STATEMENT OF WARREN HECK
CHAIRMAN AND CEO

GREATER NEW YORK MUTUAL INSURANCE COMPANY,
INSURANCE COMPANY OF GREATER NEW YORK
STRATHMORE INSURANCE COMPANY
AND GNY CUSTOM

ON BEHALF OF

THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

AND

PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

AT THE HEARING ON

EXAMINING A LEGISLATIVE SOLUTION TO EXTEND AND REVISE THE TERRORISM RISK INSURANCE ACT

BEFORE THE

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT-SPONSORED ENTERPRISES

WASHINGTON, D.C.

JUNE 21, 2007

Chairman Kanjorski, Ranking Member Pryce and Members of the Committee, my name is Warren Heck. I am Chairman and Chief Executive Officer of the Greater New York Mutual Insurance Company (GNY) and its wholly owned stock subsidiaries, Insurance Company of Greater New York, Strathmore Insurance Company, and GNY Custom.

I am pleased to have the opportunity to comment on legislation to extend the Terrorism Risk Insurance Program. I am testifying on behalf of the National Association of Mutual Insurance Companies (NAMIC) and the Property Casualty Insurers Association of America (PCI), who share many member companies in common. My views are informed by my first-hand experience as a major writer of terrorism risk insurance in New York City, both before and after the horrific events of 9/11, and as Chairman of NAMIC's TRIA Task Force.

I am convinced that the ability of New York City to regain its economic strength and its very soul after the terrible devastation wreaked on it and its residents on 9/11 is due, in substantial part, to the wisdom of this Committee and the Congress in enacting the Terrorism Risk Insurance Act (TRIA) in 2002. The Act not only helped rescue the City; it played a major role in preventing a national economic catastrophe and getting the country back on its feet economically. I am convinced that the recovery would not have occurred as swiftly as it has, nor continued as strongly as it has, absent adoption of TRIA and its extension in 2005, the Terrorism Risk Insurance Extension Act (TRIEA).

For all the good it has accomplished, the Terrorism Risk Insurance Program has been unable to do the impossible—to create a self-sustaining private market for what are fundamentally uninsurable events. When insurers have no historical track record of the frequency of particular events and a single such event could be large enough to wipe out much of the capital of the entire industry, then the only way insurers can responsibly write such a product is if the federal government limits insurers' exposure to acceptable levels.

On the other hand, those who do not have to take such risks—reinsurers and the private capital markets—provide a true test of private market capacity. Their answer has been loud and clear: they have little interest in assuming terrorism risks and absolutely no appetite for assuming risks from weapons of mass destruction—the nuclear, biological, chemical and radiological (NBCR) perils. The lack of appetite is not because the federal program is crowding out private sector innovation. There is plenty of demand for reinsurance to cover TRIEA deductibles and to cover NBCR risk. It is because the private sector understands the uninsurable nature of these risks.

That is why NAMIC, PCI and I firmly believe that if the Congress does not adopt a long-term private/public terrorism risk insurance program, many of our citizens who need terrorism coverage to operate their businesses all across the nation will be either unable to get insurance or unable to afford the little coverage that is available. The result, when the next terrorist attack occurs, will be more, not less, federal exposure because as sure as night follows the day, the federal government will pay for those losses. Absent a strong, balanced terrorism risk insurance program, there will be very limited private sector coverage, resulting in an even greater burden on limited federal resources.

Greater New York Mutual Insurance Company's business and post 9/11 experience

Let me describe briefly our experience as a medium-sized insurer of commercial properties in New York, where we have been on the front line of this problem ever since 9/11. I think our experience helps demonstrate the need for a long-term program.

Our company is a multi-line regional commercial lines company operating in New York, New Jersey, Connecticut, Massachusetts, Pennsylvania, Maryland, New Hampshire, Delaware, Virginia, Washington, D.C., and Illinois The majority of our business is in New York, New Jersey and Connecticut, where we have done business for many years. Our companies have had an A+ rating from A.M. Best for many years, and an A rating from Standard & Poors.

