<u>Testimony of Mr. Dennis Smith</u>
<u>President, Missouri Employers Mutual Insurance</u>
<u>Incoming President, The American Association of State Compensation Insurance Funds</u>

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

June 21, 2007

Chairman Kanjorski, Ranking Member Pryce, and Members of the Committee, it is my distinct honor to be here today on behalf of Missouri Employers Mutual Insurance Company, which was established by the State of Missouri in 1993. I am also the First Vice President of the American Association of State Compensation Insurance Funds, the association of twenty six (26) workers' compensation funds established by their State legislatures. As you know, Mr. Chairman, a state workers' compensation insurance fund has been established by the Commonwealth of Pennsylvania, and Members of this Committee who hail from the States of Ohio, New York, Arizona, Texas, California, Colorado, Oklahoma, Louisiana, and New Mexico also have similar funds operating in their States. State funds support the extension of TRIA, and the length of the extension you have proposed should bring stability to the marketplace. However, for the reasons I will set out in my testimony, further changes to the trigger level, co-pays, and deductibles, are crucial to the ability of State funds to survive financially a catastrophic terrorist event.

The 26 State funds operating in the United States write only workers' compensation. The funds are typically organized as non-stock mutual companies, although depending on the State law, some funds have quasi-governmental attributes. Five of the funds are their States' exclusive provider of workers' compensation insurance. The rest, like Missouri Employers Mutual, compete in their State marketplace both with small regional companies similar in size to us, and very large national and multinational companies. The 26 State funds insure over 1 Million employers, most of them small businesses, who in turn employ an estimated 10 Million workers. The market share of these companies ranges from 15% in my State of Missouri and a similar number in Pennsylvania, to 60% in Arizona.

For many reasons, Mr. Chairman, workers' compensation is a unique line of insurance, and State funds are a unique subset of that line. State funds, alone among those who write workers' compensation, provide an assured market for employers to secure coverage, that is, we are always in the market and either by law or State policy we insure all who apply. Workers' compensation provides statutory benefits, including lifetime medical benefits, rehabilitation services, wage replacement payments, and extensive survivors' benefits to spouses and dependent children. These "long tail" benefits can run for years or decades. Medical benefits are unlimited and can total in the millions of dollars for a single catastrophic injury. Coverage for injuries resulting from acts of terrorism cannot be excluded, including the terrible injuries that would occur from a nuclear, biological, chemical, or radiological attack, or NBCR attack. State funds also provide a number of other important functions for employers and their employees. These services include important loss prevention services for our policy holders such as safety audits and training, insuring that injured workers receive appropriate medical care including rehabilitation, and working for the continued improvement of the workers' compensation system.

These unique aspects of workers' compensation insurance, especially as they apply to State funds in a terrorism context, places our funds in a particularly vulnerable position in the event of a catastrophic terrorist attack. Because we must always be in the market and operate as a market of last resort, we cannot control our concentration of risk as others can. Our competitors can choose to decline coverage in a particular zip code, for example, or use geocoding to avoid concentrations of coverage in a potential high threat area. State funds cannot manage their risk in this way. Should a catastrophic event occur, especially where a State fund has risk concentration, the solvency of the fund would likely immediately be threatened. Not only would the benefits of those injured in the attack be in jeopardy, but the benefits of workers around the State who may later be injured in the normal course of work would also be at risk.

Mr. Chairman, a trio of TRIA provisions holds especially negative consequences for State funds in the event of terrorism losses: high program trigger; high deductibles, and high co-pays. The current trigger of $100M would consume the entire surplus of Missouri Employers Mutual and all or a substantial percentage of the surpluses of other State funds. The proposed trigger of $50M would therefore be an improvement. Nevertheless, even this reduced trigger would consume such a large percentage of our policy holder surplus that it could threaten our solvency and rating. Similar consequences would occur with current deductible and co-pay levels. Leaving the deductibles and co-pays unchanged has the effect of substantially negating any potential relief offered by a lower trigger. Therefore, I urge the Committee to seek a further trigger reduction as the legislative process moves forward.

Because of the unique nature of State fund company operation and coverage which limits our ability to manage risk, combined with substantial benefits payable over many years, it can be said that in a terrorism context, we have a finite amount of capital supporting infinite risk. Modeling by internationally recognized re-insurance brokerage Guy Carpenter & Company LLC has shown that in many terrorist scenarios, workers' compensation is easily the largest loss component. Even a two-ton conventional attack at one of our concentrated risk locations would produce losses far exceeding our policy holder surplus. These losses would be magnified in the case of NBCR attacks, which must be covered in any workers' compensation policy. Therefore, we are pleased that the proposed legislation provides a specific backstop for NBCR losses. Without such a backstop, the solvency of my company would be in instant jeopardy in the event of an NBCR attack. Furthermore, the State of Missouri would face substantial political, legal, and moral pressure to take over not only the payment obligations of Missouri Employers Mutual to those injured in a terrorist attack, but also those workers injured in normal workplace events unrelated to terrorist events. Other States and state fund companies would face similar circumstances and pressures in the event of a terrorist attack; an attack that all agree would be an attack against the United States, not any particular State.

Mr. Chairman, workers' compensation insurance provides important security to employers, employees, and their families. In your consideration of extending the Federal terrorism insurance program, it is crucial to recognize the impact that high program triggers, co-pays, and deductibles will have on smaller insurers and on State fund insurers. We do not have the discretion to withdraw from our market if high triggers, co-pays, and deductibles create unreasonable financial risk for the size of our policyholders' surplus. Terrorism exposure under the current terms clearly puts the safety and soundness of my company, and other State fund companies, at risk in the event of a catastrophic terrorist attack. I urge the Committee to adopt lower triggers along with lower co-pays and deductibles for both conventional terrorism and NBCR coverage. Such action will provide the meaningful backstop necessary to preserve the viability of this important coverage when it is most urgently needed.