PCI

Property Casualty Insurers
Association of America

Advocacy. Leadership. Results.

Testimony of the Property Casualty Insurers
Association of America (PCI)

Before the Committee on Banking, Housing, and Urban Affairs
United States Senate

Vincent T. Donnelly
PMA Insurance Group
February 25, 2014

Thank you M. Chairman and Ranking Member for inviting me to testify today.

My name is Vincent Donnelly and I am the President and CEO of The PMA Insurance Group (PMA). I am testifying on behalf of PMA and the Property Casualty Insurers Association of America (PCI), which is composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than $195 billion in annual premium and 39 percent of the nation's home, auto and business insurance, epitomizing the diversity and strength of the U.S. and global insurance markets.

Since our inception over 90 years ago, PMA has specialized in the writing of workers compensation insurance across the country. Workers compensation insurance provides wage replacement and medical benefits to employees injured in the course of employment -- protecting both employers and employees from harm. Representative PMA policyholders include contractors, manufacturers, health care providers, nursing homes, retailers, schools and universities.

Reauthorization of TRIA is critical to our business and our customers. The private insurance markets are not willing to accept every risk -- particularly unpredictable and potentially catastrophic risks like terrorism -- and a failure by Congress to reauthorize TRIA or a significant increase in TRIA's thresholds will force PMA and a significant amount of private capital out of high risk markets. Having a terrorism risk insurance plan in place before the next attack protects our country's economic resiliency and security at nearly no cost to the taxpayers. PMA and PCI strongly urge your support for the current version of TRIA.

The Terrorism Risk Insurance Act (TRIA) was enacted in 2002 because our nation’s economic recovery from the tragic events of September 11, 2001 was being impeded by a lack of available terrorism insurance. 9-11 was one of the largest insured losses in history, and faced with such unpredictable and unlimited risk, insurers and reinsurers began to exclude terrorism coverage where allowed, or avoid insuring certain high risk consumers or locations with high concentrations of risk altogether.

TRIA is a bipartisan success story where, in response to the attack against our nation, Democrats and Republicans came together to enact, and subsequently twice reauthorize by overwhelming votes, a private-sector focused program that has helped the marketplace function exceptionally well, with terrorism insurance coverage widely available and affordable. The Congress wisely chose to put a terrorism protection plan in place that would limit terrorism insurance losses and thereby encourage private investment to return by converting a potentially unlimited catastrophic exposure into a more manageable, still unpredictable but finite exposure that insurers can underwrite. Consumers were also given a guarantee that insurers would "make available" terrorism protection in their policies on the same terms and conditions as the underlying coverage. Construction projects that had stalled got back on track and new projects got started. Employers, even in big cities or near critical infrastructure, were again assured of workers compensation availability.

As Congress revisits TRIA, it is appropriate to inquire whether the program is working as intended or whether additional reforms should be considered. PCI's mission is to promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers, and our members generally support government reforms that maximize commercial participation and taxpayer protection. That is why our members support the current terrorism insurance program so strongly -- it has done a superb job of bringing in private capital that would otherwise not be made available, with government involvement only at the most extreme and uninsurable levels. This has been reflected in the terrorism insurance marketplace, where availability and affordability has greatly improved since 9-11, leveling off over the last several years suggesting that supply and demand are currently extremely well balanced. PCI hopes that the Committee will recognize the enormous success of TRIA in providing terrorism risk coverage in a fiscally responsible manner that protects our country's infrastructure while greatly reducing the need for government assistance after a catastrophic terrorist attack.

TRIA is Fiscally Responsible

TRIA does an excellent job of keeping commercial insurers participating in the terrorism insurance market, thus protecting taxpayers from economic loss due to terrorism. Unlike many other government insurance programs, under TRIA, private sector insurers are on the hook for all but the most catastrophic terrorism losses. Commercial insurers pay losses within the trigger and through their very high annual TRIA deductibles and co-pays, keeping the government at a super-reinsurance level -- essentially only for catastrophic loss limits that the private market is unwilling to insure on its own. The federal government currently spends an average of $12.1 billion annually on disaster assistance where private sector insurance coverage does not exist. Keeping the private sector largely responsible for future terrorism losses instead of the government after a national security interdiction failure protects the taxpayers and Congress alike from the political pressure to parachute disaster assistance for innocent victims after a tragic terrorism event.