In New York State in 2006, our companies wrote direct written premium of $190,920,362 of which $171,055,970 was Commercial Multi Peril, making us the fourth largest writer of Commercial Multi Peril business in New York State. In New Jersey in 2006, we wrote direct written premium of $74,337,700 of which $60,081,494 was Commercial Multi Peril, making us the fifth largest writer of that business in the State of New Jersey. For many years, we have been the largest writer of co-op apartment houses in the boroughs of New York, particularly Manhattan, and the leading writer of apartment buildings in the state.

Although I have served as President and Chief Operating Officer of the company for 18 years and Chairman and CEO for the past six years, I have also continued to serve as Chief Underwriting Officer, in which role I manage the underwriting activities of our companies. This has enabled me to have first-hand knowledge and understanding of the needs of our policyholders and producers, particularly with respect to the terrorism exposure.

As a result of the terrorist attack on 9/11, and prior to the passage of TRIA in late 2002, most primary insurance carriers operating in New York City began to non-renew their commercial property and workers' compensation business, or reduce limits of coverage to levels below what was needed by the business community. Most primary companies refused to insure property on buildings with values in excess of $20 million, and would not insure any risk that had more than a limited number of employees in a single building. The extreme hard market for property and workers' compensation coverage in New York State, particularly in New York City, was worse than other places because New York State prohibited carriers from excluding coverage for terrorism, and reinsurance companies universally excluded terrorist acts in property and casualty treaties. The 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. The lack of insurance capacity had a negative impact on the New York economy resulting in the postponement of many construction projects, lack of or inadequate property coverage for many commercial office buildings, and significant increases in pricing of commercial multi-peril business.

With the passage of TRIA, the fear that a worst-case terrorist event could render our company insolvent was somewhat reduced, making it possible for our company to continue to do business in New York City and other urban areas. TRIA placed a ceiling on individual company terrorism losses, which permitted our company to quantify its terrorism exposure and find a way to address the situation.

We devised a new underwriting strategy and guidelines that permitted underwriters to insure skyscraper office buildings and apartment houses up to $50 million or more depending upon risk accumulations in a given area of the city and proximity to so-called target buildings. We also do not insure commercial tenants in a property where the company insures the building. With respect to workers' compensation coverage, as long as employee counts were not too concentrated, our company considered offering coverage. We also implemented a computer system to geo-track risk accumulations to the street level as well as the number of employees in a given building, and risk concentrations by zip code. Since the passage of TRIA, we have purchased very expensive stand-alone terrorism reinsurance to cover as much of our TRIA deductible and co-insurance (which still excludes NBCR protection) as we could reasonably afford. Without the passage of TRIA and TRIEA, our company could not have kept its market open in the same way in New York City and retained the insurance capacity needed to write new business and grow its direct written premium.

The need for a long-term private/public terrorism risk insurance partnership

More than five and a half years out from 9/11, with no other terrorist attacks on U.S. soil, terrorism reinsurance availability remains extremely limited, and without TRIA and TRIEA, the primary insurance market would have dried up in large urban centers. In states that mandate that insurers offer terrorism risk coverage, insurers would have had to make the difficult decision to either offer terrorism coverage or leave those markets. These problems flow from the simple, inescapable fact that terrorism insurance is a classic uninsurable risk.

In order for the private market to function efficiently, it needs to be able to make actuarial judgments based upon an historical record of frequency and severity of an event. Years of data make it relatively easy to estimate auto insurance costs. Homeowners' insurance costs are somewhat less predictable because of the uncertainty and timing of calamities such as windstorms, earthquakes, and wildfires, but we can model natural catastrophic events because we have long historical records and sophisticated geological studies and hurricane forecasting methods to help us predict the future. We can also differentiate among risks based on such factors as location and the mitigation efforts of homeowners.

