



AMERICAN BAR ASSOCIATION

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STATEMENT OF

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SECTION OF TORT TRIAL AND INSURANCE PRACTICE

AND

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**SECTION OF TORT TRIAL AND INSURANCE PRACTICE'S TASK FORCE
ON FEDERAL INVOLVEMENT IN INSURANCE REGULATION
MODERNIZATION**

submitted on behalf of the

AMERICAN BAR ASSOCIATION

to the

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

of the

U.S. HOUSE OF REPRESENTATIVES

on the subject of

**“POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE
ACT”**

April 24, 2007

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to submit to you the views of the American Bar Association (ABA) on reauthorizing the "Terrorism Risk Insurance Act of 2002" (P.L. 107-297) also known as "TRIA". We are Peter J. Neeson, Chair of the Section of Tort Trial and Insurance Practice, and Francine L. Semaya, Chair of the ABA Section of Tort Trial and Insurance Practice's Task Force on Federal Involvement in Insurance Regulation Modernization. We are submitting this statement on behalf of the ABA.

The ABA is pleased that the Subcommittee is holding hearings to discuss reauthorizing TRIA, which Congress passed in response to the September 11 terrorist attacks. The ABA believes it is very important to enact, in the near future, a permanent or long-term reauthorization of TRIA, an act which created a three-year program to help stabilize the commercial property and casualty insurance markets and ensure the continued availability of terrorism insurance for U.S. businesses. On December 22, 2005, President Bush signed legislation, P.L. 109-144, modifying and extending TRIA for an additional two years and increasing the aggregate loss trigger. It is very important that this Congress act much more quickly to reauthorize TRIA, rather than waiting until it is about to expire as happened at the end of 2005. Terrorism insurance is required by banks and financing institutions before they will make loans on commercial real estate projects and development. Insurance companies are reluctant to offer terrorism insurance without TRIA, which is set to expire at the end of December 2007. Thus, it is critical for Congress to act in a timely fashion so that new policies can be written by insurers and purchased by policyholders in time for 2008.

TRIA has helped stabilize the price of terrorism insurance by reducing the amount of risk to be borne by insurers. Without a federal backstop, many insurers would not have provided terrorism coverage – or would have provided insufficient terrorism insurance – and prices could have been even higher. By providing a backstop, TRIA improved the ability of the market to respond to this risk. The availability may have been even worse in compulsory lines like workers' compensation insurance, where insurers would have had to choose between providing workers' compensation coverage including terrorism, or not writing the coverage at all.

In February, 2007, the ABA adopted as policy the following resolution:

RESOLVED, That the American Bar Association urges Congress and the Executive Branch to partner with the insurance industry to promote the availability of terrorism risk insurance through legislation that continues support for market mechanisms with federal government insurance backstop protection.

Attached is the report that the ABA policymakers, its House of Delegates, considered when adopting ABA policy. The report does not constitute ABA policy. It is for background purposes only. Only the resolution constitutes ABA policy.

The unpredictability of terrorism diminishes the ability of the private market to underwrite this risk. Terrorism is perpetrated by human actors who have the intention of causing harm. In order to generate greater fear and alarm, terrorists may act in ways that are unexpected. These characteristics make terrorism risk significantly more difficult to predict and model than other kinds of risks. The risk is so variable and difficult to predict that insurers and reinsurers are cautious and will only put limited amounts of capital at risk. The government backstop helps to consolidate the risk of catastrophic events so that

the consequences of modeling mistakes are shared collectively by the federal government and the private insurance industry rather than by individual insurers alone.

A role for government is especially needed in the area of coverage for nuclear, chemical, biological, and radiological attacks. At the present time, there is little insurance coverage available for such attacks apart from coverage mandated by state law, such as workers' compensation and "fire following" coverage in those jurisdictions with statutory fire policies.

The government-industry partnership benefits policyholders and the economy. Some critics of TRIA try to characterize it as an "industry bailout" bill. Such rhetoric is both overblown and misplaced. After September 11, and prior to TRIA's enactment, exclusions for terrorism risk were approved in 45 states and the District of Columbia. It is therefore reasonable to assume that without sufficient reinsurance or another financial loss-sharing mechanism such as the federal backstop, most insurers could simply exclude terrorism risk from their coverage.

