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## **Securing our Economy Against Terrorism: Congress and Insurers Must Act Now<sup>1</sup>**

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Recent regulatory issues have concentrated our industry's focus on a review of business standards and practices. That has resulted and will continue to result in healthy reforms. These reforms are essential to the creation and maintenance of a truly competitive marketplace, a marketplace that can keep up with the ever-changing needs of our customers.

It is equally important to keep our eyes on another issue that could also undermine the long-term viability of the property-casualty marketplace. This looming threat hangs over our entire economy.

I am speaking about terrorism, and the current lack of a viable, long-term solution to the daunting challenges that arise from catastrophic terror attacks. Today, three years after the terrorist attacks on the World Trade Center and the Pentagon, there's a reduced sense of urgency surrounding the consequences of another terror attack on U.S. soil.

When it comes to discussing potential terror attacks, we — the leaders of the U.S. insurance industry — have a fine line of responsibility and sensitivity to walk here, especially today, as we meet in New York City. We have to avoid being seen as either alarmists or sleepwalkers.

We need to be realists about this obvious condition of our daily lives. We very much have a responsibility to inform. I am reluctant to discuss this issue with great specificity, in terms that some might find objectionable or anxiety-producing. But I believe that as insurers we have a duty to share what we know. In our society, public debate leads to change, and perhaps today we can add some value to that public discourse.

This is what I would say if I were standing before the President and members of Congress: Our intelligence community tells us that there is a high probability that terrorists will attack a target inside our borders again. As policymakers have said, it's not a matter of "if" but "when."

Given the probability of a terrorist event in the near term, what kinds of effects can we as insurers predict with some degree of certainty?

On 9/11, Al Qaeda wanted to hit three targets, perhaps four, and early that morning, passenger-filled planes tragically hit the World Trade Center, the Pentagon, and a field in Pennsylvania.

It will help our discussion if we briefly review the effects of the World Trade Center attack. As every New Yorker and everyone in this room can attest — whether you saw the planes hit and the towers fall in person or on television — the emotion was the same: absolute horror.

According to the New York City Medical Examiner, 2,752 people were killed that day here in the city.<sup>2</sup>

In addition to the tragic human toll, on 9/11 the property destruction at the core of the nation's most populated city was staggering. The single largest source of recovery aid for victims of 9/11 was private insurers — not government or philanthropy.<sup>3</sup>

Nearly 200 insurance companies paid out claims directly related to this event. The latest estimate for the insured losses is \$30.6 billion, the largest event — natural or man-made — in the history of the U.S. insurance industry. The amount could have been several billion dollars higher without the federal Victims Compensation Fund. The fund kept many victims from pursuing costly litigation for damages.<sup>4</sup>

I am, and will always be, extremely proud of our industry's response to the 9/11 attack. We paid claims quickly and fully, and without a dollar of government assistance. We were a critical component of the nation's recovery system.

If there were another terrorist event today on the scale of a 9/11, the U.S. insurance industry would react the same way it did three years ago: We would pay claims quickly and fully. Also, once again, as the direct result of our claims dollars flowing to victims, the U.S. economy would recover and move forward following the attack. How can I be so sure?

Because of the public-private partnership for terrorism risk-sharing known as The Terrorism Risk Insurance Act of 2002, or TRIA.

TRIA allows insurers to stay in the terrorism insurance marketplace. With TRIA, we understand the expectations of our nation and industry's liabilities in the event of a major terrorist attack.

We have a number of TRIA advocates in Congress to thank for their leadership, including Congressmen Michael Oxley, Richard Baker and Barney Franks, and Senators Christopher Dodd and Robert Bennett.

Always envisioned as a temporary program, TRIA expires just 13 months from now, on December 31, 2005. TRIA was seen by Congress as a bridge to a fully functioning private terrorism insurance market, so its impending expiration is no surprise.<sup>5</sup>

At this point — little more than a year from TRIA's end date — we have allowed enough time to test the assumption that the private sector would create a long-term solution. It's clear by now that the private insurance market, by itself, cannot fully accommodate the risks arising from catastrophic terrorism.