The marketplace pays for these loss limits through a post-event surcharge (a "terrorism loss risk-spreading premium") if TRIA is triggered. This post-event payment structure is common for state insurance guaranty funds and several government residual markets, and is particularly appropriate for protecting against extreme but rare and unpredictable catastrophic risks where accumulating and segregating the necessary capital in advance would be inefficient. Under TRIA, in the event the federal backstop is triggered, Treasury has the opportunity to recoup government payments from the marketplace, in the form of a post-event surcharge on all property-casualty insurance policies providing coverage in TRIA-covered lines. The recoupment is currently mandatory when the marketplace aggregate insured losses are $27.5 billion or less (with terrorism loss risk-spreading premiums of 133 percent of government assistance within that amount) but is discretionary when losses are above that amount. Taken together, these features make TRIA an extraordinarily fiscally responsible program.

Impact on Workers Compensation

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. Under state law, coverage for injuries resulting from acts of terrorism cannot be excluded from workers compensation policies, including the terrible injuries that would occur from a nuclear, biological, chemical, or radiological (NBCR) attack. As the marketplace experienced in the year following the terrorist attack of 9-11, without TRIA, adequate reinsurance coverage for terrorism can be very difficult to obtain, especially for high profile risks, regions with high value accumulations or NBCR attacks. Without adequate reinsurance, many insurers could be forced to exit portions of the market, capacity could be strained potentially causing price spikes, and the immense scale of potential unlimited terrorism losses for workers compensation insurers could impair the ability to pay the claims of injured workers. While reinsurance is somewhat more available at the moment than it was immediately after 9-11, that won't always be the case. In the future, particularly following the next global catastrophe, and without a terrorism insurance plan in place, there will always be gaps in coverage. The rating agency A. M. Best last year identified several insurers for potential downgrades if TRIA were not renewed, mostly workers compensation carriers. The resulting restriction of high quality capital for America's businesses would be a significant impediment to economic recovery and jobs growth.

The Importance of Retaining TRIA's Current Loss Limits

Many of the reforms proposed to increase private sector participation and reduce taxpayer exposure under TRIA have been rejected in the past by Congress because they would weaken the loss limits for insurers and thereby reduce the willingness of private capital to invest in or cover terrorism risks. In particular, the key thresholds of TRIA that turn terrorism into a more manageable risk for insurers to underwrite are the deductible, co-share and trigger. Every insurer limits its risk to a probable maximum loss exposure that it can responsibly manage and still fulfill its commitments to policyholders. If TRIA is reauthorized with excessively high thresholds – deductibles, co-shares, or triggers, then the retained risks for insurers, would exceed the probable maximum losses they can retain and they would be driven out of the market. Congress would thus *reduce* insurance availability.

Deductibles: A high TRIA deductible means a greater proportion of the terrorism loss is paid out of an insurer's surplus, putting more of its capital at risk. An insurer's deductible is 20 percent of its prior year earned premiums from TRIA covered lines of insurance. No federal payments are extended under TRIA unless both the program trigger and an insurer's deductible have been exceeded, and even then only for a portion of the insurer's certified losses exceeding its deductible.

The current 20 percent TRIA deductible is greater than 10 percent of company surplus for 40 percent of all TRIA insurers (333 companies). Those companies are vulnerable to A.M. Best downgrades and precarious company stability due to the negative impact to their surplus at a 20 percent TRIA deductible. Very few companies of any kind would voluntarily put such a large portion of their capital at risk to a single threat, but insurers are required to do so under the current TRIA law. Increasing the deductible further would drive many insurers out of the market; they simply would be unable to responsibly underwrite at current capital levels with that sort of unavoidably large terrorism risk on their books. Many business consumers are only able to purchase insurance coverage from a carrier with at least a certain rating; capacity would be particularly constricted for these companies. The effect would be anti-competitive, leaving fewer insurers providing less terrorism capacity at a higher price than is presently available, where coverage would be available. This is counter to TRIA's goal of bringing stability to the market and ensuring that adequate capacity exists to meet the market's need.

