Independent Insurance Agents
& Brokers of America, Inc.

STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

June 21, 2007

Good morning, Subcommittee Chairman Kanjorski, and Ranking Member Pryce. My name is Sharon Emek, and I am pleased to be here today on behalf of the Independent Insurance Agents and Brokers of America (IIABA) to present our association's perspective on terrorism insurance. I am a managing director and partner at the CBS Coverage Group, a regional full service insurance agency with locations in New York City, Plainview, Saratoga and West Hampton Beach, NY.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, representing a network of more than 300,000 agents, brokers, and employees nationwide. IIABA represents small, medium, and large businesses that offer consumers a choice of policies from a variety of insurance companies. Independent agents and brokers offer a variety of insurance products – property, casualty, health, life, employee benefit plans and retirement products – and sell nearly 80 percent of all commercial lines policies in the country. Members of the Big "I", as we are known, write the coverage for America's businesses and serve as the conduit between consumers and insurance companies, and therefore we understand the capabilities and challenges of the insurance market. From this unique perspective, we urge Congress to develop a long-term solution for terrorism insurance that enables the private sector to serve consumers and that limits federal intervention and protects taxpayers.

Please let me begin by complimenting Members of this Committee and Congress for recognizing the importance of a federal role in terrorism insurance and enacting the Terrorism Risk

Insurance Extension Act (TRIEA) of 2005. This extension Act and the original law, the Terrorism Risk Insurance Act (TRIA) of 2002, have worked to ensure that terrorism insurance is available and more affordable, protecting our nation's economic security.

We applaud Representative Capuano and Chairman Frank for introducing H.R. 2761, the Terrorism Risk Insurance Revision and Extension Act of 2007 (TRIREA), which, if enacted, will continue to keep terrorism coverage both available and affordable. We also applaud Subcommittee Chairman Kanjorski and Ranking Member Pryce for holding today's hearing to examine this legislative solution. Clearly, the leadership of this Committee understands that the insurance market's ability to protect the American economy from the financial consequences of terrorism risk is a critical component of our national security. Your efforts are crucial to finding long-term solutions for the economic and physical risks associated with terrorism, and we thank you for your continued leadership.

Background

It is well known that the insurance community performed admirably in the immediate aftermath of September 11th, 2001, honoring its commitment and providing resources needed to quickly and fully pay claims and thus playing a pivotal role in the recovery-and-rebuilding process. However, even though the insurance marketplace responded effectively to the 9/11 losses, it was quickly apparent, and remains so today, that insurers cannot handle the risk of further large-scale terrorist events without a federal backstop.

Not unexpectedly, insurers reacted in late 2001 and 2002 to the new perception of exposure and lack of scientific terrorism modeling with exclusion clauses and outright cancellations of coverage. This left agents and brokers in the always difficult position of being unable to meet consumers' needs for coverage. But beyond our own professional dilemma, it quickly became clear that the absence of coverage presented an immediate threat to our country's economy that had to be addressed – construction and other important economic activity were being impacted by the lack of coverage.

Fortunately, through the leadership of Congress, particularly those on this Committee, and the Administration, the government did respond to address problems in the marketplace with TRIA. Those of us in the market, however, do not need to be reminded of how acute the problem was before Congress and the President enacted the Terrorism Risk Insurance Act in late 2002. Economic activity, especially significant new construction projects, was beginning to be impacted by the inability of owners to satisfy demands of current or prospective lenders to demonstrate adequate insurance coverage. Fortunately, TRIA was put in place before the worst effects of this availability and affordability crisis further injured our national economy.

However, as TRIA neared expiration at the end of 2005, many insurance policies covering businesses of all sizes and types extended past the program's December 31, 2005 sunset date. With the risk of catastrophic attacks on U.S. soil still very real, and the capability of both insurers and reinsurers to offer comprehensive terrorism coverage for an uninsurable risk still very limited, Congress wisely passed TRIEA, which provided a two-year extension of the federal backstop under TRIA with some modifications to encourage the private sector to take on additional risk.

The current public-private partnership created by TRIA, and extended in TRIEA, has worked well and generally as intended, allowing businesses across America to continue operating and growing, and preserving jobs in the process. TRIA and TRIEA have saved our economy millions of dollars by making terrorism insurance broadly available to all businesses that want and need this coverage at virtually no cost to the federal government. Prices have come down, capacity has grown, and demand is up in many geographic areas.

Unfortunately, the program is scheduled to expire at the end of this year, and there is no reason to believe that the threat of terrorism is on the decline, or that the private insurance markets alone can adequately meet our nation's need for coverage. As such, IIABA supports efforts to develop a long-term solution to this problem, and we again thank the Committee for holding this hearing to review H.R. 2761.

