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The Center On Federal Financial Institutions (COFFI) is a nonprofit, nonpartisan, non-ideological policy institute focused on federal insurance and lending activities.

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TRIA Renewal: Policy Forum Proceedings

This paper contains a transcript of a policy forum held by COFFI on potential renewal of the Terrorism Risk Insurance Act of 2002. Please see a companion piece, "Terrorism Risk Insurance Policy Forum," available at www.coffi.org, for a summary of the key points of the discussion.

Forum held:

Monday, May 2, 2005

Room 342

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PROCEEDINGS

MR. ELLIOTT: Good afternoon and thank you all for coming today. I'm Doug Elliott, the President of the Center On Federal Financial Institutions. We are a non-partisan think tank focused on the federal government's extensive role as insurer and lender, including its role as a reinsurer of terrorism risk insurance policies. We assembled this forum today in order to help policymakers and the public understand the issues surrounding possible renewal of TRIA. Our organization focuses on education and does not generally take positions.

We have copies outside of some of our papers on TRIA. I recommend our website to you, www.coffi.org, which has all of our papers on TRIA and other topics. We also have biographies outside of Debra Roberts, our panel moderator, and of each of the panel members. Finally, I'd like to express our thanks to the Senate Banking Committee and Senator Sarbanes, for generously lending us this committee room. I'll now turn it over to Debra.

MS. ROBERTS: Welcome to everyone. The Terrorism Risk Insurance Act, or "TRIA," as we will refer to it here today, was enacted in November of 2002, and it expires at the end of this year. We are here today to discuss whether TRIA should be renewed, modified, or allowed to expire.

We have this distinguished panel of experts, whom I will introduce in a moment, who will present varying views on where TRIA should go from here. But first of all, I'd like to give you a very brief summary of how TRIA works. This will necessarily be at a very high level; not getting into a lot of detail, because of the time constraints that we have today. But I would like to give a context for these discussions and TRIA's structure and wording is somewhat complex, so I'll try to just hit the highlights.

TRIA was enacted after the terrorist attacks of 9/11, in response to the reactions of the reinsurance and insurance markets. Reinsurers provide insurance to insurance companies, and insurers rely upon them to help manage their risks.

After the losses from 9/11, about 60 percent of which were reinsured, the reinsurers began excluding terrorism losses from their contracts to the insurers. This led the insurers to do the same thing. Eventually, Congress responded by enacting TRIA near the end of 2002.

TRIA has two major components. Number one, it requires all U.S. commercial lines insurers to offer terrorism coverage as a separate policy; with the exception of workers compensation insurance, which is a special case which already includes terrorism coverage in its original policy. This mandatory offer of terrorism coverage does not require businesses to purchase it. That's up to them.

Point number two is that TRIA sets it up that the Federal Government is the reinsurer on these coverages, up to $100 billion per year. These insurers have deductibles and co-pay amounts, but there's no up-front premium paid to the Federal Government as there would be in a private reinsurance contract.

There are, however, provisions in TRIA that allow recoupment if there are losses paid by the Government. Under certain circumstances, some or all of the money that was paid out by the Government can be returned after a loss.

I'll highlight here a couple of the important exclusions that are listed in TRIA. It does not cover acts of domestic terrorism; that is, acts performed by domestic sources, as opposed to foreign sources. It does not at this point cover group life insurance.

It's also important to note here that nuclear, biological, chemical, and radiological events--or "NBCR," as we shorten it to--may be excluded from the underlying policies, and therefore not covered under TRIA. There is some dispute, however, as to the legal effectiveness of these exclusions used by the insurers in the underlying policies.

Given their importance, I'll just explain really briefly the deductible, co-pay, and recoupment provisions. The deductible in TRIA is a little bit different from standard insurance policy deductibles. It's calculated as a percentage of the individual insurer's direct earned premium of the previous year.

That percentage is stipulated in TRIA by year. For 2005, it's 15 percent. So at the individual company level, the deductible for that company is 15 percent of their premiums from the previous year. My point is that it varies company by company.

The co-pay, after the deductible is applied, means that the insurer pays 10 percent, and then the Federal Government picks up 90 percent of a covered loss, up to the annual cap of $100 billion.

In the event of another 9/11 size event, the Federal Government's share depends upon how many insurers are involved in the event and the actual dollar amount of their deductibles. If there were many large insurers involved, the Government's share would be smaller, because the insurers' individual deductibles would be higher if they are larger companies. If there are just a few insurers that are smaller companies and would have smaller deductibles, the Federal Government's share could be much larger.

Now, for the recoupment, the language in TRIA is complex, and it's actually very difficult to follow; but I'll try to simplify it here. As long as the insurance industry losses are within something that TRIA calls the "insurance marketplace aggregate retention," then there is mandatory recoupment. This year, that level for the industry is $15 billion under TRIA.

That means if that event happened and it was under $15 billion, the Government would put into effect a mandatory recoupment. This is in the form of a premium surcharge, not to exceed 3 percent a year, on all commercial insurance policies; which is collected by the insurers and then returned to the Federal Government. So that's the way the money would flow.

If the insurance industry losses exceed that aggregate retention, then there is no mandatory recoupment, but it is up to the discretion of the Federal Government as to whether any recoupment would be imposed.

One final point is that TRIA requires the Treasury Department to provide a report due June 30th of this year on the effectiveness of TRIA. Treasury has performed the survey and is expected to release its report by June 30th.

So now, as TRIA expires December 31, 2005, the question is: What should be done? The good new is that we have not had another terrorist attack since 9/11. But from the insurers' point of view, this lack of another event presents some complex issues. In the context of still being under moderate to high levels of security threats, and no events, there's no hard data to feed into their models for pricing or to predict exposure levels. But the possibility of a terrorist attack is still very serious. This raises the question of whether the Federal Government should continue to be involved in terrorism risk coverage, which is a complex topic.

I am now going to introduce our distinguished panel. As Doug mentioned at the beginning, there are biographies outside on all the panel members. Because we're under a rather short time frame today, I'll just refer you to those biographies for the backgrounds of our people here. I am going to introduce them in the order that they will speak.

Starting to my right is Jim Macdonald, Executive Vice President and Chief Underwriting Officer at ACE USA; Bob Hunter, who is the Director of Insurance for the Consumer Federation of America; Jeff DeBoer, President of the Real Estate Roundtable; Kent Smetters, Associate Professor of Insurance and Risk Management at the Wharton School; Stef Zielezienski, Vice President and Associate General Counsel with the American Insurance Association; and at the end, Doug Holtz-Eakin, Director of the Congressional Budget Office.

The format we're going to use today is that each speaker will give some comments initially on their views of TRIA and where we should go. Then we're going to have a question-and-answer session; questions from me, and also, from the audience. Thank you very much. I turn it over to Jim.

MR. MACDONALD: I think I'll stay seated. I usually speak extemporaneously, but this is so important I wrote some things down over the week, and I'll work from that. So, good afternoon. My name is Jim MacDonald. I am the chief underwriting officer for ACE USA, headquartered in Philadelphia. In that capacity, I am involved on a regular, even daily, basis on risk-taking decisions on individual accounts as respects terrorism exposure.

Since joining ACE three days before 9/11, I have also been extensively involved in trying to answer the daunting strategic underwriting and capital management questions presented by terrorism.

