

Slide 1: Introduction

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Good afternoon and thank you for the opportunity to speak to you today on Treasury's progress and plans for implementing the Terrorism Risk Insurance Act of 2002.

On November 26, 2002, President Bush signed TRIA into law.

With an estimated \$40B in insured losses as a result of the events of 9/11 the market for terrorism coverage became severely disrupted.

However in addition to wanting to address Insurance industry disruptions, the Congress and the President recognized that such wide spread dislocations in insurance markets also had a negative impact on business' ability to finance economic activity and recovery.

TRIA was therefore enacted to stabilize the availability of insurance protection as well as to stabilize the overall economy.

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TRIA effectively places the Federal Government temporarily in the terrorism risk reinsurance business:

- The program provides coverage for P&C commercial lines losses including workers' compensation.
- Coverage is triggered when the Secretary of the Treasury the Secretary of State and the Attorney General together certify that an act of terrorism carried out on behalf of a foreign interest has occurred:
- This terrorism generated loss must be greater than \$5M
- And. the event must have taken place in the US, or a US foreign mission, or on a US air carrier or vessel.

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Like any program there are restrictions.

- Deductibles increase over the 3 year term of the program and are expressed as a percent of an insurer's direct earned premium.
- The Federal Governments share under the program is equal to 90% of that portion of insured losses that exceed the insurer deductible.
- The program is scheduled to end on December 31, 2005
- Many of you here today believe that all federal programs last forever. However the Former Riot Reinsurance Program and the Former Federal Crime Insurance Program are 2 examples of government insurance mechanisms that have been discontinued when it became clear that their temporary mission had been fulfilled.

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One of the least understood aspects of TRIA is the requirement that The Secretary of the Treasury must recover some if not all Federal payments made under the act.

To illustrate lets assume there is a \$20B covered loss during the 3rd year of the program

Further assume that 100 insurance companies were exposed to that loss and that their collective direct earned premiums totaled \$20B.

The third year deductible (15% of DEP) and the 10% quota share for these 100 companies totals \$4.7B.

Under this example Treasury would pay \$15.3B, which is the difference between the total insured loss and the losses paid by the 100 involved companies.

However, under the law Treasury is required to recoup \$10.3B which is the difference between the industry aggregate retention of \$15B and the \$4.7B paid by the 100 companies.

To accomplish this all companies covered under the program would impose up to a 3% premium surcharge on all commercial policy holders until \$10.3B had been recouped and paid to Treasury.

Additionally depending on economic considerations the Secretary of the Treasury has discretionary authority to impose additional recoupment surcharges and could recoup up to the entire \$20B loss.

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The Terrorism Risk Insurance Program is under Treasury's Department for Domestic Finance (headed by Acting Under Secretary Brian Roseboro) and the Office of Financial Institutions (headed by Assistant Secretary Wayne Abernathy).

TRIP's responsibilities include all of the operational functions necessary to effectively implement and manage the program, including all claims management and processing functions, as well as all auditing functions

TRIP is in essence the insurance company created by the new law.

Treasury's Office of Economic Policy will be conducting studies associated with coverage issues under TRIA and the overall effectiveness of the program.

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As you know Treasury has completed their study on whether to include group life insurance in the program and concluded that at this time Group life will not be included.

However another study is about to begin which will over a 3 year period attempt to analyze the effects of the program on the insurance industry, consumers, and business in general.

The ultimate purpose of this study will be to assess the capacity for the insurance industry to offer insurance for terrorism risk after the program expires.

The study will begin in November and the information gathered from insurance companies, insured's, and producers includes:

- Cost of terrorism coverage as a share of the total risk
- Limits of coverage
- Reinsurance availability
- Reasons coverage purchased or not purchased
- Capacity of coverage in the private market

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The *Treasury department* has been extremely active in implementing the regulations necessary to support the new act.

The first Final rule was published on July 11, 2003

Among other things this rule addresses:

- Guidance on the Lines of Insurance covered under the act
- Which entities are eligible for participation
- Control and affiliation issues

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One of the first things that had to be defined under the act was what constitutes a P&C insurer.

for purposes of the act an insurer is any entity that is:

Licensed or admitted for primary or excess insurance in any state

A surplus lines carrier on the quarterly NAIC listing of alien insurers

A State residual market or workers compensation fund

Altogether well over 2000 insurance companies are participating in the program.