When it comes to terrorism risk insurance, we have no basis for estimating frequency. President Bush and other leaders of our government tell us that there *will* be—not *may* be—another terrorist attack on our soil. They cannot tell us when or where attacks might occur or their likely nature. Harder still from an insurance perspective, we cannot predict its severity. Will it look like 9/11 or last year's foiled attempt to blow up multiple airplanes over the ocean? What we do know is that our enemies want to inflict massive casualties and that terrorists have the expertise to invent a wide range of attacks, including those involving the use of chemical, biological, radiological and even nuclear weapons. While exploding a small nuclear weapon in a major city could do incalculable harm to hundreds of thousands of people, as well as to businesses and the economy, exploding multiple bombs in one or more places with no nuclear, chemical, biological or radiological (NBCR) components could also wreak massive damage. The damages could reach into the hundreds of billions of dollars, levels that only the federal government could have the funds to pay.

Since 9/11, we have been working on improvements to our modeling technology in an attempt to quantify our terrorism exposures and reduce our concentrations in New York City. As previously mentioned, we have also geographically diversified our writings by expanding into suburban regions in other states. However, there is no guarantee that, for example, limiting one's exposure in New York City by underwriting risks in the U.S. heartland will succeed, as low-tech attacks such as those in Madrid and London could cause enormous economic harm if replicated in shopping malls in the South and Midwest. Even greater harm could be caused in these areas if terrorists attacked chemical plants or the food supply.

Smaller and medium-size insurers, which comprise a large portion of NAMIC and PCI member companies, face additional problems because they frequently operate in only a few counties in a state, in only a few states, or specialize in specific industries or markets. They lack the financial resources to withstand a terrorist attack in their home areas. They cannot easily shift their business focus to other lines of insurance or to other parts of the country. In some instances, their only recourse might be to abandon a niche market they were created to serve. In addition, many of them today are in financial jeopardy because, when they write commercial insurance with the federal obligation to include terrorism coverage, they cannot get reinsurance to cover the higher deductibles in TRIEA. They simply have too much of their capital at risk from a single event.

Workers' compensation can present highly concentrated risks, particularly in those states with a strong state fund presence. State funds (competitive or monopolistic) handle significant amounts of workers' compensation coverage for businesses in 27 states. Many of these companies serve as residual, or guaranteed, markets and must accept all applicants. While larger, multi-line commercial insurers may be able to limit the scope or aggregation of risks that they are willing to cover in a specific area, these state funds or single-state writers find themselves with tremendous risk concentration. The California State Fund best exemplifies this concentration of risk. It is the single largest writer of workers' compensation business in the United States despite the fact that it only operates in one state.

Also relevant to this discussion is the fact that insurers do not operate in free markets. State laws prohibit workers' compensation policies from excluding terrorism related losses, thus leaving many regional workers' compensation specialists in an extremely vulnerable position. Many of them have a high concentration of risk, a mandate to take all customers, and an inability to exclude terror-related events that could potentially inflict catastrophic levels of human and economic devastation in particular areas or regions. Because of rate regulation in many states, insurers also are not free to charge what they might believe is an appropriate price for the risk involved. In other words, even if insurers had the ability to assess the severity and frequency of terrorism risk, in many instances rate regulation would prevent them from charging premiums commensurate with the risk were assuming.

Even if an insurer were able to diversify its risk exposure through modeling and procure sufficient private reinsurance to cover the TRIEA deductibles, the notion that the private market can protect itself through good modeling is flawed. Absent a terrorism insurance program, a $778 billion terrorist event—the high estimate from the American Academy of Actuaries for a single terrorist event in New York City—would wipe out more than the total property/casualty insurance industry surplus for all lines (both commercial and personal), which stood at about $490 billion at the end of 2006. This would mean that the industry would be unable to meet its obligations to its other insureds for the many different coverages they provide beyond terrorism insurance—such as auto and homeowners—that are protected by that surplus.

