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On Behalf of the Property Casualty Insurers Association of America (PCI)

Subcommittee on Insurance, Housing and Community Opportunity
Committee on Financial Services
United States House of Representatives
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Chairman Biggert, Ranking Member Gutierrez, Members of the Subcommittee:

Thank you for the opportunity to testify today on terrorism insurance issues. I am Michael Lanza, Executive Vice President and General Counsel of Selective Insurance Group, Inc. Selective is the 49th largest property and casualty insurance group in the country. I am testifying today on behalf of our national trade association, the Property Casualty Insurers Association of America (PCI), which represents approximately 40 percent of the nation's home, auto, and business insurance market.

Today we memorialize the anniversary of the tragic 9-11terrorist attack that killed thousands and resulted in economic devastation greater than any insured loss in history. With economic investment freezing, President Bush asked Congress to immediately enact legislation to protect our country's security. This Committee responded swiftly and passed the Terrorism Reinsurance Act, or TRIA, in just 2 months. In September 2002, the House adopted the TRIA conference report by voice vote. In 2005, and 2007, the House voted overwhelmingly to renew this important national security program. These three House votes passed by wide margins under different majorities – and reflect TRIA's historic bipartisan support.

In the last 11 years, the threat of terrorism has not receded. Dozens of terrorist attacks against our nation are attempted annually, with terrorists evolving new strategies to circumvent federal security. TRIA is a low-cost, fiscally prudent terrorism safety net that protects our nation's economic security. Absent its extension, insurance policies will begin in 2013 to exclude terrorism coverage or, to the extent permitted under state law, not be renewed for major underlying risks.

PCI and Selective strongly believe in the private insurance market. We also believe that the private insurance market can adequately cover risks that are fully insurable. Fully insurable risks are those for which a private insurer can adequately predict the likelihood and severity of a loss. We know terrorism when we see it, but it is difficult to define. Is it a crime or an act of war? Neither, however, is generally insurable – let alone fully insurable – in the private insurance market.

Some Committee Members who have philosophical concerns about government programs that support or displace private markets may have some philosophical doubts about TRIA. TRIA, however, is essential to the private insurance market because terrorism is not a fully insurable event. The likelihood and severity of terrorist attacks cannot be adequately predicted. Terrorism in the 9/11 form, which is what TRIA was designed to address, is an inherently unpredictable political act designed to frighten the nation's security and public through death, mutilation, and the destruction of public and private property. We know that after 9-11 the federal government set up costly victims' protection funds where private coverage was inadequate. TRIA has been the government's best security protection to keep the private sector largely responsible – and avoid future federal post-event bailouts.

National security is the primary responsibility of the federal government – not the private insurance market. Our national security apparatus is focused on anticipating and preventing terrorist acts and assessing the probability and severity of such events against major economic centers and public and private symbols of our country. These government agencies gather and have access to classified intelligence information not available to the private insurance market. Insurers analyze exposure to hypothetical terrorist events, but insurers don't have access to this sort of intelligence information necessary to predict the acts of terrorists. Our policyholders who purchase TRIA coverage (and in Selective's case that is 86% of our Commercial Lines policyholders and the mandated 100% of our workers compensation policyholders) also do not.

The pool of potential terrorists and the risk of terrorism are not static. They change based on U.S. domestic and foreign policy – which is constantly evolving. These policy changes, coupled with technological developments, can also lead to new forms of attack. The scope and breadth of these policy changes cannot be adequately predicted or tracked by the private insurance industry. Companies such as Selective, which writes primarily in 22 states east of the Mississippi and has approximately $1.6 billion in premium, certainly don't have the resources to do so. And Selective's small business clients, who pay an average of $10,000 for 3 commercial policies, certainly do not. This is why they need TRIA.

Let me elaborate on this. To be insurable, events must be predictable in frequency and severity. Property casualty insurers can estimate, based on experience, roughly how many car accidents, house fires, and industrial accidents will occur in a year and what their costs will be. With over a hundred years of weather history and free access to weather pattern science, the industry can also model storm paths and predict weather losses. This experience, and access to factual evidence and trends, however, does not exist for terrorism. In fact, only one data point exists for a catastrophic terrorist event – and that happened 11 years ago today.

Another difference between fully insurable events and terrorist acts is that insurable events are generally not correlated. That means they are random and independent of each other. For example, the likelihood of a hurricane in Florida is not correlated with the likelihood of an earthquake in California. The likelihood of correlated terrorist events is known and was demonstrated 11 years ago. Coordinated attacks can cause more terror, thus simultaneous attacks on New York City and Washington. Correlation of occurrence is another reason why we believe TRIA is required.

While *some* terrorism coverage is available in the private market now, it is not widely available for the reasons I have discussed – and because the potential losses are so large. Industry models have shown potential losses for another major terrorist event to be up to $250 billion. That figure is more than half the surplus for the entire property casualty insurance industry. Without TRIA, the private insurance market would have significant difficulty handling a loss of that magnitude.

There are three additional points about TRIA that I would like to make:

1. **TRIA Is Fiscally Responsible.** To date, TRIA has not cost taxpayers one cent in direct payments. If losses were to occur, the private insurance market would repay any government assistance up to $27.5 billion. According to the CBO, TRIA's net cost to taxpayers through 2017 is roughly zero. That's not bad for a program that helps ensure hundreds of billions of dollars in annual insurance coverage. In the absence of TRIA, taxpayers would face much more exposure. Without private insurance, the Federal government will step in to assist in a disaster. That means the demand for government assistance will be greater without the possibility of any TRIA recoupment.

2. **TRIA Protects Private Sector Growth.** The impetus behind TRIA was to prevent severe terrorism-related economic disruptions. Insurance is a substitute form of capital that supports balance sheets and permits businesses to own properties and engage in activities, such as hiring and business expansion, they might not otherwise do in its absence. Moreover, insurance permits immediate rebuilding after a loss. Without TRIA, insurers may simply exclude terrorism coverage or not renew policies covering major commercial risks to the extent permitted under state law. That means if there was a terrorist act, there would be less private capital to rebuild, which is key to the economy, economic development efforts, and public morale.

3. **TRIA Is Vital to Keeping the Cost of Workers Compensation Down**. State workers compensation laws mandate coverage for terrorist acts that occur in the workplace. Without TRIA, it will be very difficult to obtain reinsurance in the private market. This could lead insurers, where possible, to exit the workers compensation market. For those that remain in the market, the extent of losses could impair the ability to pay the claims of injured workers. Just as insurance is substitute capital for business, reinsurance is substitute capital for insurers. Without it, more capital would be required to support workers compensation writings. This would certainly drive up the costs of workers compensation insurance. This could be a significant impediment to economic recovery, particularly as it impacts small businesses.

Given what terrorism is, the private insurance markets cannot provide terrorism coverage without TRIA. TRIA is a critical national security and economic development program in which the private insurance market is proud to participate. PCI stands ready to assist you as you continue your deliberations. Thank you very much.