Post-TRIA Availability of Terrorism Risk Insurance

The original enactment of TRIA in 2002 and its extension in late 2005 have been successful in stabilizing the insurance marketplace and have helped eliminate the market disruptions and uncertainties that were witnessed in the immediate wake of September 11th. A failure to reauthorize the federal program could have meant economic hardship for countless small and large communities across this country and would have had an especially devastating impact on financial and commercial centers, such as New York. As a result of the enactment of TRIA and TRIEA, our members are currently able to offer consumers options with respect to terrorism coverage.

However, months before the extension of TRIA in December 2005, these interested policyholders were concerned that exclusions and sunset clauses would eliminate their coverage as insurers prepared for the termination of the TRIA backstop. Although TRIA was extended, these policyholders – including small and mid-sized businesses – continue to worry about the impact of terrorist events in this country and their access to insurance coverage to help them get back on their feet should another event occur. This concern is evident in the increased take-up rates for terrorism insurance as consumer demand for terrorism insurance continues to grow.

Policyholder concerns are fueled not only by memories of the exclusions that they faced immediately after September 11th and in the months before TRIA's original expiration, but also by their experiences in the post-2005 hurricane market. Substantial insured losses during that hurricane season have diminished the insurance industry's capacity for catastrophic losses in general. Under pressure from rating agencies to limit exposure, insurers are reevaluating their exposure to catastrophic losses in general and terrorism losses in particular. As underwriters continue to focus on the aggregation of losses, our members and the policyholders they serve remain concerned about how many insurance companies, particularly small and monoline insurers, will continue to write terrorism risk insurance if the federal backstop expires.

Long-term Availability and Affordability of Terrorism Risk Insurance Coverage

In addition to the potential magnitude of losses from a future terrorist attack, a number of other factors will determine the long-term availability and affordability of terrorism risk insurance coverage, including: (1) the ability to accurately predict the severity and, most importantly, the frequency of terrorism given the increased threat; (2) the effectiveness of mitigation efforts; (3) the insurance market's capacity for substantial catastrophic losses combined with policyholder take-up rates for terrorism coverage; and (4) whether or not insurers are required to "make available" coverage for terrorism risk. Although most of these factors are considered in the context of many types of perils, their impact on the availability and affordability of terrorism is unique due to the nature of terrorism risk.

While modeling has shown us that the size and severity of a terrorist attack could easily threaten the capacity of the insurance market, the risk cannot be assessed in traditional ways. Insurers lack confidence in modeling terrorism risk due to the lack of past statistical records for such risk.[1] Unlike other types of catastrophic risks, insurers and actuaries know very little about where or when terrorism might occur; how it might occur; how often it might occur; or the nature, effects, and costs of such an attack. Much of the information that does exist is available only to governmental agencies that fiercely guard it for security and law enforcement reasons. As a result, underwriters shied away from terrorism risk before the creation of the TRIA backstop. Indeed, since the enactment of TRIA, insurers have proven unable to introduce wide-ranging, new products for insuring terrorism risk. There is currently no indication that the ability to accurately predict and underwrite terrorism risk will improve significantly in the future and certainly not before the Act's expiration later this year.

The unpredictable nature of terrorism also hinders the ability of the consumers who agents and brokers serve to effectively mitigate against acts of terrorism. Although policyholders may invest in increased security measures to thwart the efforts of terrorists, the effectiveness of these measures is limited due to the proven adaptability of terrorists. Moreover, the incentives offered by insurers frequently fail to match the expense of such measures.

While our members remain opposed to federal intervention in the insurance market in general, they nevertheless acknowledge that the terrorism risk insurance coverage currently available to the policyholders whom they serve would not exist without TRIA. This is a clear case of marketplace failure, and in those rare instances, limited federal involvement in a reinsurance capacity is warranted. Once the backstop expires, the challenges discussed above will likely paralyze the private insurance market’s ability to make terrorism risk insurance coverage available and affordable for policyholders. Federal legislation is necessary to ensure that policyholders continue to have access to such coverage and that the insurance market’s capacity to cover terrorism losses continues to grow.

Continued Need for a Federal Backstop

IIABA believes that a long-term private-public partnership remains essential to the challenge of making terrorism risk insurance available after the expiration of the Act at the end of this year. Although some potential solutions might allow for the reduction or even elimination of federal involvement in the years to come, it may be difficult to eliminate such a role in the immediate future without disrupting the market. Indeed, it will take decades for the industry to close the gap between the estimated $6 to 8 billion in current reinsurance capacity and potentially hundreds of billions of dollars in losses from a terrorist attack. [2] As such, public participation is necessary to encourage

[1] *See* Letter from Dennis Fasking, Chairman, Extreme Events Committee, American Academy of Actuaries, to Rep. Richard Baker, Chairman, Subcommittee on Capital Markets, U.S. House of Representatives (August 2, 2005), *available at* http://www.actuary.org/pdf/casualty/tria_080205.pdf.