Co-Shares: The impact on surplus is only made worse by the insurer's TRIA retention (coinsurance share) of an additional 15 percent of losses above its deductible. While an insurer at least knows what its maximum deductible would be in a catastrophic event, the co-share is limited only by the $100 billion annual program cap. Since workers compensation by law requires unlimited coverage for insured risks, a 15 percent co-share of a $100 billion loss would threaten the solvency of almost every insurer. For example, a medium sized insurer with $1 billion in annual earned premiums might underwrite to a probable maximum loss of $100 million; but if the terrorists go after that insurer's policyholders causing $100 billion+ of insured losses, the insurer would pay a $200 million deductible and a nearly $15 billion co-pay. While insurers conduct extensive modeling to diversify and mitigate their risks, terrorism attacks are not random and the 15 percent co-pay in TRIA already potentially dwarfs the solvency of most insurers, undermining the certainty that the program otherwise provides. Increasing this number further would create a severe disincentive to providing future coverage.

Particular Harm to Small and Medium-Sized Insurers of Weakening Changes to TRIA

Weakening TRIA's loss limits would be particularly counterproductive because it would make it more difficult, and in some cases impossible, for small and medium-sized insurers to write property casualty insurance in TRIA covered lines, thereby constricting available capacity and affordability. Ninety-eight percent of companies writing TRIA lines of insurance are small or medium-sized. These insurers write over 47 percent of the TRIA-covered premium in the nation, including many specialty lines and niche businesses that might otherwise find little coverage availability.

Because of their smaller capital base, smaller insurers are less able to absorb large losses. For example, a company with $5 billion in surplus is better able to withstand a loss of $50 million than a company with $100 million in surplus. Larger companies can also more readily access capital markets. A 10 percent or greater surplus hit to a small or medium-sized company may very well be a company-closing event, or more likely risk a downgrade by credit rating agencies below the level required to retain many commercial accounts. In underserved niche markets, fewer players translate into availability issues and higher rates. Indeed, the rating agency A.M. Best has issued a briefing paper suggesting that, even at the current 20 percent deductible, a number of small to mid-sized companies may be subject to ratings downgrades. The only way many of them could avoid such downgrades is to exit some TRIA-covered lines entirely, since the TRIA "make available" requirement prevents them from being able to limit their terrorism exposure in any other way.

The impact on surplus is only made worse by the insurer's TRIA retention (coinsurance share) of an additional 15 percent of losses above its deductible. Because smaller companies have less capital to draw on than other writers, coinsurance places a greater burden on smaller insurers*.* Again, all insurers must take care not to exceed their probable maximum loss limits, but increasing the TRIA co-share would cause them to reach those limits sooner. To avoid that, some will be compelled to exit markets or lines of business, which reduces competition and compromises TRIA's ability to achieve its intended purpose.

Triggers. The level of the trigger determines whether and when the government's obligations arise. The current $100 million trigger means that no insurer will be reimbursed unless the total industry TRIA losses exceed $100 million. Because the trigger is not indexed to an individual insurer's size, a higher trigger makes much less likely that smaller and mid-sized insurers will realize the benefits of the program that allow them to remain to continue writing coverages the marketplace and the economy need. In 2012, roughly two-thirds (67 percent) of all TRIA writers had surplus less than the current $100 million program trigger, all of which are small or medium-sized companies. For a large percentage of insurers, the $100 million trigger already exceeds their 20 percent deductible. Severe increases in TRIA's trigger would discriminate against smaller and mid-size insurers, forcing them to exit risks or markets altogether where adequate reinsurance is neither available nor affordable.

When the greatest possible number of strong, viable competitors serve the market insurance consumers have more choices, prices are more competitive, and product innovation is enhanced. If TRIA is discontinued, or reauthorized with excessive thresholds, it will become an unviable program for small and mid-sized insurers. Overall availability and affordability will be greatly reduced – not only for terrorism coverage but also for other commercial lines of insurance as well. This clearly would be bad for consumers and would undermine TRIA's intended purpose.

Potential Technical Changes

PCI and its members strongly support reauthorization of TRIA in its current form. It is one example of an extremely effective and cost-efficient disaster preparedness plan. However, if Congress decides to make changes to TRIA, PCI would suggest certain technical clarifications.

