Consumer Federation of America

November 1, 2005

The Honorable Bill Frist
Majority Leader
United States Senate
Washington, D.C. 20510

The Honorable Harry Reid
Minority Leader
United States Senate
Washington, D.C. 20510

The Honorable Richard Shelby
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Paul Sarbanes
Ranking Member, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

RE: UNNECESSARY TERROR INSURANCE SUBSIDY SHOULD BE ENDED OR SHARPLY REDUCED

Dear Senators Frist, Reid, Shelby and Sarbanes:

In the next several weeks, the Senate will make crucial decisions about the future of the Terrorism Risk Insurance Act (TRIA), which expires at the end of this year. After the terrible events of September 11, 2001, the Consumer Federation of America was one of the first organizations in the country to call for a temporary program to ensure that terror insurance would be available. However, since the capacity of private insurers to provide terrorism coverage started sharply increasing in the year before Congress enacted TRIA, it has become increasingly clear that broad government assistance is unnecessary.

Insurers are lobbying hard to extend TRIA "as is" and even to expand it. However, continuing this subsidy is not justified, particularly as Congress seeks ways to lower mounting federal deficits. **The evidence is now stronger than ever that the financially well-off insurance industry is receiving an overly generous and unnecessary subsidy from beleaguered taxpayers and consumers.** Moreover, market conditions are ideal for government assistance to end. There is no better time to end or significantly scale back TRIA to foster the growth of the private market for terrorism insurance and protect taxpayers.

Property/ casualty insurers are on track to enjoy one of their most profitable years in history, despite the negative impact of recent hurricanes on their bottom lines. CFA estimates that after-tax profits for the industry will be between $30 and $35 billion: between the third and fifth most profitable year in history. In the three years since Congress enacted TRIA, insurer earnings have been $100 billion.

The financial capacity of the insurance industry to handle future terrorism losses has grown immensely since September 11th. Property/ casualty insurers had a combined surplus (retained earnings) of only $290 billion at the end of 2001, a dramatic drop from the year before. Since then, however, the industry has enjoyed one of its most profitable periods in history. Retained earnings at the end of 2005 are projected to be $413 billion, a growth of more than 40 percent since September 11th.

The safety and soundness of the insurance industry is unparalleled. The key measure of financial strength is the leverage ratio, which assesses the amount of net premium compared to the amount of surplus. A ratio of below 2 to 1 is considered strong. The leverage ratio at the end of 2004 for property/ casualty insurers was 1.08 to 1, one of the strongest ratios in history.

Prices are dropping, making terrorism insurance more affordable. Commercial rates in the third quarter of this year dropped overall by 5 percent for small accounts and by 9 percent for large accounts compared to a year earlier. This means that even if the terrorism component of premium charges doubled, overall premiums paid by businesses of all sizes would still decline. Large businesses would see sharp reductions.

TRIA has provided a subsidy to the insurance industry of almost $3 billion since it was enacted. In testimony presented to the Senate Banking Committee, CFA documented that taxpayers have subsidized the insurance industry by $2.8 billion for the current TRIA program of slightly more than three years. This is because insurers have not had to pay for the reinsurance coverage that they were provided. The fact that insurers have not filed any claims under TRIA does not mean that there is no subsidy, anymore than a lack of claims by a consumer with an automobile insurance policy means that the insurance company hasn't taken on risk and shouldn't charge for the policy.

If the Senate chooses not to allow TRIA to expire, we urge you to dramatically scale it back along the lines recommended by the Department of the Treasury:

- **Increase the retentions that insurers must pay for losses**. The current 15 percent retention that insurers must pay is only 9.75 percent, after tax considerations. At the very least, we urge that the retention be increased to 15 percent after taxes (a pre-tax retention of 23 percent). This would require an overall industry retention level of $50 billion after taxes, versus $33 billion right now. We also urge the adoption of the Treasury Department's recommendation of a minimum $500 million event trigger for TRIA assistance. Small insurers concerned that this trigger would lead to unsustainable losses have several affordable options, including the purchase of reinsurance, which is widely available for $500 million or more in coverage. These insurers could also create a voluntary industry pool to help spread risk under $500 million.

- **Remove TRIA back up for commercial auto, general liability and other minor lines of insurance**. It makes perfect sense to limit the TRIA backstop to important lines of insurance that the industry might have trouble covering, as the Department of the Treasury proposed.

- **Do not add group life coverage to TRIA.** Despite the Department of Treasury's recommendation to reduce TRIA reimbursed lines, group life insurers are lobbying mightily for an expansion. There is no meaningful evidence that justifies expanding TRIA to cover group life insurance. Both the Treasury Department and the National Association of Insurance Commissioners have rejected appeals by life insurers for relief, perhaps because these insurers have not attempted to use the readily available measures to spread their risk privately. There is not any evidence that the group life market is experiencing poor competition or high prices. In fact, the opposite is true. Best Wire Services reported in August that "the group life market in the United States has experienced heated competition" in 2004 and 2005.

- **Increase the share of losses that insurers must pay above the deductible amount** from 10 percent to 15 percent, increasing by 5 percent a year.

- **Provide taxpayer back-up only for truly exceptional terrorist events**, such as attacks with weapons of mass destruction.

- **Ensure that taxpayers pay no costs for backing up terrorism losses**. As insurance rates are dropping fast, there could be no better time to require that insurers pay actuarially sound premiums for the free coverage that taxpayers are currently providing. This process would not necessitate the development of a large government bureaucracy, only a handful of administrative staff to handle premium payments.

As you consider important issues regarding the nation's financial security in the event of future terrorism attacks, we urge you to ignore the hype and misinformation that some insurance representatives are now offering about the need to extend TRIA "as is" and to even expand it. We have presented very strong evidence that, in fact, the insurance industry is flourishing and can well afford to cover more terrorism losses in the future. By eliminating or sharply scaling back TRIA, 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,

Travis Plunkett
Legislative Director

J. Robert Hunter
Director of Insurance

CC: Members of the Senate Banking Committee