TRIA at Ten Years: The Future of the Terrorism Risk Insurance Program
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Chairman Biggert, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to appear before you today on behalf of The Hartford Financial Services Group (The Hartford) and our property-casualty insurance trade association, the American Insurance Association (AIA), to discuss the important issue of terrorism risk insurance. My name is Christopher Lewis and I am Senior Vice President and Chief Insurance Risk Officer for The Hartford. Founded over 200 years ago, The Hartford is one of our nation's oldest insurance companies, among the largest commercial property-casualty insurers, and an insurance partner to over one million small businesses across the United States.

In my capacity as a chief risk officer, I believe that I can offer an important perspective on why terrorism risk remains a unique and uninsurable risk, describe the limited tools available to insurers to manage that risk, explain the market stabilizing value of the program established by the Terrorism Risk Insurance Act of 2002 (TRIA) and its successors, and underscore the importance of maintaining this essential program into the foreseeable future to protect our economy in the event of another major terrorist attack on U.S. soil.

The Insurance Industry's Response to September 11, 2001
Today marks the 11th anniversary of the tragic attack on September 11, 2001. That event forced all Americans to confront directly the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil – quite literally, to face a new form of war. Despite the unanticipated nature of the event, The Hartford and other insurers responded to September 11 claims in an unwavering manner and without a single dollar of federal assistance.

However, the devastating economic consequences of the attack forced insurers and other businesses to re-examine the nature of terrorism-related risks, as well as to review how such risks were being spread and managed.

In today's dollars, the September 11th attack is estimated to have resulted in almost 3,000 deaths, as well as over $23 billion in insured property loss and $40 billion in total insured loss[1] The Hartford's share of this loss was approximately 3 to 3.5%, as we helped our policyholders recover from the tragic loss. Of course, a large portion of the insured industry loss was effectively reinsured, and the reinsurance industry honored its obligations.

Unfortunately, in the aftermath of the attack, the reinsurance markets withdrew new capacity and the reinsurance market for terrorism evaporated. Without the ability to spread and diversify these risks globally through reinsurance and with no ability to price the risk of terrorism, insurance companies were unable to provide adequate terrorism coverage to commercial

[1] Source: Insurance Information Institute, 2010 dollars excluding Victims Compensation Fund

policyholders. The effects of this chain of events trickled down to lenders and the construction industry, putting a significant drag on the economy. To support the economy and allow private markets to stabilize, Congress stepped forward in bipartisan collaboration and passed the Terrorism Risk Insurance Act of 2002 (TRIA).

TRIA provides a federal backstop to insurance companies for large certified terrorism events - above a $100 million loss - while requiring insurers to “make available” (offer) terrorism insurance to commercial policyholders for such coverage as business interruption and property insurance. Under the current program, insurers would need to absorb an estimated $25 to $30 billion of insured losses before the federal government begins to share the losses. Put another way, a terrorism loss would have to be larger than $25 to $30 billion before the federal government would be called on to make any payment. Even then, TRIA requires each insurer to pay 15 cents on every dollar of loss above its deductible, and then provides a recoupment mechanism to recover federal dollars that are expended.

By creating a post-event pooling mechanism that preserves significant industry “skin in the game” and only accesses federal dollars for extremely large-scale terrorism losses, the Act allows insurance companies to understand and manage their potential exposure to losses attributable to terrorism attacks while providing a cap on the potential loss to capital from such an attack. As a result, insurers are able to offer terrorism coverage to commercial policyholders while TRIA provides the all-important market stability.

In the event of a future terrorist attack, TRIA ensures that private insurance payments flow to those affected businesses that have purchased coverage, as well as to their employees, which in turn helps businesses and the economy recover. These payments will be crucial to minimizing the economic, psychological, and social fallout from an attack. At the same time, if an attack is so massive that it triggers the federal protection established by TRIA, government payments are ultimately recaptured through a recoupment mechanism that was established in the legislation. This greatly mitigates any costs of this federal program.

It is important to emphasize that taxpayers are protected at every step under TRIA. First, they benefit from the economic security that insurance coverage provides before an attack. Second, after an attack occurs, the immediate flow of claims payments provides stability and minimizes economic disruptions to those who suffer from the attack directly as well as to all Americans. And finally, in the event of a catastrophic terrorist attack that triggers the government program, any dispersed federal funds are ultimately repaid through TRIA’s recoupment mechanism. Thus, TRIA is both a sensible and indispensable component of national economic security.

Terrorism Risk is a Unique, Uninsurable Risk

A public-private solution is necessary for the risk of terrorism because, from an insurance perspective, terrorism does not meet the core characteristics of a privately “insurable peril.” Private insurance markets are founded on the ability to (a) measure the likelihood and potential severity of loss to a policyholder for any specific peril and then (b) to effectively pool the loss experience across many policyholders exposed to relatively *homogeneous*, *random* and *independent* risks. Quite the opposite, terrorism involves an intentional act carried out at the direction of individual actors and groups with the explicit intention of maximizing overall loss of life, property, and economic disruption across as many insureds as feasible. Terrorists can pick the target, change the target at will to bypass security, and coordinate an attack on multiple targets in diverse locations. As result, terrorism, like war risks, fails the basic requirements for “ex ante” (before the event) pooling in the private insurance markets.