By way of introduction, I should say I am solely representing ACE's views right now. The ACE group of Property/Casualty insurance companies, for those of you who may not be familiar with us, underwrites property and casualty businesses in both Canada and the United States, and in 50 other countries around the globe. Our customers include a broad array of organizations that rely on a stable market for terrorism insurance.

By way of introduction, I also want to emphasize that ACE strongly endorses the Dodd-Bennett bill that proposes an extension of two years. We particularly like that bill because it has within it a plan to try to develop a permanent solution to this challenge, and we think that's what we need.

It's clear to us that over the last three years TRIA has achieved most of its goals. It has stabilized the private market for terrorism insurance. It has made terrorism insurance broadly available and affordable for all businesses that want and need this vital coverage.

At ACE, we are members of the AIA. Stef Zielezienski will be speaking later, and we basically do agree with the conclusions he'll be providing. I'd like to give you my most important issues, as someone who makes underwriting decisions.

I think the most important issue that is confronting us right now is the consensus that as time goes by the risk of a weapon of mass destruction being the source of the next attack on the United States is growing. This is the statement of both Goss and Mueller separately in their FBI and CIA testimony recently at the Senate Select Intelligence Committee. It's the same conclusion that we have heard from other terrorist experts that we've heard.

Thus, as time goes by, the risk of a large attack is growing. This means that the attack, when it occurs next, could well be in excess of the $32.5 billion insured loss presently estimated from 9/11. In fact, estimates of a WMD loss range well above $200 billion.

According to the Insurance Information Institute, there is not more, in the aggregate, than $175 billion in the American property casualty market supporting commercial lines exposed to terrorism.

The second point I want to make, though, is that discussions of overall industry aggregate actually, as a recent GAO report discusses--discussions of overall capacity obscure the larger issue to me as an underwriter: that each of us separately underwrites for our own companies. We have the uncorrelated risk that our company may be the company that gets hit. We cannot assume everyone will be hit equally by the next attack. Thus, we each have to establish our own underwriting parameters to protect the policy holders' surplus, which is what we call capital in the insurance industry.

We call it "policy holders' surplus," by the way, for a reason. That's a statutory accounting term. The reason why it's called that is that our capital is, in theory, there to pay our policy holders, both current and prior, for any deficiencies in our loss reserves.

I want to emphasize to you, there is not one dime of terrorism loss reserve as of today. It's not allowed to be reserved. In the six countries in Europe that have programs, it is allowed in those countries that have instituted terrorism programs. So any loss will impact our capital, and that means it undermines the ability of those insurance companies to pay for the workers comp losses. You may be buying insurance from us today to pay for the auto insurance. That's what that capital is there for, to pay for deficiencies in our current loss reserves.

The two prior observations lead to a third one, which is inevitable; which is that without TRIA we will see a constriction of market capacity that would otherwise be available. I was underwriting before TRIA, during it, and after, and TRIA has been successful. It has broadened our willingness to write business in high-risk areas.

As we approach the key July 1 renewals, with as much as six months into 2006 of unknown coverage regarding whether TRIA will be extended, underwriters, I can assure you, will start making tough decisions regarding whether they can quote business which they would quote were TRIA extended.

At the risk of seeming a bit contrarian, I'd like to suggest that we may actually have some more consensus on this panel than is apparent. For instance, in the CFA report last year, Bob

Hunter and his colleagues stated that, "To the extent that there are major losses in excess of, say, $50 billion after taxes, federal taxpayer involvement might be helpful." We completely agree with that statement. We would change it to "critical," rather than "helpful"; but there seems to be, at least conceptually, an agreement that the size of loss could indeed necessitate a federal role.

If we read Professor Smetters' often-cited paper, we note an important qualifier. Professor Smetters, who I've met with several times, states in his paper that in order for the private markets to basically optimize their capital capabilities, the insurance industry would have to be "mostly unfettered" by government regulation.

All too often, when people read Professor Smetters' report, they ignore this important qualifier. As a matter of fact, the insurance industry is heavily regulated. The pricing of terrorism insurance is based not on sound actuarial data, because none is available. And modeling of terrorism risk is, at best, in its infancy.

What terrorism pricing is based on is what insurance state regulators will approve, balanced with the capital risk perceived by insurance companies as the minimum that they need to assume the business. All too often, policy assessments relying on Professor Smetters' insights ignore the condition in his paper that regulation would have to change to make his capital market solution possible.

In closing, I want to emphasize that for insurance underwriters the tragic events of September 11th changed everything. What were fairly normal decisions on September 10th eventually became capital management decisions on September 12th.

One of the most important principles of successful underwriting is that we need to know when to draw a line between what we know and what we do not know. In the case of terrorism, we need to listen to our best experts from the CIA and the FBI. They are telling us in so many words, as Bob Dylan might put it, that a hard rain's going to fall. In fact, they're saying we might even need an ark.

No one knows when or where or who is at risk. We simply know that, as many informed people have told us, it is not a question of "if," it is a question of "when." TRIA is our national ark. It unites the private and public sectors. It tells our enemies we stand prepared and united as one nation. It pre-empts a principal goal of terrorist actions, which is to divide a people from its government.

To see this challenge simply in narrow economic terms is not only myopic, it is, in our opinion, dangerously myopic. The extension of TRIA and the development of a permanent solution, as proposed by Dodd-Bennett, are critical to our social welfare and the strength of our economy and our nation. Thanks.

MR. HUNTER: The ark has a couple of skunks in it.

You know, I love this room. Thirty-four years ago, I first sat in here with Senator Proxmire sitting up there. I was the chief actuary of the Federal Insurance Administration. And he was asking me, "Can you really do pricing on this riot reinsurance program?" Because we had to charge an actuarial premium under the act. And it was the same kind of problem: Where is it going to happen? It's human. How big will it be? It could have huge severity. The frequency was unknown. And we did it. We did it with a huge bureaucracy of: Me. And with help from insurance and reinsurance executives who came in and worked with us.

The riot reinsurance program ultimately went out of business in 1983 or '84, whenever it was; had a quarter of a billion dollar profit for the taxpayers. Unlike TRIA, which is costing the taxpayers billions of dollars in actuarial rates that they should have collected already.

Three and a half years ago, right after the September 11th attacks, I also testified over in the Senate in favor of a TRIA-type bill with a premium in it. And I testified in favor of the Oxley-Baker bill. And I stood out on the steps of the Senate side of the Capitol with them and said, "Come on, Senators, pass this bill. Because on January 1, 2002, the insurers are telling us the sky is going to fall. And you'll hear about the sky falling if we don't renew this."

But CFA then undertook studies, following the sky falling, and we found out the sky was still up there. We found out that there was reinsurance and insurance being written, and that the hard-to-place risks were in fact getting it.

Now, why isn’t there a larger audience here today? It's because we're all waiting for Treasury--sort of like "Waiting for Godot," you know. And really, we all are going to change whatever we say, probably, based upon what Treasury tells us, because the Treasury report is an incredibly important study, longitudinally, across the entire history of the program, and we need to know what it's going to say.

But there are some things about the market that we know. For example, the property casualty insurance industry is very flush now, compared to where it was when TRIA passed. The September 11th, 2001 losses were $20 billion; $32 billion in total, but a third--roughly 35 percent--paid by taxpayers. So for the industry it was a 20 to 25 billion dollar loss. And so the taxpayer is already paying a third with no TRIA; so it's not like the taxpayer is not involved if there's no TRIA.