The federal government, because of its massive national security apparatus and its superior access to information, is in the best position to partner with the insurance industry to provide terrorism insurance. The federal government also has access to very large amounts of capital and can use its broad powers to rebuild or repay the capital. Moreover, experience has shown that the government will likely provide assistance to victims of a major terrorist attack; it behooves the federal government to be involved prior to the attack in order to receive the benefits of advance planning, risk management, capital accumulation, and the opportunity to use the underwriting and claims expertise of the insurance industry.

Thank you for the opportunity to present the views of the American Bar Association. We would be happy to work with your Subcommittee on the legislation and to answer any questions you might have.

APPENDIX

Below is the report considered by the ABA House of Delegates when it adopted ABA policy in February 2007. This report does not constitute ABA policy; the resolution constitutes ABA policy.

Report

This Report supports the Resolution sought by Tort Trial and Insurance Practice Section regarding the need for a government-industry partnership for insuring terrorism risk. The Task Force on Federal Involvement in Insurance Regulation Modernization (the “Task Force”), which was first organized in 2005, has studied the Terrorism Risk Insurance Act of 2002 (“TRIA” or “the Act”) and the Terrorism Risk Insurance Extension Act of 2005 (“TRIEA”). In March of 2006, the Task Force issued a White Paper exploring the various issues raised by the debate about extension of the Act, and concluded that the government-industry partnership represented by TRIA should be continued, although it made suggestions for possible improvement. This Report takes a slightly different approach than the White Paper, though it makes some of the same points. The purpose of this report is to outline the reasons the Task Force supports a permanent government-industry partnership for terrorism insurance. This Report does not consider any specific proposal regarding the nature of the government-industry partnership, though it discusses TRIA and TRIEA as relevant examples.

This Report outlines three main reasons for a permanent government-industry partnership regarding terrorism insurance: 1) the unpredictability of incidents of terrorism impedes the ability of the private insurance market to take on the financial risk without governmental support, 2) a government-industry partnership can support the use of the private insurance market to provide some terrorism insurance, and 3) a government-industry partnership to provide this protection is consistent with national interests.

I. The Unpredictability of Terrorism Diminishes the Ability of the Private Market to Underwrite This Risk.

A. In General

Although the Terrorism Risk Insurance Act of 2002 (“TRIA” or “the Act”) and the Terrorism Risk Insurance Extension Act of 2005 (“TRIEA”) have succeeded in providing greater access to terrorism insurance,¹ the ability of the private market to provide terrorism insurance absent government involvement is impeded by the unpredictable nature of terrorism. Its characteristics make terrorism risk significantly more difficult to predict and model than other kinds of risks. Terrorism is perpetrated by human actors who have the intention of causing harm.² In order to generate greater fear and alarm,³

¹ According to a study conducted by Wharton Risk Management and Decision Processes Center at the University of Pennsylvania, “about 50% of commercial enterprises have purchased TRIA-line terrorism insurance.” WHARTON RISK MANAGEMENT AND DECISION PROCESS CENTER, TRIA AND BEYOND, at 2 (2005) [hereinafter WHARTON]. The RAND study reached similar conclusions. See PETER CHALK, BRUCE HOFFMAN, ROBERT REVILLE, ANNA-BRITT KASUPSKI, TRENDS IN TERRORISM: THREATS TO THE UNITED STATES AND THE FUTURE OF THE TERRORISM RISK INSURANCE ACT at 7-8 (2005) (citing Congressional Budget Office and others) [hereinafter RAND]. The most recent study, conducted by the President’s Working Group on Financial Markets, found take up rates of 58% in 2005. See TERRORISM RISK INSURANCE, REPORT OF THE PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS at 1 (2006) [hereinafter PWG REPORT].

² See WHARTON, *supra* note 1, at 13.

