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NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Statement

of

National Association of Mutual Insurance Companies

to the

United States Senate

Committee on

Banking, Housing and Urban Affairs

Hearing on

Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II

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Introduction

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide testimony on the Terrorism Risk Insurance Act (TRIA) and the private market for terrorism insurance.

NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,400 regional and local mutual insurance member companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. Member companies serve more than 135 million auto, home and business policyholders, writing in excess of $196 billion in annual premiums that account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. More than 200,000 people are employed by NAMIC member companies.

It is our firm belief that in the absence of a terrorism loss management plan such as TRIA, no self-sustaining private market for terrorism risk coverage is likely to develop. However, the existence of TRIA allows a viable private market to function for a difficult peril which involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and purposefully unpredictable.

Any discussion of the private market for terrorism insurance must start from the understanding that the TRIA program was a well-designed mechanism to encourage the private sector to put its capital at risk for losses that result from what amount to acts of war – which have always been considered uninsurable events with either an implicit or explicit expectation that financial responsibility resided with the governments involved. Having learned the lessons of 9/11, most insurers are not likely to offer terrorism coverage in a fully private market.

In fact, it is the unique structure of the program's recoupment mechanism that takes losses that could render a single company insolvent and spreads them throughout the private sector and over time. This mechanism allows for a large and temporal transfer of risk that would not occur in a fully private market, but in the end does utilize private capital and protects taxpayers.

NAMIC remains committed to ensuring that the program be designed to adequately protect taxpayers and maximize private sector capital in the market for terrorism insurance. That said, in considering changes to the present system, we would caution against adopting solutions in search of problems. In fact, alterations that increase the exposure to individual companies could have the unintended consequence of reducing overall capital in this market. Through TRIA, the private sector already has a tremendous amount of capital involved in the terrorism risk insurance market and under current law every penny the federal government pays out may be recovered.

TRIA Structure Designed for Individual Company Participation

Discussions surrounding the private terrorism risk insurance market tend to focus on aggregate numbers – i.e. how much market capacity exists, industry exposures, etc. However, the design of the TRIA program focuses on something entirely different and, in our view, more appropriate: the individual company. The program is structured this way to take into account the unique risk posed by terrorism and the fact that losses are not likely to be spread evenly among a large number of insurers even in a catastrophic event.

The current program requires all insurers selling covered lines to offer terrorism coverage, compelling many insurers that had previously exited that market to return and dramatically reducing the amount of potentially uninsured losses in the event of an attack. In return, the federal mechanism for risk-sharing provides more definitive loss parameters for each company; specifically, the individual company retention (20 percent of the prior year's direct earned premium for covered commercial lines) and the co-pay (15 percent of all losses above the individual company retention). By placing a ceiling on individual company terrorism exposure, insurers have the benefit of knowing their maximum possible losses, allowing them to make coverage available and price accordingly.

It is important to note that simply because an individual company's losses are capped, this does not mean that the private sector participation ends there and the federal taxpayer pays for the rest. Rather, TRIA works through its recoupment mechanism to take those losses and spread them back throughout the private sector and over time. In this way, TRIA acts as a shock-absorber for the U.S. economy to reduce the financial impact of a jarring terrorism event.

By law the federal government *must* recoup the difference between insurers' total costs and the industry aggregate retention of $27.5 billion (assuming the total cost of the event with government payments is $27.5 billion or higher) over time through surcharges on every policy covered by TRIA. Since 2007, the government must actually recover 133 percent of this mandatory recoupment. In the event the insurers' total costs exceed $27.5 billion, the government can still recoup whatever money it pays out, but this is at the discretion of the Treasury Secretary. The recoupment is done through an assessment on every TRIA-covered, commercial line policy sold in the U.S. over time. The initial outlays of the federal government, which are so important to maintaining an individual company's solvency, are in fact borne by private sector insurers and their commercial policyholders (and paid back with interest for the mandatory recoupments). ***Taxpayers are completely protected under TRIA.***

The structure of the program is important – it is why questions of overall industry capacity can distract from the serious concerns about terrorism risk that remain for individual insurance companies. Even in a catastrophic event, the losses are not likely to be spread evenly among a large number of insurers. This is especially so in the case of terrorism because perpetrators have the ability to precisely target particular properties or assets. Hence, a single terrorism event could affect insurance companies with similar books of business in very different ways: one company might suffer no losses from the event, while another company could suffer losses sufficient to threaten its very existence. The TRIA program – through the mechanism of initial federal outlays recovered through recoupment – allows this “bet the company” risk to be spread throughout the private sector and over time in a manner that cannot be duplicated by the private sector alone.