- Insurers lack any basis for assessing the likelihood or probability of a major terrorist attack, especially given the limited information that is publicly available. While insurers can price insurance when the nature of the risk is estimable but highly uncertain, ex ante insurance mechanisms fail when there is no credible basis for assessing the likelihood of an event.
- The potential magnitude or severity of large scale terrorist attacks, particularly those that involve the use of unconventional weapons involving nuclear, biological, chemical, and radiological (NBCR) agents, is largely unknown given the fortunate dearth of prior experience. While insurers can manage loss aggregations for "conventional" attack modes, the industry has limited information on managing exposures to wide-area loss event scenarios that would be the hallmark of NBCR attacks.
- Given the concentration of insured lives and property values in business centers, the risk of wide-area terrorism attacks poses a real solvency threat to insurers -- a threat that can easily eclipse that of natural disasters given the stated intention of a terrorist to exact maximal economic disruption.
- The interdependent nature of terrorism risks limits the markets' ability to rely on mitigation to manage exposures. Hardening a potential target may simply cause a terrorist to shift to a softer target or shift the manner of attack. Moreover, since a portion of a terrorist objective is to wage psychological war, the terrorist attacks can be directed throughout the U.S. – from New York City, to Chicago, to San Francisco and to the main streets of any town in between.

Limited Risk Management Tools are Available
Even with the existence of TRIA, insurers' ability to manage terrorism risk is limited. From a coverage perspective, while TRIA requires a mandatory "offer" as a condition for participation, state laws actually mandate coverage for terrorism for certain lines of insurance. For example, in the 49 states that require workers' compensation insurance, on-the-job injuries are covered without exclusion, whatever the cause. Further, a number of states (including those with significant business centers) mandate that insurers cover terrorism-created fire losses, even if a policyholder does not purchase terrorism coverage. As a result, while an insurer may exclude NBCR terrorism coverage in some states, losses caused by the fire following an explosion from one of these perils would be covered.

Second, as noted above, the industry's lack of credible methods for assessing the likelihood of an attack limits our ability to determine an actuarially fair premium. As noted by the most recent report on terrorism risk insurance market conditions from the President's Working Group on Financial Markets (PWG Report), "despite the reported improvements in modeling to measure an insurer's aggregate loss exposure, the industry remains uncertain about the reliability of probabilistic models to predict frequency and severity of terrorist attacks."

Third, reinsurance capacity for terrorism losses is minimal. Citing many of the same issues identified above for primary insurance companies, reinsurance companies offer extremely limited capacity for terrorism risk and generally do not offer coverage for terrorist attacks committed with NBCR weapons. According to the PWG report, reinsurance capacity available for terrorism risk remains in the $6 billion to $10 billion range, an amount that is well below the estimated industry-wide retention figure under TRIA.

To provide some perspective, The Hartford's 2011 retention under the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) is approximately $1.1 billion in company losses. With respect to property, terrorism reinsurance of any material amount within this retention is effectively non-existent. In contrast, for natural catastrophe losses, The Hartford's principal corporate catastrophe treaty provides just under $700 million in reinsurance protection in excess of a $350 million deductible. The Hartford has an additional $400 million in reinsurance protection above $1.1 billion financed through non-traditional reinsurance markets (e.g., catastrophe bonds). As the person in the company responsible for purchasing reinsurance protection for The Hartford, I can attest that I wish that the reinsurance markets were willing to provide the same capacity for terrorism within our TRIA retention as is available for natural catastrophes. But the reinsurance capacity is simply not available. The recent PWG report is interesting in that it indicates that the total amount of reinsurance capacity is up slightly from prior studies. The small increase in reinsurance capacity, undoubtedly available to smaller companies, actually demonstrates the value of the TRIA program to "crowd in" additional reinsurance capacity – that is, it provides reinsurers some assurance that the reinsured companies can manage through a large scale event and remain viable trading partners after a loss.

Given these challenges, how do insurance companies manage the risk of terrorism today? The main tool available to manage the risk of terrorism is to limit exposure concentrations in potential "high target areas." If terrorism exposure concentrations get too high relative to surplus, an insurance company could non-renew entire commercial policies to reduce the terrorism exposure – often creating hardships for the underlying policyholders. These exposure concentrations are especially difficult for certain lines of business like workers' compensation and fire following coverage in certain states where exclusions for NBCR attacks are not recognized. Over the past 11 years, with the benefit of TRIA, the insurance industry has successfully managed these concentrations of exposure within the TRIA retentions. Policies shed by one company have generally been absorbed by a competitor.

Without TRIA, however, individual insurers would face large uncapped exposure and would face difficult choices about how to manage down exposures relative to capital, including facing decisions on whether or not to non-renew large portions of their commercial policyholder portfolios, especially given the fact that they cannot exclude the peril of terrorism from workers compensation coverage and fire following coverage in a number of states. For the record, we do not believe that this outcome would be in the best interests of our policyholders or the overall economy.

Bottom Line: TRIA Has Worked

Almost ten years into TRIA, there should be no doubt that the program has brought stability to the private market and has enabled insurers to provide capacity despite the unique characteristics of terrorism risk. As the President's Working Group concluded at the end of 2010, "the Program provides incentive to property and casualty insurers and reinsurers who might not otherwise provide terrorism risk insurance at current capacity levels, or at current prices, absent Federal support or State law mandates. It does this by providing some degree of certainty of an insurers' maximum loss exposure." TRIA has been shown thus far to be a successful partnership among the federal government, insurers and policyholders to protect the economy in the event of an attack. Thanks to TRIA and its successors, The Hartford has been able to manage our terrorism exposure within acceptable limits while supporting our policyholders' need for terrorism coverage. In 2011, The Hartford's take-up rates for terrorism insurance were over 98%.

As a nation, we can take some comfort in the fact that since 9/11 and despite numerous attempts, terrorists have not succeeded in attacking U.S. interests on our soil. Other countries in the world have been less fortunate. The inescapable conclusion is that as long as this terrible risk threatens our way of life, we must fortify our economy against the potential consequences. TRIA and its successor programs have been very successful and continue to make terrorism coverage widely available. It is essential that the program is maintained so that the United States can enjoy national economic security for years to come.