned about the continued viability of the railroad liability market in the face of another catastrophic hazmat claim. We are concerned more from the standpoint of availability than merely cost. Had the Graniteville, SC loss happened at a different time of day, or another railroad derailed in a more populated area, the likelihood of the ultimate loss exceeding available insurance and thus undermining the liability market's long term commitment to railroads increases dramatically.

At Aon, we are always in search of new, additional capacity to replace underwriters who exit the rail liability market. At this point in time, there are not many options open to replace waning capacity. One more catastrophic loss could collapse the available structure of risk transfer completely.

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Follow-up Addresses

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