[2] *See* Marsh, *Marketwatch: Terrorism Insurance 2005* 33 (2005), *available at* http://www.marsh.dk/files/Marketwatch_Terrorism_Insurance_2005.pdf.

private markets to get in and stay in the business of insuring terrorism risk. [3] We remain optimistic that the industry and policymakers can develop solutions that will reduce the role of the federal government (and taxpayers) over time and enable the private market to build up greater capacity and ultimately shoulder more of the burden.

Despite our optimism that the federal government's role in terrorism insurance can be reduced over time, the terrorism insurance market is not ready to stand on its own by the end of this year and is not likely to be ready for a number of years to come. Accordingly, now is the time to enact a long-term extension of the federal terrorism insurance backstop with mechanisms for building more private market capacity.

The creation of an effective and long-term mechanism is essential for managing the risk posed by terrorist events. Without some form of an extension, terrorism coverage will be extremely difficult – if not impossible – for most to obtain after December 31, 2007, and the impact will likely be felt before then. Such an outcome would be especially troubling for small and medium-sized businesses, which are already challenged by the current environment and are not in a position to self-insure. The vast majority of businesses in this country are of this size, and the lack of some form of a terrorism insurance program could have devastating effects on the national economy.

H.R. 2761's 10 year extension of the federal backstop is a reasonable length given current market capacity and meets our definition of a long-term extension. In addition, H.R. 2761 provides a number of provisions that would give insurers additional legal certainty regarding their liability under the program cap. These provisions are important to keeping coverage affordable and building more market capacity. Accordingly, IIABA strongly supports these provisions of TRIREA.

Insurance Coverage for NBCR Events

We believe that any long-term solution to protect the nation's economy in the face of substantial terrorism losses must also address potential losses from nuclear, biological, chemical or radiological (NBCR) events. Other than coverage included in statutorily mandated lines (e.g., workers compensation), little coverage is available for NBCR events. Although NBCR losses are perhaps the most catastrophic types of terrorist attacks, coverage for these types of losses is currently excluded from most existing terrorism risk insurance coverage.

The difficulties of developing adequate capacity to cover terrorism losses and diversifying risk are aggravated in the context of NBCR events. Currently, there is essentially no reinsurance capacity for NBCR losses. NBCR terrorism risk is even more difficult to predict and underwrite than non-NBCR terrorism risk. Moreover, as discussed during the NAIC Terrorism Insurance Implementation Working Group's public hearing on terrorism insurance availability last year, it could take many years to quantify the damages from a NBCR attack.

Based on our experience in the market, we know that policyholders desire a long-term solution to the availability of terrorism risk insurance, including coverage for NBCR events. Policyholders want certainty for their business planning and operations, and they clearly do not want to be subject to

[3] Countries such as the U.K., France and Spain, which have a longer history of protecting against terrorist threats, have long accepted that government must play a role in insuring against terrorism losses.

on-again, off-again terrorism insurance mechanisms, and exclusions for NBCR losses. Terrorism is perhaps the greatest threat to our nation's economic future, and we believe that the reality of potentially large losses from NBCR events must be addressed to protect our economy, as well as policyholders and taxpayers.

Given the potential magnitude of NBCR losses, a catastrophic attack in a line not currently covered under the TRIA program (e.g., NBCR) would almost certainly lead to a substantial government bailout. In light of the potentially enormous burden that taxpayers could face as a result of NBCR risk, it is imperative that policymakers work to help develop the private insurance market's capacity for losses. At the same time, as demonstrated with non-NBCR coverage under TRIA, we do not expect the private insurance market to view NBCR risks as insurable or move toward developing capacity to cover such risks without encouragement from the federal government. However, even with this encouragement, the magnitude of potential exposure from a NBCR event is so great that many insurers, especially those that are small and medium-sized, may have trouble underwriting this risk.

Despite the obstacles, public participation is a vital requirement for any long-term solution for increasing private market capacity to cover NBCR events. H.R. 2761 would further enhance TRIA's public-private partnership by expanding its "make available" requirement to include NBCR coverage. The bill also recognizes the difficulties that insurers will face in providing this coverage by including a lower deductible for NBCR events, a step-down mechanism to decrease insurer co-payment for larger NBCR events, and rate and form interim implementation standards to ease the transition in the first year of the extension. We believe these provisions reasonably balance both customers' need for such insurance and insurers' difficulty in underwriting such exposures.