This is not to say that we are not working on the problem. In fact, the search for a long-term solution to the many challenges associated with insuring against catastrophic terror has been — and is being — explored by insurance experts from around the globe.

To date, we have made substantial progress. We have devised new and highly complex models to help us calculate risk accumulation and probable maximum loss for various lines of business.

We have even explored in detail whether the creation of a voluntary, wholly private sector pool would provide a viable solution for workers' compensation.<sup>6</sup>

Still, why should there be a sense of urgency around the possibility of a marketplace without TRIA? Why should there be a sense of urgency in an economy without a partnership for terrorism risk-sharing with the federal government?

Three years after 9/11, we know that it is within the realm of possibility, even probability, that we may in the next decade experience an even larger terrorist attack, or God forbid, a series of coordinated

attacks. That reality, coupled with the possibility of no public-private partnership solution for terrorism reinsurance, compounds the grave dangers we face in the short-term.

You've probably seen the risk models for possible large-scale terrorist events. The numbers are sobering.

A truck bomb detonated at Rockefeller Center, with ten tons of conventional explosives, during mid-day, mid-week, could kill an estimated 12,000 people and injure another 52,000. The workers' comp loss alone will top \$7 billion.<sup>7</sup>

An anthrax attack, dispersed in aerosol form over Chicago, could affect the health of more than one million people and kill many thousands more. One risk model from Risk Management Solutions estimates that the property losses will exceed \$77 billion and the worker's compensation losses will exceed \$34 billion.<sup>8</sup>

Even worse, imagine this: A suitcase nuclear bomb in Times Square, detonated mid-week, could kill 500,000 people. Graham Allison, founding dean of Harvard's John F. Kennedy School of Government and author of "Nuclear Terrorism," gives even odds that this will happen in the next ten years.<sup>9</sup>

Risk Management Solutions, estimates the property loss for such an event will reach \$309 billion and the workers' compensation costs will be \$277 billion.<sup>10</sup> That's a combined loss of \$586 billion.

But the commercial insurance industry's capacity to pay out property and casualty claims is ONLY estimated at \$114 billion. For the industry's workers' compensation capacity, add \$30 billion. That's a total industry capacity of \$144 billion.<sup>11</sup>

That combined capacity falls more than \$400 billion short of the total potential loss mark, leaving the insurance industry and the larger economy in serious jeopardy.

For the insurance industry alone — absent a public-private backstop — these losses will drive most, if not all, of us into insolvency. The accompanying negative effects on the larger economy will be equally catastrophic. Our economic security — under the scenarios I've just noted — will of course become severely undermined.

The economic effects of a large-scale terrorist event for the U.S. and the world are in many ways unknowable. However, recent history gave us some insight into the likely economic effects of a 9/11-scale terrorist event.

One week after 9/11, the stock markets reopened and the Standard & Poor's 500 index fell almost 12%. That was a decline of \$1.1 trillion in market capitalization that dogged the economy and contributed to the bear markets of 2001 and 2002.

In Osama bin Laden's most recent video communication, he specifically noted that the U.S. economy was his real target. He further suggested that any future terrorist attack would be strategically timed and placed for maximum economic devastation. He is intent, in his words, to continue this policy "in bleeding America to the point of bankruptcy."<sup>12</sup>

Again, given these terrorist event scenarios, our policymakers in Washington — and in our state capitols — should not approach these issues with anything other than a deep sense of urgency.

As a first step toward creating a deeper sense of urgency, perhaps we need to revisit the conditions of our new reality.

As I've already suggested, when it comes to terrorism, we're now in an era of the unimaginable. The human capacity to plot and carry out evil has all too often surpassed our ability to imagine and anticipate it.

Combatting terrorism will be our generation's Cold War. It will consume our best thinkers and policy makers and shape our nation in innumerable ways. Tom Ridge, the Secretary of Homeland Security, has said that this war will last fifty years. But the Cold War analogy ends there.