That year, in 2001, the retained earnings of the industry went down by $28 billion. Since then, the industry has been hugely profitable. There has been an increase of $93 billion in retained earnings. The commercial segment of the industry has seen retained earnings grow by $49 billion over what they had before the attacks; enough to fund more than two terrorist incidents of a September 11th magnitude.

While the industry has made incredible income in the last few years, the taxpayers haven't been doing so well. The taxpayers are subsidizing the industry already by billions of dollars, the actuarial value of the free reinsurance that they've been getting; which money resides in the pockets of insurance companies, rather than in the Treasury.

If S. 647, the Dodd bill, or anything like it, becomes law, the industry will continue to get an unnecessary subsidy. They do not need this hand-out.

Now, I understand that the recipients of corporate welfare don't want to see it end, as you are hearing today. But it must end. After all, insurers could pass through the cost--roughly a billion dollars a year of subsidy in the future--for a mere 7/10th of 1 percent of premium to their policy holders.

S. 647 also expands the financial risk faced by taxpayers by adding free group life reinsurance to the terrorism coverage that is offered. There is not one shred of evidence that this expansion is needed. And that's why the Treasury Department, after studying the situation, wisely refused to add it to TRIA.

To make matters worse, the Property Casualty Insurers of America have called for an expansion of the give-away to personal lines, as well. I mean, greed has no limit. There is zero justification for personal lines. If ever there was spread of risk--First of all, I don't think Osama Bin Laden is trying to bomb somebody's car. But even if he was, look how spread out they are. State Farm can certainly handle that risk.

The current TRIA welfare program robs the poor to benefit the rich. Not only are the beleaguered individual and small business taxpayers taking a hit to bail out rich insurance companies; but a recent study by Marsh reveals only 35 percent of smaller companies under $100 million in coverage have terrorism insurance, whereas over 50 percent of risk over $500 million in coverage do.

Further, the cross subsidy from small business to large has regional implications; with money flowing to the Northeast and Midwest, where 53 percent buy, from places like the West, where only 34 percent buy. There's a rural subsidy of cities, as well. The largest take-up rate is in Boston, 69 percent; Washington, 60 percent; and Chicago, 58 percent.

As CBO presumably will continue to point out, continuation of TRIA in anything like the current form undermines the development of private-sector alternatives, because the private-sector alternatives can't compete with a zero premium. One of the beauties of the riot reinsurance program was that we charged an actuarial rate, and ultimately the private sector took away most of the business.

Some have said that regulation has hindered the development of private terrorism policies. That is really laughable; especially coming from people who price-fix, according to Spitzer. Some have said that regulation has hindered the development of private terrorism policies. It's nonsense. Policies have been developed, and they are being sold today. What hinders the further development of terrorism insurance is TRIA itself.

This is not to say that private-sector solutions have not been developed to complement TRIA. Stand-alone policies are plentiful. More TRIA policies are sold in conjunction with stand-alone additional coverage--70 percent, according to Marsh--than TRIA-only coverage. These policies offer coverage TRIA does not, such as domestic terrorism, acts outside the U.S., and non-certified foreign attacks. Reinsurance is plentiful backing up these coverages.

Consider these quotes from a recent trade press article:

"The renewals we have just bound, which include major real estate holdings in several key central business districts, were renewed with full terrorism coverage and the understanding that the coverage will continue beyond December 31st, regardless of what happens with TRIA," according to Ms. Glickman, the area vice chair of real estate and hospitality services division of Arthur Gallagher.

The Montgomery County director of risk management, Mr. Fleming, said, "The county has been offered the coverage, whether or not TRIA was extended, for the same price as last year."

CFA, pending the Treasury Department's report, finds no compelling reason to extend TRIA beyond 2005. We understand why insurers and their clients, who get a subsidy, would love to see the largesse extended, but we see no reason to burden taxpayers with this.

However, if anyone does consider it, we have certain ideas. First, there should be full actuarial rates charged. It's do-able. Again, it wouldn't require a big bureaucracy. We had three-and-a-half full-time equivalents for the entire riot reinsurance program. We didn't need a huge bureaucracy as I've heard some say.

The program should target only the high-risk cities, since the rest of the country can be handled privately.

The retention level should be raised to at least $50 billion after taxes; which is equal to the growth in retained earnings of the commercial property casualty sector since before the attacks. This is also the level at which GAO finds there may be a need for federal support.

Also, I believe there must be a program of some sort if we're going to ever have coverage for nuclear, biological, and chemical events.

CFA looks forward to receiving the Treasury report. And maybe we should have another meeting then, and we can talk about it some more.

MR. DEBOER: First of all, thank you, Doug, very much, for the opportunity to be here today. And thank you all for coming. I know you all have busy schedules in your offices, and we appreciate the interest and attention you're giving this important issue.

As was mentioned, I am president of The Real Estate Roundtable here in Washington. I am also pleased to serve as part of the steering committee for the Coalition To Insure Against Terrorism, or CIAT. Just a little background, so that you know who we are: CIAT's membership includes over 70 trade associations and businesses across the country; not only real estate related firms or trade associations, but also, those involved in energy, transportation, professional sports leagues, theme parks, and of course the U.S. Chamber of Commerce is part of our coalition.

We have a very simple and straightforward message. There is really no nuance to it at all. In our view, the reasons that prompted President Bush to work almost daily in 2002 to enact the Terrorism Risk Insurance Act, unfortunately, have not changed. And our view is that until those facts do change, we see a continuing need for a federal terrorism insurance backstop.

The threat of terrorism continues. Where terrorists might strike, and how they might attempt to do so, continue to be an evolving picture. And notice that I said "where they might strike," not "who they might strike." Remember, terrorism is an act against our governmental policies. It's an act against our way of life. It's not an attack on an individual business, or an individual business owner, or an individual building. It's an attack on all of us in America.

In our view, TRIA has been a tremendous success. And it, or something much like it, should be continued. A survey that we conducted in the post-9/11, pre-TRIA days--and remember, there were about 15, 18 months there where there was no TRIA following 9/11--our survey, which admittedly was not the most scientific in the world, but it was a survey out there across the country, and it showed $15 billion worth of real estate related transactions that were either stalled or fully cancelled.

That survey was later extrapolated on by the President's economists. And what they said was that translated into 300,000 jobs that were lost in this period. So if there is a subsidy that's going on, it's to economic activity and it's to workers in America. It's not any government welfare program.

Fortunately, in November of 2002, the President and Congress joined together to enact TRIA. And almost overnight, TRIA provided capacity to the insurance marketplace, and construction projects moved forward, and these $15 billion worth of transactions became unstuck.

Now, some seem to want to wish, if you will, a private terrorism insurance marketplace that exists separate from TRIA. Let me quote from two reports that came out last week, and these reports are people who are not in the business of wishing, but who are in fact in the business of watching real markets and what's going on.

The first that I'm going to quote is from the rating agency Moody's. Now, the rating agencies, by the way, if you don't know, are probably one of the only truly independent players that analyze this situation. And Moody's says--Here's the quote, last week's report:

"Moody's is unaware of any viable private market initiative that would take the place of TRIA."

Pretty straightforward. Secondly, in an April 25th report by the large insurance brokerage firm--I believe they're the largest in the country; I'm not sure--Marsh, Incorporated, Marsh says, and I quote, again from just last week:

"If TRIA is not extended, the stand-alone insurance market is unlikely to have sufficient capacity to satisfy all of the expected demand at commercially viable prices."