³ See WHARTON, *supra* note 1, at 13.

terrorists may act in ways that are unexpected.⁴ Although terrorists have sometimes attacked “hard” targets in the past because of their symbolic significance, terrorists are showing an increased willingness to attack “soft” targets with significant civilian exposures.⁵ The religious or political fervor of some terrorists and their willingness to commit suicide in conjunction with terrorist acts is another consideration that makes it difficult to model or prevent terrorist behavior.⁶

The challenge of modeling terrorist behavior is compounded by a lack of information. The historical data available on terrorism are limited because of a relatively few number of incidents,⁷ and the utility of the available data for those incidents is limited by the wide variety of cultural and operational contexts within which the events took place.⁸ In addition, although much of the focus has been on al Qaeda after September 11, there are various terrorist organizations that have substantial differences in ideology, structure and methodology.⁹

Moreover, much of the information about terrorism risk has been collected by governmental agencies, which are understandably unwilling to share that information because of national security and law enforcement concerns.¹⁰ Government policies also affect the nature and scope of the risk through anti-terrorism and other policies.¹¹ Government, the Federal government in particular, devotes substantial resources to combating terrorism, which may reduce or increase the risk of terrorism, or may have an impact on certain kinds of risks or risks in specific geographical areas.

Another characteristic of terrorism risk is the variability of its impact. While much progress has been made in modeling the consequences of a terrorist attack,¹² even with these models there are many different impact scenarios.¹³ Although certain areas tend to present greater risk of terrorism, it is impossible to rule out any potential target. As some targets become more difficult to attack, it is possible that terrorists could switch to easier targets in less-protected locations. Nuclear, biological, chemical or radiological attacks could affect very large geographic areas and potentially millions of people,¹⁴ while attacks with conventional weapons could be limited to a single business or individual.

⁴ This been described as the dynamic uncertainty problem. See WHARTON, *supra* note 1, at 52-53.

⁵ See RAND, *supra* note 1, at 15-16; see also See WHARTON, *supra* note 1, at 13, 52, 56.

⁶ See RAND, *supra* note 1, at 26-29 (describing use of suicide attacks by al Qaeda); see also WHARTON, *supra* note 1, at 55-56.

⁷ See PWG REPORT, *supra* note 1, at 24.

⁸ See WHARTON, *supra* note 1, at 58.

⁹ The main threat to the U.S. is considered to be al Qaeda, but many terrorist events have been undertaken by other organizations that have largely limited their activities to local targets. See RAND, *supra* note 1, at 11 n.1. In addition, there is a growing risk of home-grown terrorism in the U.S. from both the left (the anti-globalization and radical environmental groups) and the far right. See *id* at 39-51.

¹⁰ See WHARTON, *supra* note 1, at 53-54.

¹¹ See WHARTON, *supra* note 1, at 54.

¹² See WHARTON, *supra* note 1, at 59-61; see also PWG REPORT, *supra* note 1, at 20-23.

¹³ See WHARTON, *supra* note 1, at 62, 65.

¹⁴ Al Qaeda has an ongoing interest in acquiring and using such weapons. See RAND, *supra* note 1, at 30-31. The implications for the economy could be disastrous. See *id.* at 36-37. For a more general description of potential catastrophic scenarios, see WHARTON, *supra* note 1, at 50-51.

Some terrorist activity appears to be specifically aimed at the U.S. economy,¹⁵ which presents the possibility of attacks in more remote areas.¹⁶

Taken together, these characteristics make terrorism very different from other kinds of risks and pose significant challenges for underwriting.¹⁷ The risk is so variable and difficult to predict that insurers and reinsurers are cautious, and they will only put limited amounts of capital at risk.¹⁸ In addition, because the size of the risk is so variable, it is hard to determine the amount of capital reserves that should be maintained for that risk.¹⁹ Under the incentive of the mandatory availability requirements of TRIA, insurers are working to develop models to try to predict the probability of terrorist attacks, but most insurers recognize that the models are simply too imprecise to be of much help. The President's Working Group, after reviewing insurer behavior in the marketplace, noted:

Skeptical of their reliability, insurers do not appear to be placing much weight on the probabilistic models at this time. A.M. Best reports that among surveyed insurers, only 19 percent reported using probabilistic modeling while 62 percent did not. As the NAIC pointed out during consultations, the ability to model frequency is uncertain and untested, and some regulators have even challenged advisory organization loss cost filings based on such models.²⁰

The government-industry partnership represented by TRIA, aided substantially by the mandatory available provisions, has helped to facilitate the availability of terrorism coverage, notwithstanding this unpredictability. While government involvement does not change the nature of the risk, the government backstop helps to consolidate the risk of catastrophic events so that consequences of the modeling mistakes are shared collectively by the Federal government and the private insurance industry rather than by individual insurers alone.