For starters, we are at war with a very different enemy, with no identifiable battleground. Terrorism is, in many ways, very difficult to predict and defend against. Still, as a nation we should continue to take counter-terrorism measures to reduce the number and vulnerability of obvious targets, the people and property that make up our communities.

And, as a nation, we must also take whatever reasonable measures we can to safeguard what is equally vulnerable: that's our economy.

Federal participation is a requisite piece of any prevention plan, of any hope of continuing free, robust commerce in this country under the current circumstances.

However, as I've noted, when conceived, TRIA was a temporary solution, sunseting on December 31, 2005. Why is the dual objective of extending TRIA and creating a similar long-term solution to terrorism reinsurance so critical? You all know the answer.

As I have said, once losses reach a certain level, a large scale terrorist act taking place on U.S. soil will exceed our capacity to pay. Since reserves cannot be established for future events and private reinsurance is largely unavailable, claims will have to be paid from our net worth and attempts to access capital markets.

Extending TRIA and creating a long-term public-private backstop is a necessary part of any sensible approach toward minimizing the effects of a major terrorism event in the United States.

Congress acted quickly in 2002. Why then have our policymakers been so reluctant to act now? I've been involved in the lobbying and policy-making around TRIA since its inception.

My assessment is that we may not have successfully framed this issue in a way that persuades both Congress and the man in the street to act.

Let's look at this together to see how we can change misperceptions about extending TRIA or other potential longer-term public-private solutions.

Let's start with the argument some lobbyists and policy makers use AGAINST the federal government playing a role in any solution.

Here are their three basic points:

First, they say government should not subsidize private industry, especially an industry that they mistakenly believe is infused with limitless amounts of capital. In plainer language, they say federal terrorism reinsurance is a handout to an industry that doesn't need it.

Second, they say given enough time and opportunity, private industry will return to the marketplace to cover catastrophic terrorist acts. They cite private reinsurance and cat bonds as examples.

Third, they say a TRIA-like solution is a single-industry solution without an evident national problem. They assert that there is no other industry calling for an extension of TRIA or a permanent solution, no grass roots citizens' group marching in support, no current crisis that needs Congress' immediate attention. They say the only hue and cry they're hearing is from insurance companies that have very healthy profits and strong balance sheets.

To the first point: TRIA is not a handout, not a big government program, not anti-free market. A public-private reinsurance solution is not like fixing the price of milk in a soft dairy market.

A longer-term TRIA-like solution is actually more analogous to the creation of the FDIC during the Great Depression.

After the stock market crash of 1929, thousands of U.S. banks failed. In 1933, Congress and President Roosevelt created the Federal Deposit Insurance Corporation. The FDIC provided a federal guarantee of deposits and restored stability and public confidence in the nation's banking systems. The FDIC established certainty in our economic system, and it established that with a government mechanism that would be rarely exercised.

The creation of the FDIC is a federal solution based on a proper and widely accepted principle in our economic system. In other words, the federal government became the banker of last resort. The FDIC was created for the sake of individual depositors and the larger economy, not special interests. It gave every American peace of mind about their hard-earned savings.

In a model example of a public-private partnership, the federal government essentially established with bankers a “stand-by capital” mechanism. This was created in case of another “Perfect Storm” economic event, or series of events like those that brought about the Great Depression.

There are contemporary examples of similar “last resort” insurance partnerships between government and the private sector. Florida does it for hurricanes, California for earthquakes, and the federal government for floods.

To the second point: the private markets have shown they do not have the capacity to reinsure the staggering amount of uninsured losses — pick your scenario and loss number here — that would result from a terrorist event on the scale of another 9/11, or certainly a number of coordinated 9/11-scale attacks.

To the third point: To say insurers are the only group advocating for TRIA or a longer-term TRIA-like solution is plain wrong. The Coalition to Insure Against Terrorism represents more than 70 businesses and organizations throughout the transportation, real estate, manufacturing, construction, entertainment and retail sectors.