Our coalition, CIAT represents the true consumers of this product. We listen to these market analysts. And we fear that the result, without a federal terrorism program, will be sort of a "back to the future": back to the post-9/11, pre-TRIA days, when transactions are stalled or cancelled, and jobs are lost across the country.

Even now, with only months remaining on the current program, our industry faces the threat of going bare on terrorism coverage for our existing portfolios.

And remember, unlike private reinsurance treaties, TRIA does not provide for what's called a "run-off period," where primary insurance policies continue to be covered after the reinsurance treaty expires. That's not the case here. Beginning January 1, coverage will stop.

This is an important point, and helps to demonstrate what will happen without a federal terrorism program. Again, I can quote Moody's, the rating agency. Moody's reports, again last week, that 50 percent to 75 percent of all policies written in America since January 1 have adopted conditional endorsements that will automatically void terrorism coverage beginning January 1st, 2006, if TRIA is not extended in some fashion.

These conditional endorsements are strong evidence that, unless TRIA is renewed, we're either going to see premium prices, as well as a sharp reduction in the availability of what insurance is out there in the few stand-alone products that go forward.

The ultimate victim of all of this will not be corporations; they will not be insurance companies; they won't necessarily be large real estate firms. They will be--the victims, that is--will be the American economy, and jobs. Just who the terrorists are in fact targeting.

Many have mentioned nuclear, biological, chemical, radiological exposures. I'll make two points. The first is, TRIA does cover these events, if in fact a primary insurer will write the coverage. We see no evidence in America today that it's being written. Insurers won't write it unless they're mandated to, as they are other forms of terror coverage. And why should they? Think about it.

Second point. Some captives are being used by our industry, and they are able to be used in concert with TRIA. These captives, in effect--although it's not terribly widespread--they are arguably the only way that you can get NBCR coverage in America today. The captives will write it, and they can leverage off of TRIA. So if TRIA goes away, the only coverage in America that is now available for chemical, biological, radiological attacks will go away as well.

And I just might say as a footnote, just a few months ago, our Vice President told us that the thing that keeps him up at night is worrying about chemical, biological, and radiological attacks in America.

Some rightly ask the question: Are businesses buying terrorism coverage? The answer, obviously, is "Yes, and increasingly so." There has been a continuous increase in the take-up rate for terrorism insurance over the last seven quarters. Remember, we've only been tracking this for seven quarters. Continually going up. The take-up rate in the fourth quarter of 2004 was more than double the rate in the second quarter in 2003. The 2004 annual take-up rate of 49 percent was an 80 percent increase over the 2003 rate.

GAO is in this game, too. They issued a report at the request of Congressman Oxley about two weeks or so ago. GAO said these take-up rates are far higher than other government insurance programs with much longer histories and GAO cited the flood and the earthquake coverage.

"Who is buying this coverage?" you might ask. Financial institutions, real estate firms. health care facilities, are the highest take-up industries. But right behind them, and not very far behind them, are media companies, educational institutions, energy companies, and transportation firms.

Just a couple of other general statements. Some are seeming to imply that the mere existence of TRIA is delaying the private sector's adjustment to a continuing risk of terrorism. In other words, the existence of TRIA is being cited as delaying people across America adjusting to the risk of terrorism. There is no response, except to say there is absolutely zero evidence that this is true. None, whatsoever.

I've also heard it said that TRIA acts to discourage policy holders from taking steps to mitigate the risk of terrorism. This is also completely without any factual basis. First, if you believe this theory, then you would imply that those companies who are not buying TRIA are taking extraordinary steps to mitigate against terrorism. There is no evidence of that, no evidence at all.

In fact, what's happening--and I can speak from the real estate industry, across the board, regardless of whether somebody buys TRIA, buys terrorism coverage or not--the real estate industry is expending vast sums on improving their terrorism preparedness. We are doing it in security personnel, in security systems, barriers, all kinds of additional protections. Perhaps you've noticed them when you go into buildings, particularly in the large cities.

Future developments in design protocol already call for increased setbacks and strengthened building cores. Maybe some of you read the New York Times article yesterday about the changes that are being made in the World Trade Center as far as strengthening the core, setback requirements, and so on and so forth. HVAC and air intake systems are now much more heavily secured than they were prior to 9/11.

But let's be real. First, last year there was only about 15 million square feet of office space in major buildings delivered in America--15 million square feet. Now, that may sound like a lot, but guess again. In the late 1980s, early 1990s, hundreds of millions of square feet were brought to market each year.

Why do I bring that up? Because most of the properties in America are existing properties. In order to retrofit them and change design and so on and so forth, you've got to have a new building. And all I'm suggesting to you is that's a small percentage of the product out there.

But perhaps more importantly and more to the point of these comments about mitigating against terrorism, let's remember that one of the most secure buildings in America, the Pentagon, was a victim of terrorism on 9/11. If the Pentagon is vulnerable, what could you realistically expect private businesspeople to do to stop terrorism?

One more point on this. TRIA has also been compared to the federal flood insurance program by saying that, "Look at what happens in flood plains. Because there's flood insurance, people continue to build in flood zones." Besides being completely inappropriate to compare flood possibilities with terrorism, which is almost--I don't even imagine how we can talk about it in the same sentence--but in contrast to flooding, businesses do not know when or where a likely terrorist attack will take place. Unlike flooding season, there really is no terrorist season. Also, we don't know whether the mitigation steps we're likely to take are going to be effective in any event.

In conclusion, let me just say the real estate industry is one of the most competitive market-oriented industries in America. We want markets to operate freely and openly. That's how our members all make their business. But sometimes, we have to set aside what we wish for, and realize what's really happening out there.

As Alan Greenspan recently testified, there is no evidence--no evidence, Alan Greenspan said--that a private terrorism insurance market has yet developed, or in fact can ever develop.

Given this situation, our coalition supports the continuation of a federal terrorism insurance program. We think without it the terrorism insurance market is very likely to once again become unstable, with potentially very harmful effects for the overall economy.

And again, Doug, thank you very much.

DR. SMETTERS: Thanks for the opportunity to speak, Doug.

As pointed out by Debra earlier, TRIA is obviously set to expire, and Treasury will issue its report in June. To be up front on where I stand, I was previously at Treasury. And Doug Holtz-Eakin was also in the administration at the time. We helped put together TRIA. I'm also one of the biggest critics of TRIA, after I left the administration, obviously. And so, I stand still as pretty much a critic.

Obviously, industry wants TRIA to be extended. And it should be pointed out, initially industry was actually unhappy with TRIA. They wanted something more. And in fact, stock prices of insurance companies went down when TRIA was passed, because shareholders were hoping for something more generous. And now they realize it's the best they can get.

The industry has lots of, I think, arguments to try to rationalize government intervention. Most of them are cheap patriotism arguments, arguments that I don't think hold much water. They talk about the difficulty of making projections, the highly correlated losses, things like that. These are all just bad arguments, I think economists would agree to. First, they don't explain why there's a market failure. There's a difference between a tough job, and a market failure. Lots of things in life are tough. We don't necessarily have the Government do them.

But they also don't explain what the Government advantage is. As a former bureaucrat, I can testify that I don't think us bureaucrats are somehow better at calculating risk probabilities and so forth, relative to the private market who actually have money on the line.