B. Nuclear, Chemical, Biological & Radiological Risks

A role for government is especially needed in the area of nuclear, chemical, biological, and radiological ("NBCR") attacks. At the present, there is little insurance coverage available for such attacks apart from coverage mandated by state law, such as workers' compensation and "fire following" coverage in those jurisdictions with statutory fire policies ("SFPs").²¹ Although TRIA requires that insurers offer terrorism insurance to

¹⁵ See RAND, *supra* note 1, at 21-23

¹⁶ See RAND, *supra* note 1, at 22 (noting examples of oil installations, seaports and shipping).

¹⁷ See WHARTON, *supra* note 1, Chapter 3.2.

¹⁸ The PWG Report notes: "While insurers and reinsurers are willing to allocate some capacity to terrorism risk with untested probability models or by making their own internal probability assessments, given the degree of uncertainty associated with these modeling efforts, there may be limits in the confidence insurers may place on such models. Many commenters (*e.g.*, the Reinsurance Association of America) highlighted the fact that allocating additional capacity is tied to determining potential frequency and severity." PWG REPORT, *supra* note 1, at 24.

¹⁹ See WHARTON, *supra* note 1, at 49.

²⁰ PWG REPORT, *supra* note 1, at 24 (citing A.M. Best, Special Report, "Terrorism: Too Risky Without TRIA?," December 2005).

²¹ According to a 2005 Treasury study, less than 3% of policyholders reported purchasing NBCR coverage in their commercial property/casualty insurance policies. See GAO REPORT, TERRORISM INSURANCE: MEASURING AND PREDICTING LOSSES FROM UNCONVENTIONAL WEAPONS IS DIFFICULT, BUT SOME

their policyholders, they are only required to offer terrorism insurance on the same terms and conditions as property and casualty coverage for non-terrorism losses.²² Because most property insurance policies in non-SFP jurisdictions have long excluded losses from nuclear and some chemical events, TRIA does not require terrorism insurance to cover such events.²³ Moreover, as the President’s Working Group noted, “[t]here is virtually no CNBR [sic] reinsurance available.”²⁴

The absence of insurance coverage for NBCR attacks outside of state-mandated lines and the absence of available reinsurance for this type of terrorism exposure represent a significant gap. The use of NBCR materials for a terrorist attack is a serious risk. According to RAND, “al Qaeda has long expressed an interest in the offensive employment of NBCR materials.”²⁵ Although al Qaeda has yet to demonstrate any such capability in an actual attack,²⁶ there is evidence of plans and efforts to develop it.²⁷ Models have shown that a large-scale biological attack, such as with anthrax, could generate as much as \$90 billion in losses.²⁸ Nuclear or radiological attacks could have an even more severe impact.²⁹ The RAND study concluded that the “most profound risk” of uninsured losses is in the area of a NBCR attack.³⁰

There is no evidence that the market will provide meaningful insurance coverage for NBCR risks.³¹ Indeed, as the President’s Working Group concluded, “there may be little

INDUSTRY EXPOSURE EXISTS at 20 (September 2006) [hereinafter GAO REPORT ON UNCONVENTIONAL WEAPONS]. The GAO found that “property/casualty insurers generally have attempted to limit their exposure to NBCR risks by excluding nearly all NBCR events from coverage, both for commercial property/casualty and homeowners.” *Id.* at 3.

²² See Terrorism Risk Insurance Act § 103(C)(1), Public Law No. 107-297, 116 Stat. 2322.

