Statement of

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on behalf of the

American Council of Life Insurers

on

Policy Options for Extending the Terrorism Risk Insurance Act

before the

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Introduction

Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee, my name is Thomas Watjen and I am President and Chief Executive Officer of Unum Group. I am responsible for the overall strategic direction of Unum and oversee the operations of each of its three business segments – Unum US, Colonial and Unum UK. Unum is the fourth largest writer of group life insurance, including accidental death (AD&D), in the United States. We insure approximately eight million lives and provide over $800 billion of group life and AD&D coverage.

I am here today on behalf of the American Council of Life Insurers (ACLI). The ACLI is the primary trade association of the life insurance industry, representing 373 member companies that account for 93% of the industry's total assets in the United States. ACLI members offer life insurance, annuities, pensions (including 401(k) plans), long-term care insurance, disability income insurance, reinsurance and other retirement and financial protection products.

Overview

I would like to thank the Subcommittee for holding this hearing on the Terrorism Risk Insurance Program (TRIA).

We are all, unfortunately, well aware of the risks that our country continues to face from various domestic and international extremist and terrorist groups. In addition to implementing effective homeland security measures that will help prevent large-scale terrorist attacks, we must also sufficiently insure our nation's most vulnerable assets, including its critical infrastructure, and its citizens in case such attacks do take place. Terrorism insurance and reinsurance is a vital component of maintaining our robust economy.

While much of the ongoing discussion on extending the TRIA program has focused on the property and casualty (P&C) insurance industry, it is also important to discuss how this issue affects the life insurance industry and its policyholders and beneficiaries, particularly with regard to group life insurance. While we certainly agree that there needs to be adequate terrorism insurance coverage for buildings, we also believe that the people who work or reside inside those buildings should be adequately covered for such events as well.

If Congress decides to extend TRIA, the ACLI and I urge you and your Committee to add group life insurance as a covered line (as the House did in the 109th Congress). The National Association of Insurance Commissioners (NAIC) has also adopted a resolution in support of the inclusion of group life insurance.

The Importance of Group Life Insurance

Group life insurance is a critical employee benefit and is usually part of an employee's benefit package that contains medical, disability and other coverages, and remains available and affordable (as it did before September 11, 2001). For millions of Americans, especially lower-income workers, it is the only life insurance that their families have and can rely on if they were to unexpectedly die. Almost $20 billion in death benefits were paid to group life beneficiaries in 2005 (which represented about 37% of all death payments).

Group life insurance represented about 45% of all life insurance in force - $8.26 trillion out of a total $18.4 trillion at the end of 2005. There were about 167 million certificate holders of group policies, with an average coverage amount of $49,500.

In addition, approximately 60% of ACLI member companies sell group life insurance. Group life insurers received about $29 billion in net group life insurance premiums in 2005 (which is a little more than 20% of the $142 billion of total net life insurance premiums received).

Potential Exposure to Group Life Death Claims

Unlike individual life policies where insured individuals are generally scattered throughout a particular area or region, group life policies usually have very high concentration risks. Most, if not all, individuals of an insured group are often gathered in one or several locations (e.g., office buildings, factories) and a single catastrophic event in a particular city could cause many or all of them to die at once, resulting in a high number of death claims.

For example, if a terrorist attack were to kill 20,000 individuals insured under one or more group plans, based on an average coverage amount of $49,500, group life insurers could collectively be liable for almost $1 billion in death claims. If 100,000, 500,000, or one million people were to perish, potential claims would increase to almost $5 billion, $25 billion and $50 billion, respectively. In many urban locations, the average payout per life, including AD&D benefits, would exceed $49,500, exacerbating the losses.

While these death totals and claims amounts may sound exaggerated, unfortunately they are not inconceivable, especially if a nuclear, biological, chemical or radiological (NBCR) attack were to strike in a densely populated area (e.g., New York City, Washington, D.C, Chicago, San Francisco). The amount of loss that a particular group insurer would incur would depend on several factors, including the type and timing of an attack, the concentration of lives in the effected area, and the amount of catastrophic reinsurance it has (if any).

Insurers' Limited Capacity to Cover Catastrophic Losses

Life insurers are required to put aside reserves and maintain surplus accounts for expected and unexpected death claims. For deaths that fall within a company's expected mortality rates, claims are paid from allocated reserves and pooled mortality charges. For deaths that exceed expected mortality rates (such as those resulting from a major terrorist attack), payments come primarily from surplus accounts.

However, only a portion of a company's surplus is generally available for unexpected claims (approximately 40-50%), and this amount may not be enough to meet its financial obligations. If surplus funds are insufficient and a company becomes insolvent, state guaranty associations would have to step in to provide a mechanism for outstanding claims to be paid to beneficiaries (up to certain statutory limits). In order to obtain the necessary funds to pay off these claims, these associations would then assess the remaining solvent insurers according to certain formulas (e.g., premium volume).