And the third thing is that it's difficult to rationalize lots of these industry arguments--about difficulties of calculating time series, and where terrorists are going to attack, and so forth-- with the existence of other markets. The IPO market, which has trillions of dollars on the line in many years, should not exist if we really believed calculating time series was really hard. The time series does not exist for initial public offering, by definition. Yet people take bets on it all the time. They provide lots of liquidity.

And look at the liability market. The courts have continuously screwed up the liability market, created seismic shifts, completely under government control. Yet, the insurance companies still provide liability markets.

And the fact that stock options exist. People that are willing to take one-sided bets when they write these contracts, knowing that they're perfectly well going to lose a lot of money. This is hard to rationalize with lots of the industry arguments.

In fact, one of the puzzles that's hard to understand at first is, why are insurance companies so worried about another 9/11-type loss? We're talking about $30 billion. That's like chicken scratch in comparison to capital markets. During our time talking here, the S&P 500 could easily lose $30 billion. That is just a 0.3 percent, one-third of 1 percent, movement in the S&P 500. That's $30 billion. That's a market daily variation.

So when I bring this up to the industry people, they say, "Well, you know, there's a difference there. With financial markets, there's a down side, but there's also the upside potential. And so that's the big difference here." And it's not a very persuasive argument because, using that logic, you shouldn't see a derivatives market; you shouldn't see a options market. People all the time are writing derivatives at which they in fact could lose a lot of money if in fact the market moves in just one direction. Yet, the reason why they're willing to write those derivatives is because they priced the probability of that risk into the premium price. They're willing to take that bet.

So I actually agree with Jim MacDonald on a couple of points. First of all, there's a lot more agreement than maybe meets the eye; despite all of the rhetorical tomatoes and spitwads that the insurance industry has thrown at me in the last year or two. I actually think there is lots of agreement on some things.

First of all, regulations and the tax structure in the United States make it very, very hard to do terrorism insurance. It's, as I'll explain in a second, not impossible. In fact, I think a market can still exist. But here are the three main problems.

First of all, as Jim MacDonald pointed out correctly, he said obviously you have to reserve for something like terrorism losses. And that creates an extra layer of taxation you could reserve. The point is, you can’t reserve it in a tax-free way.

And that creates a third layer of taxation above their normal taxes on the business and the individual level. And that third layer of taxation is actually more distorting than the first two layers of taxation, due to a well-known public finance law that says that the rate of deadweight loss increases with the square of the tax rate. So that additional third layer of taxes is actually very distorting.

As Jim pointed out, Europe allows for tax-free reserves. Why don't we have it in the U.S.? Well, traditionally, the U.S. Treasury, which has a legitimate gripe against the insurance industries,has traditionally opposed it. And their logic is as follows: They are afraid of allowing for tax-free reserves and firms basically taking a bunch of retained earnings, accumulating them in these tax-free reserves, not getting taxed on it, and basically tax arbitraging that way.

I think that's a problem we can work around. I think it's possible to actually have legitimate tax-free reserves that deal with this problem.

But the real issue that the U.S. Treasury, I think, is mad about -- and they have talked about this in public and so no secrets here -- is that the insurance industries get so many breaks already. They get accelerated write-offs on losses. Also, so many insurance products out there are tax scams, like variable life annuities and finite risk contracts which offer almost zero insurance value. They are just completely ripping off the U.S. Treasury. And so, why give these insurance companies yet another tax-free break?

In my opinion, let the U.S. Treasury win on those issues. Many in Congress have bitterly opposed the U.S. Treasury's attempt to get rid of these tax dodges; my party, as well. Congress should back down and get rid of these tax dodges. And then at the same time, let's actually allow for sensible tax-free reserving.

The second and I think more important problem is that it's very hard to in fact tap into the capital markets in the U.S. And this is due to NAIC rules and regulations that make it very hard to do onshore securitization that will effectively allow us to tap into the capital markets. And you really need to have onshore securitization to deal with a problem called diversification risk, that I can talk more about with Q&A if that comes up.

And basically, the only type of securitization contracts that are allowed in the U.S. as recoverable assets on primary insurer's balance sheets are contracts that pretty much look like standard insurance contracts. They have to look like standard indemnity contracts with no basis risk. And that kind of rule undermines the whole point of doing securitization.

If we actually had a reasonable policy that allowed for securitization, we could start tapping into the capital markets, and $30 billion losses would seem like nothing. They would seem like a regular volatility in the S&P 500 that happens on a daily basis.

And thirdly, there are serious problems with price controls, especially in the workers' compensation area. It's just a completely screwed up line of insurance. Now, keep in mind, insurance is regulated on the state level, and so you have state commissioners--actually, more than 50 commissioners, because Guam and those places have commissioners, too. And all these guys want to run for governor some day. And so what do they want to do? Do you want to run for governor as the guy who got rid of price controls and allowed the big, greedy insurance companies to gouge the little guy? No, of course not.

Insurance is the one last market where socialism and cheap populism are very, very much alive. I really think we need 50 Ronald Reagans, or at least federal preemption, to basically get rid of these modern gas price controls.

Rules make sense, regulations make sense, when it comes to enforcing contracts and fair and full disclosure. Controlling prices does not make sense.

But I'm often asked this one question. Given that the market is completely screwed up, can insurance companies still provide terrorism insurance? And I didn't really address this in this paper that always gets criticized by the insurance, but let me take a guess at it. I bet you that the market probably could.

Now, don't get me wrong. I don't want to give policymakers an excuse not to address the problems I mentioned earlier. But here are two pieces of evidence that probably suggest that insurance markets probably could.

First, remember, TRIA took a whole year to pass, because the Republicans and Democrats were in this big argument over tort reform. And so it wasn't even 100 percent clear it was going to pass. But still, what happened during that period is that lots of markets actually started developing at that point for writing terrorism losses. Lots of hedge funds got involved. Standard insurance companies were starting to reintroduce this type of product.

The insurance industry loves to talk about the extreme cases, the Golden Gate Bridge, the trophy properties in New York City. What they don't tell you about is, actually, even for those hard cases, the prices were actually coming down. They quote prices right after 9/11, or that are on the renewal date. They don't mention the fact that a lot of these prices were actually coming down over time.

And certainly, average prices were coming way down. And capacity in the market was going way up; even though the insurance companies knew that the Government was probably going to pass something. That's what's pretty amazing about it. More capacity, even though the Government was probably going to crowd them out.

The second piece of evidence is that today, according to the same Marsh study that was mentioned before me, insurance companies in fact are writing policies for non-certifiable, domestic terrorism claims. Seventy percent of the companies buying TRIA-type policies are also buying additional policies of domestic acts of terrorism that won't be covered by TRIA.

So how can insurance companies say that they can write this other stuff that's not covered by TRIA, and at the same time they need TRIA? Now, you might try to come up with possible reasons: Well, domestic acts of violence, they may be smaller, or something like that. I could tell other stories, of how they could actually be bigger.

When I ask the industry people themselves, they'll say things like, "Well, if we don't write it, some competitor will come along and write it, too, and steal our business." I always find it funny talking to insurance executives, this sense of righteous anger of how bad competition is, about how those competitors are going to steal their business.

But what's interesting about that point: It's predicated on the fact that they believe the market will actually work. If you didn't believe the market would work, you could just completely exclude these non-certifiable events, domestic events, and not worry about competitors, because you believe that the market can't provide this stuff. So the fact that they are writing stuff is because they fear that the market can provide this stuff.