²³ See RAND, *supra* note 1, at 6-7 (citing Marsh, Inc., *Marketwatch: Property Terrorism Insurance Update—3rd Quarter 2004*). See also WHARTON, *supra* note 1, at 86. It should be noted that workers compensation insurance is a notable exception to this because of the mandatory scope of coverage of workers compensation insurance. See *id.* at 81.

²⁴ PWG REPORT, *supra* note 1, at 5 and 78.

²⁵ See RAND, *supra* note 1, at 30. The RAND study cites a news interview of bin Laden in which he “specifically asserted that acquiring weapons of mass destruction (WMD) was a religious duty for all Muslims.” *Id.* See also WHARTON, *supra* note 1, at 50 n. 68.

²⁶ See RAND, *supra* note 1, at 31.

²⁷ See *id.* at 31-32.

²⁸ See WHARTON, *supra* note 1, at 50.

²⁹ See *id.* The RAND study suggests that a “dirty bomb” could contaminate an area as large as ten square miles, and that demolition of contaminated buildings may be the only practical solution, resulting in huge losses. See RAND, *supra* note 1, at 33.

³⁰ See *id.* at xii.

³¹ The number of insurers offering terrorism insurance for conventional attacks rose from 73% to 91% after the adoption of TRIA, but the percentage offering coverage for NBCR remained constant a constant 35% before and after TRIA (and offering a single policy with NBCR coverage was enough to count the company). GAO REPORT ON UNCONVENTIONAL WEAPONS, *supra* note 21, at 16. One reason that as many as 35% of insurers offer some NBCR coverage is that such coverage is mandatory for workers compensation insurance and “fire following” coverage in property policies in SFP jurisdictions, and too difficult to meaningfully exclude from life and health policies. See *id.* GAO at 4. The GAO found that “NBCR risks largely fail to meet most or all of the principles of an insurable risk,” *id.* at 3, and that “insurance experts, representatives of insurers and reinsurers . . . agreed that difficulties in predicting NBCR events, as well as the prospects for catastrophic losses, make these risks difficult to insure,” *id.* at 14.

potential for future market development” for NBCR terrorism risk.³² As a consequence, if such risks are to be insured, the government must play a significant role.³³ It is true that the economy has survived for many years without such coverage, and that the government would likely provide post-disaster aid and assistance in the event of a major NBCR event. The purpose of insurance is to create incentives for risk management, and to establish mechanisms for the payment of claims in the event of covered losses. If government payment of NBCR claims is inevitable, which seems likely in the event of a NBCR terrorist attack, it would be more efficient and economical from a policy standpoint to use an insurance mechanism at least in part rather than to rely on an after-the-fact disaster relief approach.

II. A Government-Industry Partnership Can Support a Market Mechanism for Terrorism Insurance.

A. TRIA Supported a Market Mechanism for Terrorism Insurance

TRIA’s backstop approach to terrorism risk actually supported the development of the terrorism insurance market. Because of the unpredictability of a terrorist attack and the amount of losses that might be caused by such an attack, insurers have an incentive to not insure terrorism events at all, or to charge a high premium to reflect the unpredictability, where they have the regulatory flexibility to do so.³⁴ TRIA, by reducing the amount of risk to be borne by insurers, has helped stabilize the price for terrorism insurance.³⁵ Without a federal backstop, many insurers would not have provided terrorism coverage and prices could have been even higher.³⁶ From a theoretical standpoint, larger and more uncertain risks generally have higher prices reflecting the greater risk, so it is not surprising that terrorism insurance would be expensive.³⁷ Competition, in theory, provides an incentive to lower prices, but even competitive pricing for risks with high levels of unpredictability are likely to reflect a higher premium for the high risk.³⁸

By providing a backstop for catastrophic terrorism risk, TRIA improved the ability of the market to respond to this risk. One of TRIA’s primary functions was to provide access to funds to pay claims in the event of a catastrophic loss. Under the extended version of TRIA individual insurer retentions (or “deductibles”) were raised to 17.5% in 2006 and

³² PWG REPORT, *supra* note 1, at 78.

