Consumer Federation of America
1620 I Street, N.W., Suite 200 * Washington, DC 20006

September 18, 2007

RE: URGE "NO" ON UNNECESSARY TERROR INSURANCE SUBSIDIES IN H.R. 2761, HOUSE FLOOR CALENDER NO. 201

Dear Representative:

The Consumer Federation of America (CFA) writes to express its strong opposition to legislation that will soon be voted on by the House to dramatically expand the Terrorism Risk Insurance Act (H.R. 2761) and extend it for 15 years. **There is strong evidence that TRIA already provides a generous and unnecessary subsidy to overcapitalized insurers and large real estate developers.** CFA estimates that TRIA has resulted in more than a $4 billion loss to taxpayers since 2002 because the program has granted reinsurance to insurance companies at no charge. Last week, the Congressional Budget Office (CBO) estimated that the net loss to taxpayers under H.R. 2761 would be an additional $8.4 billion over ten years (CBO has not even calculated what the taxpayer subsidy will be because H.R. 2761 continues the provision of free reinsurance).

It is extremely difficult to justify such enormous taxpayer assistance to an industry that has an unprecedented financial capacity to handle terrorism losses and has been criticized for operating in bad faith in many cases after Hurricane Katrina. Insurer profits and surplus since 2004 have been the highest ever recorded. In the last three years, property/casualty insurance profits were $158.1 billion, an amount that is more than $500 for every American.[1] Despite this fact, over ten thousand homeowners along the Gulf Coast have filed lawsuits or complaints with the state alleging that insurance companies used improper claims settlement practices.

We urge you to sharply cut back and reconfigure TRIA to cover truly catastrophic terrorism losses rather than enlarging and extending it for a lengthy period of time. Market conditions are ideal for the House to reduce government assistance in order to spur the growth of the private market for terrorism insurance and protect taxpayers. As the Department of the Treasury has reported, terrorism risk insurance is much more available and affordable since the initial response to the September 11th attacks, even though insurer retentions have increased and federal assistance has declined.[2] As a result, the "take up" rate by policyholders buying terror

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[1] "Property/Casualty Insurance in 2007: Overpriced Insurance, Underpaid Claims, Declining Losses, and Unjustified Profits," Consumer Federation of America, January 8, 2007. http://www.consumerfed.org/pdfs/2007Insurance_White_Paper.pdf.

[2] "Terrorism Risk Insurance: Report of the President's Working Group on Financial Markets," September 2006. U.S. Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002."

insurance coverage has increased to over 50 percent. Further, terrorism insurance rates continue to fall even with the higher retentions and triggers they must meet at the beginning of the year under TRIA.[3]

By contrast, when Congress enacted TRIA in 2002, the insurance industry was in some financial trouble. Rates for commercial insurance were rising fast, often by double-digit amounts. In 2007, commercial insurance rates are declining by double-digits.[4] In 2002, the surplus (retained earnings) of the property/casualty insurance industry was $290.6 billion, now it is $494.8 billion, over a $200 billion growth in retained earnings since TRIA was passed.[5] Many property/casualty insurers are buying back their stock because they are overcapitalized, including Allstate,[6] Progressive,[7] and Safeco.[8]

As TRIA has developed since its enactment in 2002, the amount of terror losses that would trigger federal assistance has risen to $100 million, the industry retention to $27.5 billion, and the deductible to 20 percent of losses. This significant reduction in federal subsidies has been handled with ease by insurance companies. A report from the reinsurance broker Guy Carpenter demonstrates that, despite the increased risk that they must shoulder, insurers are allocating additional terrorism coverage capacity, selling more policies and dropping prices.[9]

Despite overwhelming evidence that federal assistance is not necessary to ensure terrorism coverage in all but the most catastrophic situations, H.R. 2761 would extend TRIA coverage to domestic terrorism, nuclear, biologic, chemical and radiological (NBCR) attacks, and group life policies. It would lower the TRIA "trigger" at which free coverage begins from $100 million in losses to $50 million in losses. It would also *retroactively* grant TRIA coverage in New York City at much lower levels than under the rest of the program to large building owners and real estate developers near "ground zero." Not a single provision in the bill would reduce insurer coverage or increase their financial risk in any way. The legislation would, however, extend this new and much more generous program for fifteen years.