Altering the Program

Most insurers would likely not offer terrorism coverage in the absence of a federal risk-sharing mechanism like TRIA. Recent research by Aon shows that more than 85 percent of insurers will no longer insure terror risk if the federal program went away.[1] Additionally, state insurance regulators indicate that they have not seen evidence suggesting that the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing coverage for acts of terrorism in the absence of the program. It was only with a program in place that put some structure around an ill-defined catastrophic risk that the private sector was able and willing to participate at current levels. We cannot hastily conclude that because the private sector can handle a portion of the risk, it could raise enough capital to handle all of it. Similarly, assuming that a substantial diminution of the federal government’s role will necessarily result in private market innovation that has heretofore failed to materialize is unwise. Although individual market players may indicate willingness to take on greater exposure in the abstract, the private market has consistently demonstrated an unwillingness to accept a significantly larger portion of this potentially devastating risk, in particular when it comes to offering affordable limits to protect the solvency of the workers’ compensation insurers.

One reason to doubt that reinsurers would provide additional terrorism coverage where and when primary insurers needed it is that reinsurance capacity would likely be severely constrained following a large-scale natural catastrophe, such as a major hurricane striking the Gulf or Atlantic coasts. The U.S. commercial insurance market would be right back to where it was following 9/11 with limited availability and no guarantee that the capacity and willingness to take on terrorism exposure would return.

Additionally, in seeking to accomplish the goal of increasing private sector participation in the terrorism insurance market, it is important to recognize the presence of other risks that need to be insured in our dynamic economy. That capacity cannot be exposed beyond a reasonable level without failing in its primary purpose - supporting the economy by protecting against non-terrorism related losses and events. In the event of a major attack, substantially depleted reserves and surpluses, and insolvencies could mean that policyholders of non-covered lines could go unprotected. A company that engages in business that endangers its ability to pay claims on existing or future policies is violating its duties to its policyholders.

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[1] ”Response to U.S. Treasury and President’s Working Group: Terrorism (Re)Insurance, AON, September 2013, page 9. <http://www.aon.com/attachments/risk-services/2013-Aon-Response-to-Presidents-Working-Group.pdf>

An important example of this issue is the workers' compensation market. Workers compensation writers are not permitted to exclude any peril from their coverages and are particularly susceptible to having highly concentrated losses in the event of a major terrorist attack. In the absence of a private/public, risk-sharing mechanism workers' compensation carriers will retreat from having highly concentrated losses in the event of a major attack. There would almost certainly be a simultaneous and significant increase in the cost of these policies and decrease in their availability for employers based in the major metropolitan areas and industries involved with, or adjacent to, symbols of America which are currently covered by private carriers. The only way a workers compensation writer could eliminate its terrorism exposure in high-risk markets would be to completely withdraw from those markets. In the absence of the TRIA program, or an increase in the deductibles and/or co-pays, we would expect to see a shift from the private workers' compensation writers to the insurer of last resort – usually a state fund or residual market pool, causing ripple effects throughout the business community.

Trigger Level

Finally, NAMIC would caution policymakers not to assume that they can guarantee increased private sector participation through statutory changes. Increasing the nominal amount of private sector involvement in the current TRIA structure does not automatically translate into an increase in private sector capital in the marketplace. As with increased company retentions, altering trigger levels may cause market participants – particularly small and medium-sized companies – to exit, thereby reducing total private capital. An effective terrorism loss management plan depends on participation by insurers of all sizes and structures.

The rationale given by those who favor raising the event trigger and/or the company deductibles and co-payments is that such modifications would increase the share of terrorism risk borne by the private insurance market while reducing the government's exposure. In fact such measures would result in a smaller private insurance market, which would further expose the federal government to greater costs in the form of post-disaster assistance to terrorism victims that were left uninsured or underinsured due to the decrease in coverage availability and affordability brought about by ill-considered revisions to the program.

Consideration of just one proposed change in particular is illustrative of this dynamic. It has been suggested that raising the event "trigger level" will further the goal of taxpayer protection. As a practical matter, however, a higher trigger would do nothing to reduce taxpayer exposure in the event of an attack.