³³ This resolution and report does not take a position as to what kind of government involvement would be appropriate, only that if NBCR coverage is to be provided in any meaningful way, the government must show some leadership and play a major role.

³⁴ In more technical terms, an underwriter setting the price for insurance considers the “probable maximal loss.” In light of the September 11th attack, the probable maximal loss for a terrorist attack can be billions of dollars. Insurers want to charge fairly high premiums to take on such a large risk. TRIA, by providing a reimbursement mechanism for large terrorism losses, reduces the probable maximal loss and thereby encourages a lower price.

³⁵ See RAND, *supra* note 1, at 7 (reporting that in the first 9 months of 2002 property insurance rates dropped by 50-75%, and have continued to fall by about one-half so that by third quarter 2004 the typical prices for terrorism insurance represented about 4% of the total premium for property coverage compared to 10% the year before). See also PWG REPORT, *supra* note 1, at 1 (noting that by 2005 the cost of terrorism insurance “had dropped to 3-5% of total property insurance costs”).

³⁶ See RAND, *supra* note 1, at 9; WHARTON, *supra* note 1, Appendix 1A, at 28.

³⁷ See WHARTON, *supra* note 1, at 35-36.

³⁸ See *id.* at 87.

then to 20% in 2007, but it retained the backstop protection up to the \$100 billion annual limit. While some of the payments made under TRIA could be recouped through discretionary post-event surcharges, the availability of federal funds reduces the catastrophic front-end risk to insurers. This allows the market to address the remaining risk. Because the catastrophic risk is backstopped by the Federal government and would be spread by the industry through the TRIA mechanism, insurers are more willing to put their capital at risk while still maintaining capital for other kinds of risks (such as natural disasters).³⁹ As a result, with TRIA, more capital presumably is available in the market for terrorism insurance.

TRIA also supported the affordability of terrorism insurance in the market. By reducing the amount of front-end capital at risk, TRIA gave insurers greater capacity to offer terrorism insurance at lower prices. In addition, while TRIA did not mandate the price for terrorism coverage, it required that participating insurers offer such coverage. The combination of a reduction in an insurer's capital at risk, the requirement of mandatory offering, and competition to satisfy policyholders who were purchasing property and other insurance products, encouraged lower prices for terrorism insurance. Studies show that prices for terrorism insurance decreased after the adoption of TRIA,⁴⁰ and a greater number of policyholders purchased terrorism coverage.⁴¹ According to a several studies, the take up rates with TRIA in place have reached nearly 60% in 2006, from around 30% in 2002.⁴²

By improving availability of terrorism insurance, TRIA encouraged pre-event planning rather than reliance on after-event ad hoc governmental assistance for victims. Insurance offered before an event creates an opportunity for risk assessment and management, and market forces create an incentive to take advantage of such opportunities. On the other hand, a mechanism that operates primarily after the event, such as government aid for victims of terrorism, may work against market incentives. If potential victims rely on the government to provide aid after the fact, they may not have incentives to assess and manage their risks. By encouraging availability and use of terrorism insurance, TRIA provided opportunities to use market incentives for assessing and managing terrorism risk.

B. Without Government Support, the Insurance Market Would Not Provide Sufficient Terrorism Insurance

Under the present market circumstances the availability of terrorism insurance likely would have decreased if TRIA had been permitted to expire.⁴³ The situation may have been even worse in compulsory lines like workers' compensation insurance, where insurers would have had to choose between providing workers' compensation coverage

³⁹ For a historical summary of property losses from natural catastrophes and made-made disasters, including September 11th attack, see WHARTON, *supra* note 1, at 46-48.

⁴⁰ See *supra* note 31.

⁴¹ See *supra* note 1.

⁴² See PWG REPORT, *supra* note 1, at 42.