And then, people sometimes come back to me and they say, "Ah-ha, but we know, in terms of TRIA events, that all these policies--" not all of them "--about half these policies have these conditional endorsements that basically say that if TRIA expires, you know, the rules of the game change."

Well, of course, they have conditional endorsements. That's because the current TRIA has been so heavily subsidized that, of course, if you don't get the cheap subsidy any more, you want to change prices. And so that itself is not evidence at all that the market is failing. It just means that the market knows how to price things.

And of course, the insurance premiums should go up for terrorism acts, because right now the taxpayer is subsidizing it. When you get the taxpayer not subsidizing it, you actually have companies paying their fair share.

So let me give what I think is the bottom line in this whole debate. If you believe that there is an argument for extending TRIA it is because you believe the Government has so screwed up the insurance market that you kind of need more government policy to correct for all the government policy that's so screwed up.

And this reminds me of a good dictum by Milton Friedman. "Bad policy begets bad policy." The idea being, you have some bad policy screwing something up, and so what do you do? You come up with more policy to deal with that screw-up. And now, he wasn't trying to rationalize more bad policy. His point was, just deal with the bad policy to begin with.

And so I think what this debate comes down to is your belief of whether or not we can really deal with this bad policy. And I want to deal with the bad initial policy, instead of just loading on additional bad policy. Thanks.

MR. ZIELEZIENSKI: Thank you for inviting me to come today. My name is Stef Zielezienski. I'm with the American Insurance Association. And I promise, I'm not running for governor of anything--including Guam.

I want to, instead of talking about the program, address some of the myths that have come up and been discussed here today. TRIA is not a hand-out or a bail-out. Before the backstop is triggered, you've got to understand, the private insurance mechanism must sustain losses that are roughly equivalent to $30 billion. As Mr. Hunter notes, that's, by his calculations, more than the World Trade Center. And that's not backed by nearly enough premium to cover that.

It's not a subsidy of insurers. Rather, it is a level of government involvement in our nation's post-9/11 terrorism risk management program.

And that is important to note. Because there is one thing that I agree with Mr. Hunter on today. He said Osama Bin Laden is not trying to bomb someone's car. Well, I think that's right. Osama Bin Laden is attacking all of us, as Americans, and not declaring war on any individual; but declaring war on us.

We have declared war on terrorism and we don't fight war in the private sector. We fight war as a matter of national policy. Certainly, insurers can be part of that; but certainly, the government has to be a part of that, too.

Let me talk a little bit about some of the myths that have been discussed here today and in other places. The first one is that terrorism is insurable. Terrorism is not insurable. It's impossible to predict how, when, where, or how often terrorists will strike.

Terrorists are adaptable. They act on intent. It's not accidental. They plan; targets harden; they change their targets to others. So as much as we would want to prevent a loss on a building in Manhattan, if that target becomes hard maybe they go to attack a water supply system in upstate New York. The fact is, we don't know. They are adaptable.

As far as government having a better plan to insure the risk, well, government has access to classified intelligence information that insurers don't. There is this asymmetry of information that doesn't enable us to adequately assess the risks that we face.

Third, unlike natural catastrophes, terrorist attacks are not random events. They are intentional.

And finally, the modeling, while it's improved, it's useful only for exposure management. It can tell us somewhat what the severity of a loss will be in any particular geographic region, but it can't tell us how frequently an attack will occur. So accordingly, insurers have to manage, but they can't use the modeling to judge frequency.

The second myth I'm going to dispel is that there are no incentives for private-sector risk management under TRIA. Well, it's an interesting theory, but it really doesn't match the reality of the program. You've got to look at this from two perspectives: one, within the TRIA retention levels, where there is no federal participation; and secondly, above the retention levels, where there is "free reinsurance."

Let's take the first perspective. Within the TRIA retentions, there's approximately four to six billion dollars in reinsurance capacity that's available. Very little of that is available for managing NBCR type risk. And there's a lot of that that is attributable to domestic terrorism, which is not covered by TRIA. That falls well short of the approximately $30 billion that insurers would have to shell out in the event of a loss. There's a huge gap there.

And that brings up another point that Professor Smetters stated earlier. And that is, what's likely to happen six months from now? I think a good indicator of what might happen is where the reinsurers are today. Because they really operate, for all intents and purposes, in a free market without price controls.

Their unwillingness to provide any more capacity than they're providing now I think is a good indicator of where they're going to be in the future. They don't like this risk. They don't think this risk is insurable. They equate this risk to war and political risks, which they've never reinsured. So I would posit that that might be a way to look at a more accurate picture of what happens post-TRIA.

Now, let's address the issue of what happens above the retention levels. This has been called free reinsurance, and you would think that at that level there would be some market to step in; but there really isn't. There isn't a market that's being crowded out because of TRIA. It's simply once you get to a certain catastrophic level, there is no appetite for that risk in the private marketplace. And the Government needs to be the mechanism of last resort.

Let me jump to the third myth here. And I think it was addressed earlier, so I'll be brief. That is that TRIA removes incentives for mitigation. I think that is patently offensive, to suggest that policy holders, particularly commercial building owners, would not want to minimize the risk that they face, just because TRIA is in place.

I think--and Jeff alluded to it earlier--policy holders are taking as many measures as they possibly can to mitigate loss. But what can you do about a risk that really is interdependent? It doesn't depend on what you do. You could do everything you could to harden the building, but you probably couldn't stop or predict at the time of 9/11 that security failures at Logan Airport would cause hijackers to board planes which would fly into your buildings. Certainly, building owners and insurers learned from the 1993 attack. But you can only learn based on what information you know.

And the final myth I'd like to address is the myth that we are a hugely profitable industry, and that capacity is adequate to address catastrophic terrorism. A major terrorist attack in some scenarios, likely scenarios, puts the cost of an attack at over $250 billion. It would dwarf the commercial line surplus of our industry; would bring the entire industry under.

The commercial line surplus now is estimated at $175 billion. And although the surplus has grown since 9/11, now it is less than 10 percent more than it was in 1999.

So what's the reality? The reality here is that TRIA is working as intended. The reality is that the federal backstop is urgently needed. The reality is that our economy will be hurt, even in the absence of a future terrorist attack, if we don't have a federal mechanism at least in place to address catastrophic terrorism. And the reality is that our economy will suffer serious harm if we do have an event and there is no mechanism in place. Thank you.

DR. HOLTZ-EAKIN: Well, let me echo everyone else's thanks for the chance to be here today.

I was unaware that Senator Sarbanes was instrumental in providing the room. I want to take this opportunity to thank him for the many years of tireless support for good economics and government policymaking. I've had the privilege of serving at the Council of Economic Advisors, as well as the CBO, and the Senator has always been one who is interested in getting good, solid analysis into the policy issues. And his retirement will leave that voice absent. It's been a great service over the years.

The issue we face today is one about the correct economic policy in the face of terrorism and its economic consequences. It is the case that long-lasting terrorism risk imposes economic cost.

Now, there has been much made about the degree to which financial incentives or insurance contracts, per se, can diminish the nature of those costs. I think that that has largely missed the point. It's not the case that those incentives are going to stop terrorists cold in their tracks, intercept them at the border, or disarm them. Those are largely the role of defense strategy, international diplomacy, and homeland security. We will face, in the event of terrorist events, economic costs.