This approach will stifle the growth of private terrorism coverage and reinsurance, and will dramatically reduce the incentive for developers to invest in safer buildings. Why pay for anti-terror devices when you have subsidized insurance? Astonishingly, TRIA does not

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[3] Quarterly reductions averaging more than 2 percent in the first quarter of this year were reported by the Council of Insurance Agents and Brokers in a press release dated April 23, 2007.
[4] "Sharp Premium Drops, Looser Underwriting Reported for First Quarter 2007," Council of Insurance Agents and Brokers, April 23, 2007.
[5] "2003 Aggregates and Averages," "Review/ Preview," January 2007, A.M. Best and Company.
[6] In October of 2006, Allstate announced a new $3 billion share repurchase plan starting in 2007 that will "compliment" the $12.8 billion program that was completed at the end of 2006. "Allstate Posts Solid Earnings," National Underwriter, October 19, 2006.
[7] Progressive announced that it was buying back 1.1 million shares in April 2006. A representative of the investment firm Bear Sterns stated that the share repurchase was necessary because "both management and the board are working to address the company's significant excess capital position." "Progressive Announces Stock Split, Dividend," National Underwriter, April 24, 2006.
[8] In August, Safeco announced a $1.4 billion repurchase for almost 20 percent of its outstanding shares. "Safeco Increases Share Repurchase," National Underwriter, August 14, 2006.
[9] "Terror Insurance Climate Improves," National Underwriter, June 12, 2007.

impose mitigation requirements in exchange for access to free reinsurance, exposing the public to greater risk if safety precautions are not taken.

Expanding TRIA would also not help rural America. Rural consumers are currently paying affordable rates for unsubsidized insurance. The rates would likely not change much, if at all, if TRIA expired. Indeed, TRIA requires rural taxpayers to subsidize large insurance companies and real estate interests in a few very large cities.

CFA urges the Committee not to lock in an unjustifiable and costly expansion of TRIA for many years. Rather, we recommend scaling the program back to cover truly catastrophic losses of over $100 billion. Specifically, we recommend the following:

1. Do not expand TRIA coverage.

- Insurers, not TRIA, should guarantee NBCR coverage for losses of less than $100 billion. Although there still is very little coverage available for NBCR at any level, the financial position of the property-casualty insurance industry is so strong that it would be relatively easy for insurers to cover up to $100 billion in losses.[10] In order to ensure that NBCR coverage is available for losses of less than $100 billion, the Department of the Treasury should revoke its decision to allow insurers to exclude this coverage if states allow such exclusions. At the state level, the National Association of Insurance Commissioners should begin immediate proceedings to forbid NBCR exclusions and to create insurance pools that cover losses of less than $100 billion to spread the risk of terrorism across all insurers writing commercial coverage.

- Reducing the TRIA coverage trigger to $50 million is not warranted. Small insurers have complained that TRIA triggers and retentions are too high for them. CFA has seen no evidence that this is a problem, but the solution to such a concern should not be to lower triggers for small *and* large insurers. The problem should be handled through the private purchase of reinsurance.[11] Further, as CFA has repeatedly recommended to the National Association of Insurance Commissioners, states are free to create pools for this sort of problem. Congress could authorize the creation of multi-state pools under interstate compact if the states seek such a pooling base.[12]

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[10] Insurer retentions under TRIA right now are about $30 billion, plus an additional 20 percent of losses. The President's Working Group on Financial Markets estimates that there is presently about $6-$8 billion in terrorism reinsurance capacity and $3-$4 billion in private capital from sources like hedge funds. As this demand for reinsurance and private capital will undoubtedly increase if TRIA coverage is reduced, it is quite conservative to assume that at least $10 billion in reinsurance and $5 billion in private or securitized capital would be available. Thus, property casualty insurers would only have to fill a "gap" of about $20 billion under this program, which is just over 4 percent of the industry's current $495 billion surplus.