⁴³ See RAND, *supra* note 1, at 9; see also WHARTON, *supra* note 1, at 168 (noting that survey respondents from the National Association of Real Estate Investment Trusts reported "significant negative repercussions from non-renewal" of TRIA including loan defaults, difficulty in refinancing, and going without terrorism insurance).

including terrorism, or not writing the coverage at all. Although some reinsurers have re-entered the market for terrorism risk, reinsurers have indicated a willingness to provide only up to approximately \$6-8 billion in coverage,⁴⁴ which is a fraction of the \$25 billion industry aggregate for program year four and is only about one-fourth of the estimated \$30 billion in individual insurer retentions. Survey data shows that reinsurers are not likely to significantly increase the coverage available for terrorism.⁴⁵ Without access to reinsurance or TRIA, if actions post-September 11 are any guide, many primary insurers would take actions to avoid underwriting terrorism risk or to ration existing capacity.⁴⁶

C. Without Government Support, Some Insurers will be at Risk of Insolvency

While some insurers would voluntarily exclude terrorism risk from their policies if there is no government-industry partnership, in some states existing laws preclude insurers from excluding terrorism losses from coverage. Most workers' compensation insurance policies, for example, cannot exclude terrorism coverage.⁴⁷ As a result, a major attack could present a risk of insurer insolvency in certain markets, or, alternatively, reduced overall availability in certain insurance lines. The September 11th attack resulted in insured workers compensation losses of \$1.8 billion.⁴⁸ That exposure could be as much as \$90 billion in the event of a major nuclear, chemical, biological or radiological attack.⁴⁹ Even a conventional five-ton bomb used against a single building in New York could cause more than \$7 billion in workers compensation losses.⁵⁰ Because there is only about \$30 billion of capital available in workers compensation insurance,⁵¹ a major attack could substantially deplete or even exceed the available capital.⁵² Moreover, because only a few key insurers provide workers compensation coverage in states such as California and New York, "some insurers in these states are likely to be declared insolvent after a large terrorist attack."⁵³

A second form of mandated coverage is for certain fires in states using the Standard Fire Insurance Policy. At the time of the September 11th attacks, 29 states required commercial property insurance to conform to the coverage of the so-called "standard fire

⁴⁴ See PWG REPORT, *supra* note 1, at 26.

⁴⁵ See WHARTON, *supra* note 1, Appendix 1A, at 27-28.

⁴⁶ See U.S. DEPARTMENT OF TREASURY, ASSESSMENT: THE TERRORISM RISK INSURANCE ACT OF 2002, at 6 (2005) (nearly 50% of insurers responding to a treasury survey said that they do not plan to write terrorism coverage after TRIA expires; 25% of policyholders indicated that their current terrorist coverage excludes coverage after the expiration of TRIA) [Hereinafter TREASURY REPORT].

⁴⁷ See WHARTON, *supra* note 1, at 81 (noting that workers compensation insurance "is mandatory for a large majority of employers in all states except Texas where it is optional").

⁴⁸ See TREASURY REPORT, *supra* note 42, at 26, Figure 2.9 (relying on data from the Insurance Information Institute).

⁴⁹ See WHARTON, *supra* note 1, at 50; see also Towers Perrin, *Workers Compensation Terrorism Reinsurance Pool Feasibility Study: Summary of Study Findings and Conclusions* (March 2004) (available at http://www.towersperrin.com/tillinghast/publications/reports/WC_Terr_Pool/WC_Terr_Pool_Study_ES.pdf) [last visited Nov. 4, 2005].

⁵⁰ See WHARTON, *supra* note 1, at 99, Figure 6.4.

⁵¹ See Towers Perrin, *supra* note 47.

⁵² See *id.*

⁵³ See WHARTON, *supra* note 1, at 113.

insurance policy.”⁵⁴ This requirement mandates that property insurance provide coverage for fires that ensue from a terrorist event even if other damages from the terrorist events are specifically excluded by the policy.⁵⁵ After TRIA was adopted, twelve states modified their statutes to exclude in various ways coverage for events of ensuing caused by acts of terrorism.⁵⁶ This leaves ensuing fire coverage for terrorism events mandated in 17 states. If reinsurance or some other kind of pooling mechanism like TRIA is unavailable for insurers in these states, a major terrorist attack may force some property/casualty insurers into bankruptcy.⁵⁷