The issues are whether the costs of terrorism can, even to a small degree, be smaller than they would have been in the absence of good economic incentives, and the degree to which they will be spread across the financial population in an economically efficient way. The costs themselves will be there regardless. It is unlikely that financial incentives, per se, are going to make those costs go away.

Now, those costs could be a little bit smaller. How much is in the eye of the beholder. It's certainly the case that insurers have distinguished between higher- and lower-risk areas. Geographic diversification has the same virtues as diversification on other fronts: It will lower costs overall.

Terrorism risks could very well cause us to rethink the composition of economic activity. I don't think the benefit-cost analysis of spent nuclear waste looks the same in the presence of terrorism risk as it did in the absence of terrorism risk. The economic activities that produce it will be evaluated differently as a result.

Now, financial markets as a whole have a valuable role in managing these risks and the costs that they carry. They convey information about the costs; whether it be through financial prices, such as insurance premiums, or stock market prices of those firms which are more or less financially exposed to terrorism risk. By conveying that information, financial markets can direct mitigation wherever it's possible to do so.

Importantly, financial markets are a way to shift the burden of the costs of terrorism in a voluntary and, hopefully, efficient fashion, either through diversification, or the direct purchase of insurance products.

This is where the legislative decision enters. What will be the decision in terms of extension and/or modification of TRIA as we know it? It strikes most observers that, number one, Congress has faced this decision before, not that long ago. But number two, TRIA was explicitly a temporary policy that was enacted to temporarily deal with the circumstances that had arisen after 9/11.

What is really striking about the current environment is the notion that somehow terrorism risk is not a temporary event. Whether it be the testimony of the CIA and the FBI, the report of the 9/11 Commission, the notion that terrorism risk is a far more durable element of the financial landscape is the real difference between then and now.

But it's also true that much has gone on that suggests that, for a bandaid, TRIA was relatively successful. Equity markets have rebounded. The property and casualty insurance industry has seen its net worth rise by about a third, and underwriting profitability return. Prices for terrorism coverage have fallen and stabilized. There has been some development of risk-based pricing within the industry, certainly between more and less risky locations, if not perfect pricing. Reinsurers, while perhaps not as active under TRIA as some might have hoped, have provided other kinds of coverage, as Kent Smetters mentioned, for domestic terror, and priced it. About 50 percent of firms have chosen to take up terrorism insurance as part of their overall strategy of managing the risks in this environment.

One of the difficulties in looking at the world now, versus the world then, and looking at these improvements, is trying to decide how much was due to TRIA, and how much was due to the fact that the economic performance of the United States as a whole has significantly rebounded. There is just very little evidence that will allow us to tell those two apart. With all due respect to the Treasury, I doubt that their report will definitively answer that question either. So there is a fair amount of difficulty parsing through the record.

Now, in light of that, one can appeal to how to think about the problem. As I stressed at the outset, it should be thought about comprehensively. This is not about stopping terrorism. This is about the financial markets' distribution of the risks of the costs of terrorism. It's not about any single insurance firm; certainly not even Mr. Buffett's. It's not about the insurance industry, even. It's about the particular piece that will be diversified and shifted through insurance policies.

It's also worth thinking about the different risks from a policy point of view. The typical way to frame this up is to ask: What did TRIA do, and what would it do without it?

But another way to ask the question is, “Which risk is greater: letting TRIA go away or developing a government program with poor incentives for the financial industries involved?” Suppose TRIA went away. Would private financial markets be capable of stepping up and bearing terrorism risks? That could be done through the use of equity instruments, with shareholders bearing risk and the probability that losses would spill over onto bond holders, or through private direct insurance and reinsurance. The other risk is if we developed a government program and perhaps ended up with a program that we might not like, such as the savings and loans program, which was a not particularly effective government risk-spreading program that led to great bills for the taxpayer. There are design risks with both approaches. It's worth thinking about those risks.

Now, what lessons do we have? One lesson is that we are in a different world, and if we do have to adjust our economy to sustain terrorism risks, putting in place policies which are explicitly designed to insulate people from those risks is unlikely to be successful. So we should probably rethink TRIA going forward.

One possibility would be for markets to price terrorism risk in some way, if at all possible by allowing TRIA expire. Then the price of terrorism risk insurance is going to depend on innovation of financial markets. Promoting innovation might require some of the things that came up earlier: changing tax treatments, changing accounting treatments so that catastrophe bonds would qualify as reinsurance, things like that.

But there are others: new instruments; mutual insurance tools; participation in new entitles such as hedge funds. What would be the willingness of the private-sector reinsurers to step in?

Or the government could add premiums to the existing TRIA program, and price it in that way. This raises questions of expertise in setting premiums that I'll defer to people with experience on the panel. It raises questions about whether federal programs that have a dedicated premium might have a life beyond their usefulness in the federal budget. In setting the premium, the Government may convey, perhaps inappropriately, the appearance of more knowledge about a terrorism event than in fact the intelligence community possesses. That would be another issue in setting the premiums.

Another strategy would be to take a look at our experience, and perhaps focus the next version of TRIA more closely on those things which jump out as difficulties in the current environment. Many have spoken about problems with workers' compensation. Clearly, there is an asymmetry now in regard to nuclear, biological, chemical, and radiological risks between workers' compensation, which cannot exclude these risks, and the remainder of the property and casualty insurance lines which can. Given the predominance of the fear that a nuclear event will be a dominant part of terrorism strategy -- risks excluded from most other kinds of insurance-- maybe a federal program could focus on workers' compensation as well as the risks faced by landmark properties.

So it's, I think, an important decision. I think that the Congress is going to have a very healthy debate over the future of TRIA. You've heard a flavor of it from the panelists already.

But certainly, it is the case that it would be a mistake to think of this as our primary weapon against the costs of terrorism, per se. It's not. It would be a mistake to think of the policy issue as an insurance industry or an insurance firm problem. It is not. It's part of the larger issue of distributing those costs, whatever they may be, among economic entities in the United States. Thanks.

MS. ROBERTS: Thank you all very much. I'm going to start off with a few questions, and then we'll open up questions to the floor.

This first one I'd like to initially address to Doug, Kent, and Jim--just so I have your attention. Putting aside the actual numbers, what should the theory be behind setting deductibles and co-shares? Do you want to start, Jim?

MR. MACDONALD: Okay. It's real simple. The theory should be that the tradeoff between making available terrorism insurance by law, having to do that--the tradeoff should be that the insurance policies you buy today from companies like mine are good; that our solvency is protected by whatever structure we put in place.

You do not want your insurance company on your homeowner's or your worker's comp or the property in this building to go under, to be insolvent. You do not want to be told to go to a guaranty fund because they wound up with this incredible, uncorrelated loss to an explosion and, "We're sorry, but they're out of business; the insurance policies you bought are no good."

So the tradeoff for "make available" has to be not a bail-out, but assurance of our solvency in the event of a large or uncorrelated loss.

DR. SMETTERS: It's very simple: a 100-percent deductible. Of course, I'm kidding.

It's hard to say, because I believe that the private market probably can do this. And so I think it's hard come up with a hard and fast rule. Obviously, the insurance companies, they want very low retention. They want to pass as much of a subsidy as possible. They want to get as much of that as possible.

I don't buy the idea that competition rules out government subsidies. If we believe that, we wouldn't have farm bills, we wouldn't have lots of things. We have lots of industries where there's lots of competition, where they all get together collectively and say through trade associations, "We want government subsidies." That's not incompatible with competition. This is a hand-out.