Consumers rely on insurers to pay insured claims in a timely manner. Insurers in turn rely on TRIA's certification process to determine whether a terrorist attack is considered an act of terrorism, and thus whether terrorism coverage applies. The Boston Marathon attack exposed flaws in the TRIA certification process. State laws generally require timely payment of claims. However, there is no federal requirement that the Treasury Secretary make a determination to certify an act of terrorism within any particular time period. In many cases, businesses would not know if their losses were covered until a certification decision was made (if ever), and insurers would have to make claim payment decisions without knowing whether an event will qualify as a certified event. Consumers and insurers are thus both disadvantaged by the uncertainty, increasing the likelihood of litigation and forcing insurers to either make inappropriate claims payments or potentially violate state unfair claims practices laws and/or state bad faith laws. TRIA currently provides unreviewable and non-delegable discretion by the Treasury Secretary to certify a terrorist event for TRIA purposes, in consultation with the Attorney General and the Secretary of State. Finalizing liability and business interruption claims could take months, and one of the three government officials required for certification could be unavailable for a time, pushing the timing of the government certification process far past the needs of consumers and insurers.

There may be value in statutory clarification of the program's treatment of nuclear, chemical, biological and radiological (NBCR) risks and cyber risks. Treasury's current interpretation is that the federal backstop covers these losses to the extent insurers provide the coverage, but TRIA's requirement to make coverage available applies only to the extent that NBCR and cyber coverage for losses arising from non-terrorism causes are covered in the underlying policy. PCI believes that is the correct interpretation but it may be appropriate to consider whether and how to make this clear in the statute.

There have also been suggestions to clarify the statutory ambiguity as to whether multiple events occurring in the same year, such as the four different plane attacks on 9-11, none of which independently meets the trigger, can be aggregated to trigger the program collectively. Treasury appears to read the current statute as meaning that the program is not triggered unless a single act of terrorism results in losses that exceed the $100 million trigger. However, this reading would render the current $5 million event certification threshold meaningless. Other observers, including the Congressional Research Service (CRS), read the statute as permitting aggregation of loss events in a program year that exceed $5 million. PCI believes that Congress did not make a mistake in retaining the $5 million threshold and the better interpretation is that aggregation is permitted. Multiple copycat terrorist bombings in a year, even if each is just under $100 million in losses, is clearly the type of exposure that can rattle the marketplace in ways that TRIA was successfully designed to prevent. However clarification of this issue would create more underwriting certainty, benefiting both consumers and insurers.

PCI will be pleased to work with the Committee on ways to address these technical, but important issues.

<u>The American People Support TRIA</u>

Last year, PCI surveyed voters and conducted focus groups to learn what voters think about how their government protects them from the effects of terrorist attacks. Among the key findings were:

- A majority of voters, 72%, agree that responsibility for the costs from injuries to workers and property damages from a terrorist attack should be a combination of the federal government and private insurance companies.

- A majority of voters agree that it is important for America's economy to have a plan in place before an attack to ensure large projects can be built in a timely, cost effective manner.

- 90% of the participants agree that the federal government should be at least in part responsible for protecting against losses from terrorist attacks against the United States.

- A majority of voters, 64% agree that it is difficult for insurance companies to provide affordable terrorism insurance because of the randomness and difficulty in predicting the likelihood or magnitude of terrorist attacks.

- A rural-urban divide does not exist; 68% of voters understand the national economic implications of a terrorist attack.

- 67.6% of voters favor continuing the Terrorism Risk Insurance program.

The study showed unmistakably that Americans want their government to have a risk management program in place to protect the U.S. economy against the effects of a catastrophic terrorist attack and that both the commercial insurance industry and the government have important roles to play in such a plan.

Conclusion

It is essential for America's economy to have a terrorism risk insurance plan in place to ensure large projects can be built in a timely, cost effective manner after an attack occurs which would help keep the economy stable and provide jobs. Having a terrorism risk insurance plan in place helps thwart the devastating economic impacts of a terrorist attack and protects our national security. TRIA is a fiscally responsible program that has cost the taxpayers almost nothing in its 11-year existence, while protecting economic resiliency. It also reduces the need for additional government catastrophic response programs that can be far more costly after the fact. PCI strongly supports reauthorization of the current TRIA program with thresholds that will continue to encourage insurers of all sizes to provide private sector capital to compete and ensure availability of terrorism coverage. PCI also supports efforts to clarify TRIA's application and coverage, particularly with respect to improving the terrorism event certification process.