Consider the below comparison between two trigger levels $100 million and $1 billion. Because of the recoupment provision under the law, the federal government is required to recover 133 percent of any money it spends for losses below $27.5 billion, and is permitted to recover 100 percent above that level at the discretion of the Treasury Secretary. Consider a $500 million loss scenario under the two trigger levels:

$500 M Event	**$100 M Trigger**	**$1 B Trigger**
Program Triggered?	Yes	No
Insurer Paid Losses	$160 M	$500 M
Initial Government Outlays*	$340 M	$0
Mandatory Recoupment (Private Sector Loss Sharing)	$452 M (133% X $340 M)	$0
Net Gain/Loss to Fed. Government	**+ $112 M**	**$0**

* Worst Case Scenario - Losses equal 20% of 500 million (deductible) plus 15% of the remainder (co-share)

While raising the trigger level would in some circumstances reduce initial government outlays, we can see that, ultimately, the cost to the taxpayer is not reduced. Nor would raising the trigger level necessarily impact initial government outlays, because the individual company deductibles and co-payments of the insurers involved could exceed the event trigger by orders of magnitude. Consider the same scenario with a single impacted company with an individual retention level of $1 billion:

$500 M Event	**$100 M Trigger**	**$1 B Trigger**
(Company deductible =$1 billion)		
Program Triggered?	Yes	No
Insurer Paid Losses	$500 M	$500 M
Initial Government Outlays	$0	$0
Mandatory Recoupment (Private Sector Loss Sharing)	$0	$0
Net Gain/Loss to Fed. Government	**$0**	**$0**

Here, the trigger level has no impact. Where it does have a very significant impact is in cases involving smaller or regional insurers. Consider the same scenario for a single company with a retention level of $100 million.

$500 M Event	**$100 M Trigger**	**$1 B Trigger**
(Company deductible=~$100 million)		
Program Triggered?	Yes	No
Insurer Paid Losses	$160 M	$500 M

Initial Government Outlays*	$340	$0
Mandatory Recoupment (Private Sector Loss Sharing)	$452	$0
Net Gain/Loss to Fed. Government	**+$112 M**	**$0**

* Worst Case Scenario - Losses equal 20% of 500 million (deductible) plus 15% of the remainder (co-share)

A $500 million loss could easily render such a company insolvent. Potential exposure like this would cause these companies to take a long look at their underwriting and risk concentrations.

Indeed, the only impact of raising the trigger would be on smaller, regional, and niche insurers whose deductible – and even total exposure – falls under a level set too high. This situation would create a "bet-the-company" risk for these companies and would likely force them to constrain coverage or leave certain markets entirely. Because it is not at all clear that remaining companies could or would provide this missing coverage, the probable effect of a higher trigger would be to reduce the amount of total private capital allocated to terrorism risk.

In short, raising the trigger does nothing to reduce taxpayer exposure while simultaneously having the potential to drive private capital from the market.

Certification of Terrorist Attack

Treasury has taken steps to streamline and facilitate certification; however, it is complex and difficult process requiring extensive investigation and correlation of information from multiple sources. Delays in certification raise issues for insurers, who are required by state law and regulation to make prompt payment of claims. NAMIC believes that Congress should facilitate expeditious information exchange between various national and international agencies to provide Treasury with information in a timely manner.

Congress could also provide a certification protocol with appropriate timelines to ensure that all parties understand the process, their duties and obligations, and the applicable timeframes. Also, requiring an affirmative determination on certification could help to strengthen the predictability of the process.

An efficient and effective certification will benefit the taxpayers, insurers and their insureds.

Conclusion

Private insurance companies, including mutual companies, are return-seeking operations. Therefore, if they believe there is an opportunity to earn an economic return and it is possible to do so in accordance with an overall successful business model, then they will. In other words, if there was money to be made in insuring against terrorism risk, coverage would be offered without government intervention. If such were the case, the companies would be arguing for less—not more—government intervention to increase their earning potential. The fact that they are uniformly not doing so and in fact suggesting that without the TRIA program private coverage would not expand and instead contract, is telling.

Under the current TRIA program the private sector is heavily involved in absorbing the losses from a terrorist attack against the U.S. Ultimately, it is responsible for covering *all* the losses at the discretion of the Treasury Secretary. This private sector involvement addresses the needs of victims and limits the need for government intervention – thus taxpayer exposure – post attack. In contemplating altering the current program, it is important to identify the specific problems that need to be addressed.

In the end, the purpose of the program is not to protect insurers, but to make sure that the economy can recover in as orderly a fashion as possible from a terrorist event. In order to encourage private sector involvement in the terrorism insurance marketplace – and thereby protect and promote our nation's finances, security, and economic strength – we should maintain a long-term, well-functioning terrorism loss management plan. Fortunately, the current TRIA program has proven to be just such a plan.