[11] If small insurers insist that a $100 million trigger is too high and a $50 million trigger is not, surely reinsurance to cover the difference is readily available.

[12] Testimony of Travis Plunkett, Legislative Director for the Consumer Federation of America, before the National Association of Insurance Commissioners, Terrorism Insurance Implementation Working Group, Regarding Terrorism Insurance Coverage, Long-Term Solutions, March 29, 2006.

- Insurers do not need TRIA to provide coverage for domestic terrorism. For decades, through hundreds of domestic terrorism events, the private insurance market sold the coverage with no separate charge. It makes no sense that insurers would suddenly need federal assistance in paying for domestic terrorism losses, especially given the extraordinary profits the industry has been reaping in recent years. Moreover, the industry has not demonstrated that domestic terrorism risk has increased and an additional federal subsidy for this purpose is necessary.

- Group life coverage under TRIA has been repeatedly rejected by the Department of the Treasury. There is no meaningful evidence that justifies expanding TRIA to cover group life insurance, which is why the Treasury Department has twice refused to do so. The Treasury Department pointed out that group life coverage has been, and is expected to continue to be, widely available at rates that have been declining, despite the lack of TRIA coverage.[13] This is because the group life market is so competitive. Insurers have also refused to take meaningful steps to spread their risk privately, an option open to them. In short, group life insurers have not demonstrated a real need for this risk to be federally subsidized.

2. **Reduce TRIA coverage and increase insurer risk to spur private market participation.** Any extension should, in fact, reduce or eliminate any subsidy, either by raising triggers, retentions and deductibles, or charging an actuarially sound premium, or slightly more, to encourage private sector development. Had Congress required that actuarially sound premiums for TRIA be charged, the Treasury Department would have collected about $4 billion, which would now be in the Treasury in reserve to offset the costs of any future attack. If a long-term TRIA extension is adopted by Congress, insurers should pay actuarially sound rates for this coverage. The Senate should also reduce the lines of insurance covered by TRIA for which there would likely be relatively few terror losses or low aggregate risk exposure. Candidates for such a reduction include lines of insurance such as fidelity, boiler and machinery, and general liability.

3. **Increase financial incentives for insurers and building owners to mitigate terrorism losses**. Charging premiums for TRIA coverage will help increase mitigation and eliminate the current taxpayer subsidy to overcapitalized insurance companies. In order to purchase the reinsurance, insurance companies should have to meet approved underwriting criteria that will reduce the terrorism risk.

4. **Convert TRIA to a program that covers losses related to truly large-scale attacks that result in between $100 and $200 billion in losses**. If insurers' retentions are increased to $100 billion, then a case could be made to require insurers to make NBCR available.

5. **Keep TRIA a temporary program**. Extending TRIA permanently, or for more than three to five years, would freeze the program in time, inhibiting the further ability of the private market to expand and making it very difficult for Congress to adjust the program as market conditions change. This would be a major error. If we have learned anything about the

[13] "Terrorism Risk Insurance: Report of the President's Working Group on Financial Markets," September 2006. U.S. Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002."

terrorism insurance marketplace since September 11th, it is that developments that were once thought to be highly unlikely can occur with startling speed. For example, very few people would have thought that in the wake of the significant terrorism losses incurred on September 11th, the property/casualty insurance industry would develop into a financial tiger with record profits and surpluses and an enormous financial capacity to handle terrorism losses.

The Consumer Federation of America urges you to reject proposals to dramatically expand TRIA and to sharply scale back and restructure the program to address the very limited problems with terrorism coverage that still exist for events greater than $100 billion. You will not only be protecting the nation's taxpayers from unnecessary expense at a time when Congress is seeking to restrain spending, you will be spurring the growth of a stronger private market for terrorism coverage and enhancing mitigation efforts by businesses with terrorism exposure.

Sincerely,

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J. Robert Hunter
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