While the private market cannot cover events of such magnitude without either bankrupting insurers and reinsurers or wiping out so much insurer surplus that they could not meet their obligations on other lines of insurers, the private market has been able to cover lesser, clearly defined losses. TRIA and TRIEA were both reasonable attempts to limit the maximum exposure of insurers so that the private market can play a role in terrorism risk insurance. These statutes made a private/public bargain: Insurers would offer terrorism coverage in return for a guarantee from the federal government that it would pick up losses beyond the insurers' capacity. The purpose is not to protect insurers; it is to make sure that the economy can recover in as orderly a fashion as possible from the next terrorist event.

What would have happened to the property and casualty insurance market had there been no federal program to insure terrorism? My experience tells me that it would have been similar to what happened after 9/11. Insurers would have excluded terrorism risk unless required by states to offer it or withdrawn entirely from perceived terrorism-exposed areas. In urban centers such as New York City, there would likely have been high demand and a low supply of terrorism insurance, forcing prices to increase (if permitted by state law) for the limited amount of terrorism insurance that would have been available, thereby inhibiting development and economic growth. In short, we would have seen classic economic shortages for an essential product, with prices skyrocketing and many consumers going unserved.

Some have argued (unpersuasively) that the TRIA program has served to inhibit the development of a comprehensive private market solution to the problem of terrorism risk. They recommend drastically curtailing the program, or allowing it to expire, in order to unleash the power of the free market to provide increased reinsurance capacity and innovative financial mechanisms for spreading terrorism risk. But this advice ignores the fact that terrorism insurance does not operate in a free market in the United States. For example, state regulators in New York, which many view as the state most likely to be a terror target, have prohibited companies from excluding coverage for terrorism. In addition, New York aggressively regulates the rates insurers are allowed to charge for coverage. There is no similar regulation requiring the reinsurance market to provide protection to the direct market, nor are reinsurers subject to rate regulation. Far from increasing private reinsurance capacity and spawning market innovation, a government retreat from the terrorism insurance market would present small and medium-size companies with a difficult choice: leave the marketplace for terror target-area risks or face the prospect of a financial disaster that could result if they write coverage. To the extent that companies choose to leave the market, competition would be significantly reduced.

Would the capital markets provide the necessary additional risk-bearing capacity if TRIEA expires and private reinsurance capacity fails to materialize? There simply is no reason to believe the capital markets would replace the missing insurance capacity, just as there is no evidence that TRIEA has crowded out private market capacity. Terrorism risk has presented a real opportunity for reinsurers and they have not chosen to take on very much of this risk. The Reinsurance Association of America has indicated that worldwide capacity for terrorism risk in the United States is approximately $6 to $8 billion without NBCR, far below the amount needed. The capital markets have taken their cue from the reinsurance market. There have been very few terrorism catastrophe bonds issued and a visit last year by some insurers to Wall Street revealed that the potential market for such instruments might reach $1 - $2 billion annually, at best, over the next five years. Moreover, there is no capital market appetite whatsoever for bonds for NBCR events.

NAMIC and PCI support most of the provisions of the new bill but strongly oppose adding a mandatory NBCR component

NAMIC and PCI have strongly supported enacting a new long-term extension of the TRIA program and, for that reason, commend the Subcommittee for moving this issue forward and for developing the draft legislation we are discussing today. NAMIC and PCI believe that the legislation would accomplish many of the objectives we support, but we oppose adding mandatory NBCR coverage. Let me discuss the key provisions.

<u>Creating a 10 year program will avoid disruption in the marketplace</u>

NAMIC and PCI support the bill's long-term program. The threat of terrorist attacks is an ongoing one that we will face for many years to come. It makes sense to have a program whose length reflects that reality. Moreover, absent an extended reauthorization, the markets would see the kind of disruption that occurred at the time TRIA was scheduled to expire in 2005, with companies scurrying to address the uncertainty, often asking state officials to permit them to provide exclusions in future contracts and sometimes making plans to withdraw from certain markets or restrict coverage. The situation was chaotic for all concerned, both companies and policyholders, and a 10 year program would avoid such disruptions again.