They range from the American Bankers Association to Major League Baseball and the NFL to the Associated Builders and Contractors. They are all seeking passage of a terrorism insurance backstop on Capitol Hill.<sup>13</sup>

This demonstrates the wide-spread support for a public-private reinsurance solution. The importance of adequate insurance against major terrorism events is critically important for our entire economy, our cities, and the people and small and large businesses that might be affected by such a catastrophe.

So, again, why no sense of urgency by policymakers? What's missing from our argument and counter-argument?

Here's the missing premise within the argument that should cut through partisan wrangling and splintering of the issue. This should help FRAME the issue more effectively with both Congress and the public.

It's very simple: Government's core purpose is the protection of life and property from external threats.

This principle goes back to the founding principles of our country, that the federal branch of the government was established for a number of core purposes.

The founding fathers we're very clear on this. The federal government exists largely to provide for the common welfare and defense. It's a principle addressed in the preamble of the U.S. Constitution. It doesn't get more elemental than that.

As I've suggested, terrorism is an "act of war." It's the new face of warfare in the 21st century. As such, terrorism is a fundamentally uninsurable event.

As Robert Hartwig of the Insurance Information Institute has recently explained, to fully insure a risk, we need to be able to estimate the frequency of the occurrence and its severity. We must be able to spread and diversify loss. And the loss must be random in nature. Terrorism defies all of these criteria.<sup>14</sup>

Hence, we face a stark choice: either the government plays a role as insurer of last resort. Or, going forward without insurance, we put our economy at significant, unacceptable risk.

As a nation, we must come together and provide for the defense of our economic infrastructure, which will directly provide for our common good.

Ironically, the very people who argue for more defense, more police protection, more border controls, more protection by agencies and forces of the federal government, are often the same people who ignore the importance of a public-private backstop to protect our country's basic economic security. We should not allow this inconsistency to go unchallenged.

Terrorism is relatively new inside the borders of the U.S., but terrorism is not new in other countries. The UK, Germany, France, and South Africa, for example, all have a history of terrorist events on their homeland. They have each responded by instituting a nationally-funded terrorism reinsurance backstop.

Like other nations, we should expect and prepare for the irrational, the unimaginable. Our homeland security leaders have been imploring U.S. businesses to prepare in every way possible for this high probability. That is why it is imperative that Congress extend TRIA, and, at the same time, help create a longer-term public-private reinsurance solution.

In an economy without this fundamental backstop, a catastrophic terrorist event will not be contained to the site of a terrorist event; it will have grave national and international economic effects.

Without public-private reinsurance, insurers will adopt terrorism exclusions or other coverage limitations wherever permitted by state regulators. Where not permitted, insurers may also begin to make strategic decisions to exit certain locations and lines of business.<sup>15</sup>

Without public-private reinsurance, fewer businesses will have terrorism coverage, exposing more businesses to bankruptcy if there is an attack.<sup>16</sup>

Without public-private reinsurance, the attendant higher terrorism insurance costs will likely translate into job loss or job dislocation as employers reduce or relocate their workforces.<sup>17</sup>

Without public-private reinsurance, the federal government's financial exposure will be less, but the likelihood of additional costly federal government responses following a disaster will increase. According to R. Glenn Hubbard, a former Bush administration economist, "it is more efficient to define the costs and response ahead of time rather than in the immediate aftermath of another terrorist event."<sup>18</sup>

Without public-private reinsurance, even absent another attack, it is estimated that U.S. gross domestic product may decline by \$53 billion and household net worth by \$512 billion. In addition, 326,000 fewer jobs will be created.<sup>19</sup>

The extreme losses associated with a catastrophic terrorism event cannot be borne by the private sector alone. The private sector will still support the largest number of claims up to the limits of its capacity.

But TRIA or a long-term reinsurance solution should be there for the rest. It is the proper role of the federal government — in a public-private partnership with the U.S. insurance industry — to be the insurer of last resort.