Therefore, while the life insurance industry as a whole would be able to absorb tens of billions of dollars in death claims resulting from most terrorist attacks, those small to medium-sized insurers, and possibly some larger-sized insurers, that receive an unexpectedly high number of claims (especially those whose main line of business is group life) would be forced into insolvency. Such insolvencies would also affect the payment of benefits to all of the policyholders of the insolvent companies, not just the group life policyholders.

However, in the case of a major, cataclysmic terrorist attack (e.g., NBCR event), several (or many) insurers, including medium to large-size carriers, may become insolvent, and the guaranty association system may not have the capacity to fund unpaid claims. It is this potential system collapse that concerns the group life industry and is why it urges that group life be included in any TRIA extension.

Group Life Insurers' Vulnerability to Large-Scale Attacks

In addition to concentration risk, there are several other reasons why group insurers are highly vulnerable to major terrorist attacks.

First, group policies are not currently designed or priced to account for the immediate or short-term deaths of hundreds of thousands or more people from a terrorist attack. Unlike deaths from accidents, diseases, homicides, and natural disasters, which have been tabulated and analyzed over dozens of years and incorporated into mortality tables (which help determine pricing of policies), there is insufficient historical data in this country relating to deaths from terrorism that can be factored into such tables. Terrorism is by its nature, unpredictable; it cannot be accurately or economically forecasted or priced. Similar to the P&C exposure for property losses, the extent of losses for any particular carrier would be highly dependent upon the specific location of an event, rendering loss prediction useless.

Second, neither Unum, nor the ACLI, are aware of any states (except for Kansas and North Carolina under very limited circumstances) that allow the use of terrorism exclusions (including those for NBCR events) by group (or individual) life insurers for group life coverage. Even if most states allowed such exclusions, unless the entire industry took the same approach, any group insurer that tried to manage its risk exposure by excluding terrorism coverage would be putting itself at a severe competitive disadvantage, particularly small to medium size insurers. Furthermore, we do not believe that it is good business, or sound public policy, to exclude coverage for deaths due to a catastrophic event. The importance of coverage would in fact be highlighted by the horrible nature of a terrorist attack, and families of victims would rely very heavily on these benefits for continued financial well being.

Third, catastrophic reinsurance is generally not available for group life insurance in sufficient amounts. Immediately after 9/11, group life insurers were generally unable to obtain catastrophic reinsurance, especially for terrorist events. While such catastrophic reinsurance has become somewhat more available since, it often comes with higher deductibles, various exclusions, and most importantly, with overall coverage limits that are substantially lower than were available prior to 9/11. Reinsurance is a fundamental risk spreading mechanism underpinning the insurance industry. Without adequate catastrophic reinsurance, many group life insurers risk financial ruin from a significant terrorist attack.

Group Life Should be Included in any TRIA Extension

While group life has been readily available to consumers, mainly for competitive reasons, if a major terrorist attack were to occur, it is very likely that some group insurers would be unable to fully pay their death claims. We also believe that group life insurance would not be widely available after such an event since many or most insurers would likely decide to exit the marketplace. It is for these reasons that we strongly urge Congress to include group life insurance in any TRIA extension.

Group life is very similar to workers compensation and most workers across the country are covered by both. The latter was included in the original TRIA legislation, as well as in its extension, and as a result, the industry experienced a significant increase in the availability of related reinsurance. As with workers compensation, we believe that catastrophic reinsurance would become more available and less expensive for group life if it were included in a TRIA extension. This additional reinsurance capacity would significantly reduce the risk of insolvency that many group insurers would face if a large-scale terrorist attack were to occur.

Separate Recoupment Mechanisms Should be Created

If TRIA is extended again and group life insurance is included, we urge that separate recoupment mechanisms be created for P&C and group life insurers. Recoupment of amounts paid by the Treasury for losses relating to P&C insurance should only be made from P&C insurers. Similarly, recoupment for losses relating to group life insurance should only be made by group life insurers.

Group life insurers take on different types of risks than P&C insurers and the premium structures of the two industries are very different. In the event of a catastrophic terrorist attack that primarily results in P&C losses, and without separate recoupment mechanisms, group life insurers would have to reimburse the federal government for millions or billions of dollars for claims unrelated to their line of business and for which they received no prior premiums. The opposite would be true in the case of an event that killed thousands of people but spared properties. Given the various types of potential terrorism events, it is not possible to predict how an event would effect the distribution of losses between the two types of coverage.

All states (with the exception of Wisconsin) have created separate guaranty associations for the life and P&C insurance industries. The state guaranty association system was designed so that: (1) only life (and health) insurers would be responsible for contributing to the unpaid claims of another life (or health) insurer and (2) only property and casualty insurers would be responsible for contributing to the unpaid claims of another property and casualty insurer.

Conclusion

We look forward to working with your Committee, others in Congress and the Administration. Thank you for allowing me the opportunity to express our views on this very important matter. For the record, on April 13th, the ACLI also submitted written responses to various questions relating to TRIA that were posed to us by this Subcommittee. I will be glad to answer any questions that you may have.