Slide 1: Introduction

Slide 2:

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 wide spread dislocations in insurance markets such 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.

Slide 3:

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.

Slide 4:

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.

Slide 5:

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.

Slide 6:

The Terrorism Risk Insurance Program is under Treasury's Department for Domestic Finance

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.

As you know Treasury has completed the 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 has begun which will 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 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 and industry capacity
- Reasons coverage purchased or not purchased

Slide 7:

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

Slide 8:

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.

Slide 9:

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

Slide 10:

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.

Slide 11:

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. The comment period has ended on the proposed claims rules. However as in any rule making procedure a final rule will be released only after all comments are considered.

In our draft rule we proposed 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.

Slide 12:

We received numerous comments representing most segments of the Insurance Industry.

Some Companies asked us to consider paying the federal share in advance of the insurance company payment of a loss.

Others objected to Treasury’s methods for avoiding duplicate federal payments.

Some were confused about paying one entity in a group affiliation

And others were concerned about methods for processing claims of residual Markets

I cannot at this time tell you the outcome of the discussions we have had in response to these issues I can tell you that serious and thoughtful consideration was given to each and in every instance our goal was to find a way to respond in a helpful manner.

Slide 13:

We have also released proposed rule # 5 which addresses Litigation Management under the act.

With one exception this regulation tracks the act as passed by Congress

However in addition to signing the legislation the President issued a memorandum to the Secretary of the Treasury asking him to promulgate a rule giving the Secretary the Authority to Approve settlements of Federal causes of action.

That Additional Authority is included in the proposed regulations on settlements for personal injury over $1M and for settlements over $5M for property damage

Slide 14:

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 will be drafted, debated, and finalized over the next 3 years. And believe me there are still many issues to deal with.

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Slide 15:

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.

Slide 16:

There are also what I consider to be market related issues

Who is buying this terrorism and why

Is pricing too high and is it market driven or driven by the underwriting risk

Finally: Should the Secretary of the Treasury extend into 2005 the mandatory make available provision of the Act.

I have my own opinion as to this third issue but to make certain we hear from as many interested parties as possible we intend to publish a request for comments to seek the opinions of all interested parties in order to make the most informed recommendation possible.

As to questions of who is buying and is the price too high we can look to some large US based brokers who have been tracking the evolution of the program.

Generally the Brokers are finding:

- Access to coverage is improving
- The market is becoming more competitive

More specifically:

- Pricing is in the 10% - 15% of premium range
- Low risk profiles are as low as 2% of premium
- Target risk rates for commercial real estate Has been in the 10% - as high as 50% but trending down

Slide 17:

In addition to program issues and market issues we still have good old 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.

Slide 18:

And finally we have future issues

Under any program to deal with terrorism a discussion must take place in the US to determine what if anything should be done with the exemptions from coverage in some states for nuclear biological and chemical attacks.

Currently TRIP follows the laws in the respective states because we did not want to be in the business of regulating insurers. This does create coverage gaps sine TRIP will cover these NBC attacks if they are not exempt from coverage in a particular state.

The debate still rages about what to do when TRIP expires.

- New insurance pools to provide terrorism coverage have been set up in France, Germany, Austria, and Switzerland.
- The UK and Spain already had a state insurance facility.
- Australia has a reinsurance Pool.

Many concepts have been debated in the US as a replacement to TRIP including some of the ideas you see on the slide before you. The Administration has not taken a position on these alternatives so neither at this time will I.

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.