With public-private terrorism reinsurance, our industry will be there to help society become whole again. That's been the insurance industry's function in our democratic, capitalist system for more than two centuries. We are the free market solution that helps our neighbors put their lives back together in the event of a catastrophe.

Again, with public-private terrorism reinsurance, our industry will be there to help our communities and economy rebuild. There's no more important calling for government than creating the conditions for this to occur.

Calling attention to this, in this way, doesn't make insurers alarmists. Again, it makes us realists. It underscores the civic responsibility we share with our neighbors to be ready for any contingency, to be prepared for every eventuality.

Let's note that, to date, TRIA has achieved its mission. Nearly every business that wants terror coverage has it. The take-up rate has increased from about 25% early in the program to about 50% today, with 100% for workers' compensation.

But this will change if TRIA is not extended or a permanent solution is not found. It's clear we have a short-term solution to a long-term threat. So, with TRIA sunset in thirteen months, what's our next step?

Congress must act. We must help them act. We will do so by reminding them of one their primary roles on Capitol Hill. Protecting the commonwealth from external threats includes securing our economy. And securing our economy means we must extend TRIA while supporting the search for a permanent public-private reinsurance solution.

U.S. insurers need "stand-by security" if they are going to continue to be the free-market providers of an important part of a terrorism safety net.

I look forward to partnering with you all here today on making this effort a success. Thank you.

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<sup>1</sup> Several people were very generous with their research, feedback, and support in the formulation of this presentation. They include Julie Rochman, senior vice president of communications, American Insurance Association; Robert P. Hartwig, senior vice president and chief economist, Insurance Information Institute; Bruce Deal, a managing principal and director of economic analysis, The Analysis Group, Inc.; and Professor Glenn Hubbard of Columbia University, formerly the chairman of the Council of Economic Advisors.

<sup>2</sup> Office of the New York City Medical Examiner. Total noted in text does not include 10 hijackers.

<sup>3</sup> Robert Hartwig, Gordon Stewart, and Claire Wilkinson, "Terrorism, Insurance and the United States Government," Insurance Information Institute, September 2004, page 2.

<sup>4</sup> Hartwig, page 2.

<sup>5</sup> The Terrorism Risk Insurance Act of 2002 was signed into law by President George W. Bush on November 26, 2002.

<sup>6</sup> Bruce Hockman et al., "Workers' Compensation Terrorism Reinsurance Pool Feasibility Study: Summary of Study Findings and Conclusions," Towers Perrin (Tillinghast), March 2004, page 5.

<sup>7</sup> Hartwig, page 9.

<sup>8</sup> Risk Management Solutions (RMS), founded at Stanford University in 1988, is the world's leading provider of products and services for the quantification and management of catastrophe risks. Their corporate headquarters are located at 7015 Gateway Blvd., Newark, CA 94560.

<sup>9</sup> Graham Allison's *Nuclear Terrorism: The Ultimate Preventable Catastrophe*, is published by Henry Holt and Company (2004). This information was also noted in the *New York Times*, in Nicholas Kristof's syndicated column, "An American Hiroshima is Possible," which appeared in on August 11, 2004.

<sup>10</sup> RMS.

<sup>11</sup> Hartwig, page 24.

<sup>12</sup> Transcript of Osama bin Laden's 18-minute video appeared October 29, 2004, in the National Business Review (New Zealand), among other news sources.

<sup>13</sup> See The Coalition to Insure Against Terrorism at [www.insureagainstterrorism.org](http://www.insureagainstterrorism.org)

<sup>14</sup> Hartwig, page 5.

<sup>15</sup> R. Glenn Hubbard and Bruce Deal, "The Economic Effects of Federal Participation in Terrorism Risk," The Analysis Group, September 14, 2004, page 4-9.

<sup>16</sup> Hubbard, pages 4-9.

<sup>17</sup> Hubbard, pages 4-9.

<sup>18</sup> Hubbard, pages 4-9.

<sup>19</sup> Hubbard, pages 75.