III. The Government-Industry Partnership is Consistent with National Interests

Because the government-industry partnership would help to reduce the risk of insolvency for insurers selling certain lines of insurance or issuing such coverages in certain states, some critics of TRIA try to characterize it as an “industry bailout” bill. Such rhetoric is both overblown and misplaced. After September 11, and prior to enactment of TRIA, in 45 states and the District of Columbia, regulators approved exclusions for terrorism risk.⁵⁸ It is therefore reasonable to assume that without sufficient reinsurance or another financial loss-sharing mechanism such as the Federal backstop, most insurers could simply exclude terrorism risk from their coverage.⁵⁹ This is exactly what happened prior to TRIA’s adoption. Because of the unavailability of terrorism risk insurance, for example, banks were hesitant to lend on major construction projects, which created a “drag” on the U.S. economy.⁶⁰ As with the adoption of TRIA, a government-industry partnership to curtail the financial losses of another terrorism attack is there to benefit the economy rather than to benefit the insurance industry.

In addition, terrorism is a national threat that justifies a Federal response. As explained above, terrorists try to create fear and terror by undertaking surprise attacks. Thus, they could strike anywhere at virtually any time. Moreover, in addition to creating fear or terror, these attacks are increasingly aimed at the U.S. economy.⁶¹ Thus, even though

⁵⁴ See WHARTON, *supra* note 1, at 85.

⁵⁵ See, e.g., Opinion Regarding Commercial Property Insurance Terrorism Limitation for Fire Following, General Counsel, New York State Insurance Department, June 26, 2003, available at <http://www.ins.state.ny.us/rg030627.htm> [last visited Nov. 4, 2005].

⁵⁶ See WHARTON, *supra* note 1, at 85. Amendments are under consideration in additional states. *Id.*

⁵⁷ See Insurance Information Institute, Updates and Releases, *Terrorism Coverage is a Taxpayer – Not Insurance Company – Responsibility, Industry Forum Told*, Jan. 23, 2002 (available at www.iii.org); *California, New York take Big Risks on Terrorism Policies*, National Underwriter – Property Casualty, Jan. 24, 2002, at 24. Richard J. Hillman, *Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities*, United States General Accounting Office Report, Testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives, February 27, 2002, at 7 (reporting that the NAIC found that a \$25 million loss for a single primary property/casualty insurer would threaten the solvency of 886 companies, or 44% of the companies writing commercial property/casualty insurance) (available at www.gao.gov).

⁵⁸ See Hillman, *supra* note 55, at 5.

⁵⁹ As noted above, Workers Compensation insurance and fire following property coverage is an exception.

⁶⁰ See Joint Economic Committee of the U.S. Congress, *Economic Perspectives on Terrorism Insurance* (2002) (available from the Government Printing Office); see also Robert P. Hartwig, *The Impact of the September 11 Attacks on the American Insurance Industry*, in *INSURANCE AND SEPTEMBER 11 ONE YEAR AFTER: IMPACT, LESSONS AND UNRESOLVED ISSUES*, at 28-29 (Patrick M. Liedtke & Christophe Courbage, eds., 2002); Hillman, *supra* note 55, at 9.

⁶¹ See RAND, *supra* note 1, at 21-23.

owners of property that is damaged by a terrorist attack suffer more directly and significantly than those who don't own property, all property owners are at risk of a terrorist loss and all U.S. residents potentially suffer the economic consequences of an attack, which can be mitigated to some extent by the availability of insurance.⁶²

Finally, the government, because of its massive national security apparatus, is in the best position to do something about terrorism risk. Because the Federal government has better access to information and can use the information to reduce the risk of attacks, the government provides meaningful benefits by partnering with the insurance industry to provide terrorism insurance. The Federal government also has access to very large amounts of capital, and can use its broad powers to rebuild or repay the capital. Moreover, experience has shown that the government will likely provide assistance to victims of a major terrorist attack, so if the Federal government is going to be involved after the attack, it behooves the Federal government to be involved prior to the attack in order to receive the benefits of advance planning, risk management, capital accumulation, and the opportunity to use the underwriting and claims expertise of the insurance industry.

Respectfully submitted

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⁶² See RAND, *supra* note 1, at 58.