<u>Maximizing private sector participation: Setting the event trigger at a level that will enable small and medium-sized insurers to offer coverage and maintaining deductibles and copayments at present levels or reducing them further</u>

NAMIC and PCI have deep concerns about the effect of the current TRIEA program's escalating event trigger level on the ability of small and medium-size insurers to participate in providing terrorism risk insurance. We have provided research to the Subcommittee staff, to the Treasury Department, and others demonstrating the very significant risk higher triggers pose for medium and smaller insurers. We believe that a $50 million trigger, as proposed in the bill, would enable most small and medium-size insurers to continue to write terrorism risk insurance. A lower trigger would enable even more insurers to participate and would preserve competition for the benefit of consumers.

For small and medium-size companies, the event trigger is the key to their ability to continue to provide coverage. Too high a trigger would drive them from the market because of the extreme risk to their capital base. As a medium-size insurer in New York that covers some very large buildings, I can tell you that a trigger in excess of $50 million would severely limit GNY's ability to offer as much coverage as it now offers. I simply could not justify to policyholders or state solvency regulators my company's decision to take such a large risk relative to the size of the company's surplus. Furthermore, my company would risk a downgrade in our financial strength rating and action by solvency regulators who closely examine our exposure to terrorism risk, including estimated potential insured losses resulting from simulated terrorism events.

Any increases in company deductibles or insurer co-payments could also drive medium and smaller-size companies out of the market. We applaud the authors of the legislation for their willingness to maintain them at existing levels (20 percent), but strongly urge that you consider lowering them further.

Why should Congress care about maintaining a market for smaller carriers? The answer is simple. Consumers benefit from competition. Large companies do not operate in all areas and markets. Small and medium-size insurance carriers, those with annual direct written premium of less than $1 billion, inject competition in markets where little or none would otherwise exist, provide coverage that would otherwise be unavailable in certain regions, and serve specific niche markets that many larger carriers have avoided since 9/11.

In 2004, of the 2,100 property and casualty insurance companies operating in the United States, only 40 had writings in excess of $1 billion and only 58 had policyholder surplus in excess of $1 billion. Of the 1,027 companies that write TRIEA-covered lines of business, 94 percent have less than $1 billion in surplus. Small and medium-size companies represent 85 percent of all companies writing workers' compensation, with 27 percent of the premiums.

A high event trigger or higher deductibles and co-payments would force small and medium-size companies to exit the market, which would erode capacity for consumers rather than build it. A smaller private insurance market would further expose the federal government to greater costs should another terrorist attack occur.

A $50 million trigger will probably be low enough to assure small and medium-sized companies continued involvement in the sale of terrorism risk insurance, although it will be a stretch for some smaller companies. Indeed, their prospects for participating in the market would be enhanced if the trigger was lowered even further to $10 or $20 million. A realistic event trigger will prevent the problems that would occur if a higher trigger forced insurers to abandon markets where large insurers would not take up the slack, resulting in serious harm to policyholders in those markets. While the cost to the federal government of a long-term trigger of $50 million or less would be negligible, the cost to these companies of a higher trigger would be too much for them to assume and the cost to the economy could be overwhelming.

Ending the distinction between foreign and domestic terrorism will assure protection against all terrorist events and avoid any delays in payments while bureaucrats debate the source of the attack

NAMIC and PCI also endorse the provision ending the distinction in existing law between foreign and domestic terrorist events, with only the former covered. Events subsequent to 9/11 have demonstrated that there are many home-grown terrorist cells around the world, including some in the United States. The damage to our nation would be just as great whether the source of a particular terrorist attack is foreign or domestic. Moreover, an attack could involve both foreign and domestic elements or it might be very difficult to identify conclusively where the perpetrators are from. That is why both NAMIC and PCI recommend that legislation include both kinds of terrorist events so that the country does not run the risk of finding itself in some bureaucratic limbo while we sort out the source of the destruction. We applaud the bill's provision to do so.