Reasonable Trigger Level

We would like to stress that the interest in, and the need for, a terrorism insurance backstop is not confined solely to large urban areas or to large businesses. IIABA represents agents and brokers selling coverage to consumers across the country. Our collective experience establishes that terrorism insurance coverage is not just a 'big city' or a 'big business' problem. It is a business customer problem throughout the country; this is truly a national issue. As take-up rates have gone up across the country, we have seen terrorism coverage purchased by a wide and diverse variety of interests, from small towns in Mississippi to small and large businesses in New York City. As the intermediaries between those customers and the insurers, our members support reasonable trigger levels that meet the needs of the communities, large and small, which rely on terrorism coverage, as well as those of the insurers, both large and small, that provide coverage. TRIREA's $50 million trigger is a reasonable level that would keep terrorism coverage both available and affordable and protect the communities that our members serve. The Big "I" strongly supports this provision.

Elimination of Foreign vs. Domestic Terrorism Distinction

Although domestic terrorism is excluded from the current federal terrorism risk insurance program, we support the elimination of the distinction between domestic and international terrorism in any extension of the program. Domestic terrorism, which presents many of the same characteristics of international terrorism, is a very serious threat and coverage for this risk is largely unobtainable in the marketplace today. IIABA believes that such distinctions are likely to prove irresolvable in the aftermath of an attack. Distinguishing between domestic and international terrorism can be difficult (if not impossible) as the anthrax incidents of 2001 and the London Underground bombings of 2005 demonstrated. In short, IIABA continues to believe that the terrorism peril should be treated on a seamless basis without such distinctions. Accordingly, the Big "I" supports TRIREA's elimination of this distinction.

Long-Term Solutions

Although potential terrorism losses in the United States have been estimated at over $100 billion, current reinsurance capacity is only estimated at $6 to 8 billion.[4] As former Federal Reserve Chairman Alan Greenspan and other notable experts have asserted, the private insurance market is simply not in a position to handle the unpredictable nature and possible immense size and scope of terrorist attacks.[5] Despite the warnings of these experts, a specific plan for developing a private reinsurance mechanism to spread catastrophic risk from terrorism has yet to emerge.[6]

Recognizing the lack of specific plans for building capacity, H.R. 2761 wisely includes a number of provisions that facilitate long-term solutions over the course of the proposed 10-year extension. The bill proposes reports from Treasury, at regular intervals, regarding market and program conditions. This requirement will allow both the industry and policymakers to assess the development of market capacity on a regular basis and encourage the development of long-term plans well before the expiration of the 10-year extension. Additionally, the bill proposes a 19-member commission to propose long-term terrorism risk solutions and issue reports on an interim and final basis, both well before the extension expires. The Big "I" strongly supports this approach to developing long-term solutions and is pleased that the views of independent insurance agents and brokers will be represented on the commission.

Conclusion

IIABA applauds Congress for not ending TRIA abruptly in 2005 and for having the foresight to try to "phase-out" the program only as markets are able to develop. With the program's expiration only six short months away, the need for action is urgent. If a solution is not in place well in advance of the end of this year, insurance markets may once again face significant disruption and uncertainty, and we anticipate that insurers would exclude terrorism risks from policies where authorized. Our members, along with many in the insurer and policyholder community, recognize that we must find a long-term and market-based solution to our nation's terrorism insurance problem and are committed to this process.

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[4] *See* Franklin W. Nutter, President, Reinsurance Association of America, Testimony at the Public Hearing of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners 5-6 (Mar. 29, 2006), *available at* http://www.naic.org/documents/topics_tria_testimony0603_RAA.pdf. Some industry representatives, however, fear that capacity is much smaller. *See* Warren W. Heck, Chairman and CEO, Greater New York Mutual Insurance Company, Testimony at the Public Hearing of the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners 4 (Mar. 29, 2006), *available at* http://www.naic.org/documents/topics_tria_testimony0603_NY_Mutual.pdf.

[5] *Greater N.Y. Mutual CEO Makes Case for Terror Coverage*, Insurance Journal, July 27, 2005.

[6] In fact, the Department of Treasury's (Treasury) June 30, 2005 report to Congress concerning the terrorism risk insurance program did not analyze this problem. *See* U.S. Dep't. of Treasury Office of Economic Policy, *Report to Congress: Assessment: The Terrorism Risk Insurance Act of 2002* 5 (June 30, 2005).

The Big “I” strongly supports H.R. 2761, the Terrorism Risk Insurance Revision and Extension Act of 2007. This type of thoughtful approach, which recognizes market capabilities and restraints, is essential to ensuring the affordability and availability of terrorism insurance as well as market capacity in both the short-term and long-term. We thank Representative Capuano and Chairman Frank for introducing this important legislation and thank this Subcommittee for holding this hearing today. We look forward to working with this Committee and House leadership to pass this bill.