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One of the most discussed issues in the new regulations was the definitions of affiliate and what constitutes control.

The issue is important because it goes to the heart of understanding the appropriate deductible to assign various affiliated insurance groups. In passing TRIA Congress wanted to make certain that assessing the appropriate deductibles was critical to the success of the Act

Conclusive Control Exists

- If an insurer has power to vote 25% or more of any class of voting securities of the other insurer.
- If an insurer controls the election of a majority of the Directors or Trustees of the other insurer.

Presumptive Control Exists

- If the Secretary of the Treasury determines that an insurer exercises a controlling influence over another insurer.
- In determining presumptive control The Secretary will consider approximately 11 other factors outlined in the regulations the presence of any 2 could lead to a determination of presumptive control

In our efforts to bring equity to all program participants we will do all that is necessary to maintain the integrity of insurer deductibles under the program

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However we do understand that these rules and regulations can be confusing and that honest minds can differ over the meaning, intent, and interpretation of all aspects of the program.

In fact these rules envision that there will be some confusion over many issues including the definition of an insurer and what constitutes a controlling interest.

We continue to receive many questions on these and many other topics. So if after reviewing these regulations in some detail you still have questions you may request an interpretation of the regulations as they apply to your specific situation.

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The ink was not dry on the first final rules when on October 17, 2003 we published a second and third set of rules which address and such issues as:

- Make available requirements
- Disclosure requirements
- State residual markets

These topics were the subject of interim rules which most of you are familiar with so I will not elaborate on them further here.

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We have also released for public comment A fourth round of rule making which will address proposed claims regulations including some program Audit requirements.

These proposed claims regulations seek comments from all interested parties on the issues you see on the slide. As in any rule making procedure a final rule will be released only after all comments are considered.

In our draft rule we are proposing that claims made under the program be processed and paid in a manner highly consistent with what you now experience with the reinsurance industry.

In implementing all of the requirements necessary to pass our own audits, as well as the expected GAO audits, we will be mindful of current insurance industry practices standards and needs.

We will do our best to meet those needs as well as protect the people's assets without overreaching.

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Altogether there are about 15 steps to implementing new government regulations and the process can take several months

Unfortunately this process is really never ending.

Thousands of pages of rules, definitions, procedures, and regulations will be drafted, debated, and finalized over the next 3 years. And believe me there are still many issues to deal with.

However even though the overall process can be lengthy I am proud to point out that the TRIP staff completed the initial draft of these proposed claims regulations in only 21 days

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Even though much has been accomplished, considerable work remains. Many in the industry have expressed concerns over such program issues as:

- Adverse selection
- Continued lack of reinsurance availability
- Huge exposures particularly in worker's compensation
- Affordability

In fact most of these issues have been volatile at various and numerous times in the past.

TRIA was passed in part to address them. *These issues are in fact characteristic of other past Federal and state Insurance programs.*

I believe that over time the free market, with help from this program will help solve these problems.

Helping the private sector build capacity and stabilize the market. was precisely what the Terrorism Risk Insurance Program was designed to accomplish.

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Right now, what keeps me awake at night are operational issues. We have a huge amount of work ahead of us and not very much time to accomplish it.

In addition to having a tremendous amount to accomplish to get our program up and running we have also had to put emergency procedures in place so that should there be a loss before we are fully operational we will be able to respond to that loss.

In essence this means working on a duel approach to make certain we are prepared.

Looking at some of these operational issues I am pleased to note that we have completed the recruiting and hiring of the TRIP staff.

We have put emergency procedures in place.

And concurrent with proposing claims regulations we have begun the process of implementing a physical plant which will be positioned to process the payment of claims should it become necessary to do so.

In creating this physical plant however we will not be creating a huge federal infrastructure.

Rather we will establish a virtual company that permits us to form new partnerships with the private insurance sector, harnessing that Insurance Industry's talents and skills to make this an effective streamlined operation.

Conclusion:

Hopefully I have provided you some insight today into this new government program and the efforts required to make it operational. As I mentioned earlier much work remains.

Like all of you I sincerely hope and pray that this program will *never be tested*.

However we will be prepared and as in the past I look forward to working with the industry on this new venture and in closing thank you for your time here today as well as for your future support.