Finally, I'd like to turn to the very important issue of providing additional, mandated coverage for NBCR perils. This is a matter of very grave concern to the Subcommittee, to our industry, and to the public. We have reviewed it and considered many aspects of the issue and know that the Subcommittee has as well. We do, however, differ strongly with the approach taken in the bill draft outline we have seen.

Considering NBCR coverage, we believe the approach taken should respect existing contracts and expand the work of the bill's commission to consider the unique nature of NBCR risks, but should not mandate that insurers provide coverage for acts of terrorism that utilize weapons of mass destruction.

Attacks utilizing weapons of mass destruction (NBCR) are the ultimate in uninsurable events and they can have qualitatively different consequences than non-NBCR attacks. In contrast to the attacks on 9/11, for example, an attack in which a 10 kiloton suitcase-type nuclear device was exploded 120 feet above the ground would kill everyone in the surrounding 30 mile radius and destroy or render unlivable all properties in that area. This type of threat presents dramatically larger and more concentrated risk exposures than any other threat we know of. Providing our citizens with financial protection against attacks using weapons of mass destruction is a fundamental duty of the federal government.

With the exception of workers compensation, all states allow, and most commercial property insurance policies contain, nuclear exclusions. All states also allow nuclear/radiation exclusions and most policies contain filed and approved nuclear and pollution exclusions. That is how the private sector insurance industry and its regulators have historically handled NBCR risk. As for the capital markets, while they have limited appetite for non-NBCR terrorism risk, they have no appetite for NBCR coverage. In this regard, they take their signals from the reinsurance market. Given this market response, NAMIC and PCI believe strongly that the Congress should not overturn state law and re-write insurance contracts to include these uninsurable risks. I would note that the demand for private NBCR coverage appears to be focused narrowly on larger commercial developments in a few at-risk cities. It does not appear to be widespread throughout the economy; moreover, construction activity has recovered from its post-9/11 losses without this protection.

Even if we assume that substantial and widespread demand exists, is it possible to reconcile the public interest in economic development with a threat that presents the ultimate uninsurable event? It is one thing for the Congress to require insurers to "make available" terrorism risk insurance for non-NBCR events, where all but the most severe attacks could more likely be handled by insurers within the parameters of TRIEA. It would be quite another for the Congress to impose a new TRIEA-type regime for NBCR events. This presents an extremely complex set of questions and challenges that cannot and should not be taken up without careful study and deliberation.

Rolling NBCR into terrorism coverage will likely result in significantly increased premiums and would likely have the unintended consequence of reducing the take-up rate for terrorism insurance. Requiring any retention of NBCR risk by primary insurers (even where the federal program bears most of the risk) makes little sense if insurers cannot find private reinsurance and if we are unable to resolve a set of very serious operational concerns and issues.

In addition, because insurers would immediately be required to have capital sufficient to back this new risk (and would face potentially reduced financial strength ratings), we would also expect to see an immediate diminution of capacity available to provide this coverage. Many small mutual insurers would probably not be able to raise sufficient capital quickly enough to stay in this business. The most likely outcome would be reduced, not expanded, capacity for all lines of insurance, as insurers divert capital from other products to support this new risk they'd be required to bear. In addition, creating new, stand-alone NBCR coverage would lead to adverse selection, in that only the most vulnerable risks would opt for coverage.

In any case, it is unclear how NBCR coverage could possibly be priced, let alone with any actuarial certainty. The unknowns include when and where such an event might occur, how often, involving what types of weapons, and with how much resulting loss.

Perhaps the most logical way to meet the country's economic needs for NBCR coverage was contained in a 2005 RAND Center for Terrorist Risk Management Policy report on *Trends in Terrorism*, which found that NBCR attacks "pose a challenge that may be most appropriately covered through a direct government insurance program."

- Terrorist attacks using weapons of mass destruction are not the business of private insurers; they are the responsibility of government. They require a qualitatively different response, not simply a mandate to offer coverage through a private insurance policy, because of the magnitude and breadth of the destruction and their impact on the very fabric of life. NAMIC and PCI believe this is a very serious issue demanding national attention and the commission established in the bill is the proper place to begin this review. Among the issues or questions we would propose that the commission consider are: Is the need for NBCR protection limited to commercial properties, or does it extend to personal homeowners coverage as well?
- If there is a need, how should it be addressed and is it best handled by a direct federal program?
- Is there an appropriate and cost-effective role for the private sector? If so, what is the most effective role for private industry? What are the roles of federal, state, and local governments?:

- If an offer of this protection is mandated and insurers cannot find private reinsurance for this new exposure, would a "make available" requirement threaten the solvency of many insurers unless they significantly reduce their writings in TRIA lines? If that occurred, would the "make available" requirement have the unintended consequence of reducing private sector capacity?
- What limits on NBCR losses would be necessary to make sure that the industry can meet its obligations to its other policyholders, once this mandate is applied to them?
- If there are limits on private sector insurance losses, how can one draft them to prevent insurance commissioners, the courts and/or the Congress from overriding them?
- If there are private sector limits, how would insurers determine which claims to pay and which to decline?
- If there are private sector limits, who, if anyone, would be responsible for paying the losses above those limits?
- Would the federal government pay the losses of people who did not insure their properties?
- How long would it take for insurers to educate and train claims adjusters, underwriters, and loss control personnel?
- How long would it take to develop standards for claims, underwriting, and loss control for a risk never insured before?
- How long would it take to develop coverages and policy forms for a risk never insured before?
- Traditionally, property insurance policies do not provide coverage for damage to land or clean-up. Given the potential magnitude of NBCR event, how and by whom will these costs be financed?
- How can site access and safety concerns for claims adjusters and other insurance personnel be addressed?
- How should the exposures faced by American homeowners (whose insurance policies typically exclude this risk) be addressed? This issue has been raised recently raised by the Financial Services Roundtable and would seem to merit consideration by the commission envisioned in the bill.

NAMIC and PCI recommend that the mandate of the commission be expanded to study these and other complex legal, moral and practical issues of national import. Again, we understand and believe that this is a grave national issue that must be addressed, but we do not believe it can be resolved simply by adding a make-available requirement to this legislation. We believe it deserves significant additional study and review and should be the focus of the commission discussed above.

For a more detailed description of NAMIC's and PCI's views regarding NBCR coverage, I am attaching a copy of a joint May 23, 2007 letter from the leaders of the two organizations to Chairmen Frank and Dodd.

Mr. Chairman and Members of the Committee, thank you once again for the opportunity to present testimony on this issue of vital importance to me, NAMIC and PCI member companies and the U.S. economy. We think the proposal that is the subject of today's hearing goes a long way toward establishing an effective long-term terrorism insurance plan to maximize the ability of the country to recover from terrorists attacks. We commend you for your good work and stand ready to assist you in any way we can going forward.

May 23, 2007

Senator Chris Dodd
444 Russell Building
Washington DC 20510

Congressman Barney Frank
2252 Rayburn H.O.B.
Washington DC 20515-2104

Senator Dodd and Congressman Frank:

On behalf of our combined membership and the millions of policyholders they serve, we wish to express our appreciation to you and the members of your staff who are working diligently to craft legislation to ensure that America's business community will continue to have affordable insurance coverage for acts of terrorism when the current Terrorism Risk and Insurance Extension Act (TRIEA) expires at the end of this year.

We are concerned, however, about the possibility that the legislation that emerges from this process will include a requirement that insurers offer commercial property and liability coverage for attacks utilizing nuclear, biological, chemical, and radiological (NBCR) weapons of mass destruction. We believe it would be a serious mistake to add mandatory NBCR coverage to the federal terrorism insurance program. The reasons are several.

From an insurance standpoint, NBCR events are qualitatively and quantitatively different from events arising from the use of conventional terrorist weapons. Indeed, even before the atrocities of September 11 exposed the vulnerability of the United States to large-scale terrorist attacks on American soil, insurance companies and insurance regulators had long regarded losses caused by nuclear incidents as uninsurable. That is why the insurance laws of every state allow standard commercial property and liability policies to exclude coverage for accidents at nuclear power facilities and intentional detonations of nuclear devices. In addition, virtually all personal homeowners insurance policies exclude this coverage for the same reasons.

During the 1950s, Congress recognized that private insurers' inability to assess the risk and provide coverage for losses resulting from nuclear accidents required Federal assumption of this risk. A deliberate terrorist attack using NBCR weapons, strategically executed to inflict the greatest possible harm, would likely produce losses many times greater than those arising from an accident at a nuclear power plant. Given the private sector's inability to provide coverage for nuclear accidents, it stands to reason that intentional terrorist attacks using weapons of mass destruction would be regarded by terrorism risk analysts as categorically uninsurable. Indeed, the Government Accountability Office, the President's Working Group on Financial Markets, and the RAND Center for Terrorism Risk Management have all concluded that virtually no private market exists for NBCR insurance or reinsurance and that these risks meet every classic definition of uninsurability.

These conclusions are borne out by the fact that in the nearly six years since the attacks on September 11, 2001, virtually no private reinsurance has been offered for this coverage nor have the capital markets developed any alternative risk transfer products for NBCR events. That this state of affairs is unlikely to change is reflected in a 2005 RAND report's observation that NBCR attacks "pose a challenge that may be most appropriately covered through a direct government insurance program."

What would be the consequence of requiring insurers to offer NBCR coverage under a renewed TRIA program? At the outset, insurers would need to quickly raise large amounts of capital to cover an utterly unpredictable risk whose potential loss costs are staggeringly high and variable—somewhere between $27.3 billion and $778.1 billion, according to projections by the American Academy of Actuaries. To rapidly accumulate the necessary capital, insurers would have to obtain it either from private market sources or from policyholders. Since 9/11, private capital markets have demonstrated no willingness to securitize this type of risk. That leaves rate increases on existing policyholders as the only source of the needed capital. Moreover, since there is no way to predict when the capital will be needed, the only reasonable approach would be to raise all of the required additional capital immediately. According to RAND, such price increases will probably reduce the overall take-up rate for terrorism insurance, as many policyholders would be unable or unwilling to afford the higher rates, with the net result that fewer businesses have access to insurance coverage after an event.

In addition to unrealistic capital requirements likely to affect many insurers, we believe adding NBCR risk to the terrorism insurance program will be especially problematic for many medium and smaller insurers. These carriers are likely to be faced with assuming a risk and an operational exposure of great danger and complexity for which they have no previous insuring or claim adjustment experience. There are a number of operational issues that have not been addressed by insurers or the government, including: (1) the accuracy of catastrophe loss models for property and liability terrorism risk; (2) regulatory controls on insurer pricing for this risk; (3) possible correlations between this risk and others that an insurer may have in place; (4) issues arising from possible "mixed attacks" involving both NBCR and non-NBCR exposures; (5) proper protection of claim site workers (a very serious issue in the 9/11 attack); (6) procedures for claim site access, which may require months or even years of waiting; and many other issues. Our point in raising these operational issues is not to suggest that they should not be addressed. To the contrary, we believe that the complexity of this issue demands careful study and analysis, rather than a premature and counterproductive mandate to provide NBCR coverage now.

In conclusion, our organizations are united in strongly urging Congress to resist the temptation to demand that commercial property and liability insurance contracts provide coverage for NBCR-related terrorism risk. Because we recognize how serious this issue is, we recommend instead that Congress enact legislation to create a commission to study all of the risks associated with NBCR attacks, the many operational questions involved, the various ways that such events might be financed, and the role of the federal government versus the private sector. Upon completing its work, such a commission would be in an excellent position to make recommendations to Congress concerning how best to address this issue.

Sincerely,

June T. Holmes
Interim CEO
Property Casualty Insurers Association
of America

Charles Chamness
President & CEO
National Association of Mutual Insurance
Companies