And so I think it's very unclear to have a very hard and fast rule. But I will say one thing. If we're going to have TRIA, let's do two things. First of all, every economist agrees with pricing TRIA. I've never heard an economist on either said saying, "Oh, yeah, the correct price is zero. We should be giving away this thing for free."

And it is a free subsidy. I mean, it's amazing how industry people tell me this isn't a freebie because they have this retention level. I say to them, give me free car insurance, and I'll have a $500 deductible, you know? I'll use the same argument. Of course, that's a free insurance. And of course, it should be priced.

But the second thing is, if we're going to have this TRIA extension, let's just keep in tune with the philosophy of TRIA. And that was to be a receding role for the Government. So let's increment the retention levels. Right now under TRIA, the retention levels increment over time. Let's just keep with that time path, and let's just increase it.

DR. HOLTZ-EAKIN: That's the standard economist's argument on the design. I'll just remind you of why the top end is important, the 10 percent co-insurance. After the fact, you want to retain incentives for claims adjustment. You really do want to take advantage of the fact that the insurance industry has the experts in this area and ought to have a financial incentive to go out and examine claims, make sure they're appropriate and are adjusted to the actual losses.

That's an important part of the design that shouldn't be lost in the discussion. It's not something that you want to trade off for one with a deductible. You want to hold onto co-insurance for reasons that have to do with after-the-fact performance.

MS. ROBERTS: Any other comments from the panel on that question?

[No Response.]

MS. ROBERTS: Okay. Continuing on with the subject of deductibles, is anyone on the panel aware of any study that measured what the industry's share of losses would be in a future event the size of 9/11 and with the same pattern of insurance coverage? Anybody aware of that?

MR. MACDONALD: Well, I'd like to make a comment on that. The 15 percent retention today that's based on last year's direct earned premium translates in some cases to 20, 30, 40, more than 50 percent of the net worth statutorily of insurance companies who are at risk.

In other words, if insurance companies were to sustain a loss today like 9/11, there are many cases--And we've looked at all 1,200 of those companies that wrote business in 2003. We've done the math. And we can tell you that Standard and Poor's, for instance, when you have a sudden drop of just 10 percent of your surplus--At a recent Wharton seminar I was at, they used 10 percent as a rule of thumb for rating action.

In other words, if the 15 percent deductible based on direct earned premium under TRIA translates to 30, 40, 50 percent of your capital, and you sustain a large loss that will exhaust that capital, you will likely be out of business long before you get to the federal reinsurance level.

MR. HUNTER: It's the text for my testimony before the Senate here. And I didn't do the precise $30 billion; I did a 40 and a 25. And the insurers would save, compared to what they paid before, 56 percent on a $40 billion attack, and 35 percent on a $25 billion. So it's probably about somewhere near a third. They'd pay a third less than they did last time. They paid after taxes about 20 billion last time. So they'd pay about 13, 14 billion in a 9/11, even under the current year three TRIA.

MS. ROBERTS: Is that using the same companies that sustained losses in 9/11?

MR. HUNTER: Yes. I was using that as a model.

MR. MACDONALD: Can I give an underwriter's answer to that? As I said before, all these discussions, like Kent Smetters has offered, about industry averages are meaningless if you work for--I work for an insurance company. Our capital is voluntarily committed by our board of directors to this market.

We were created 20 years ago by Fortune 100 companies who needed coverage. Our board of directors needs to know that there is a risk-return relationship to any policy we underwrite. They cannot commit our capital when the risk is unlimited and represents a risk of ruin which would be inappropriate.

Under Sarbanes-Oxley, which is not going to expire, there is much that's been done, and there are new controls in place. These rules have always been there, though. Free market capital needs to know the parameters within which capital is going to be placed at risk. And we need to know the return for that risk. And there needs to be a correlation.

TRIA provides a ceiling. It's a high ceiling, in our opinion; but at least it's a ceiling within which we can work. You take that ceiling away and on lines like worker's comp where on 9/11 we insured as many as three, four, five thousand employees in the same building, and you do that in a state with $500,000 or more in average death benefits--Do the math.

We have $2 billion in capital, statutory capital, and change, in this country. It's easy to see why we worry about the arrow hitting us. Industry averages mean nothing.

MR. ELLIOTT: Could I just say, Debra is being a little too nice to you guys. In the interest of time, could we try to stay on the specific question that's being asked? Because she has a series of additional questions, and I'm sure the audience would like to ask some, as well.

MR. DEBOER: Yes, let's get to some specific questions. But the insurance industry gets bashed a lot, you know, on Capitol Hill. And I think that it's time for some people to recognize what they did on 9/11.

On 9/11, they stood up and they honored those insurance policies. There were, I think, a lot of people around the country who thought the insurance industry could litigate as to whether it was an act of war, they could litigate a lot of other issues. But they paid out roughly $40 billion.

Now, a good question might be: What would happen if TRIA goes away, and if the similar attack occurs? Well, what's going to happen is, most of those buildings aren't going to be insured because, as we know, the capacity is not out there. The stand-alone policies aren't going to be out there. People aren't going to have the insurance.

What's going to happen? The Federal Government is going to pay all of those losses. They're going to pick up the first dollar loss. What happened in 9/11, remember, there were two layers before the Federal Government ever got involved. First of all, property owners have deductibles on insurance policies. Right? Then the insurance company pays. Nobody's arguing that. Then the Federal Government stepped in.

What we're postulating is, without TRIA there is not going to be that additional, that first-dollar loss protection out there for the fisc of the United States. You talk about spreading economic costs, the economic costs without TRIA will go up substantially if there is another attack.

And one other thing that I think really gets lost in these discussions up here. Everybody talks about, "What's the market doing today? What's being created? What's being innovated?", and so on and so forth. Remember why TRIA was enacted. And we've only answered part one.

TRIA was enacted for two reasons, and the President of the United States articulated it very, very well when he signed the bill. Number one was we needed a policy in place that allowed our economy to operate in the face of a threat of terrorism. All right? That's what this does. It provides reinsurance.

But part two, which we haven't talked about here at all, and people seem to want to glaze over--We have statements that, "I believe that markets probably might work." Well, that's some assurance for people who are out there trying to create jobs and go forward in business. In the real world, you've got to be able to operate.

And part two of the reason why the President of the United States signed this into law when he did was, he said we needed in place a policy that will allow our economy to rebound in the event of a second attack.

And all I can say is, we can debate about markets, where markets are today and where they might be tomorrow in the terrorism insurance industry. Maybe something gets developed, and maybe some transactions go forward. The day after the next attack will be precisely the same way that it was after 9/11. Whatever private market exists will be gone. Transactions will cease. And our economy will have to bear the brunt of that. So all I am suggesting is, there are other reasons for TRIA; not just the snapshot of what the marketplace is today.

MS. ROBERTS: Okay, let's move on. Should insurers have to pay any up-front premium for TRIA? This has been touched on a little bit by Kent. And also, part of this question is, is there any way to measure whether this lack of premium paid--whether that encouraged lesser mitigation efforts than would have occurred if premiums had been charged? And let's try to stay with the question, please, in your answers.

MR. HUNTER: Well, I've already said they should. If there is a renewal, which I don't think is necessary, but if there is, I think one change has to be to charge a premium, an actuarially sound premium, just like we did in the riot reinsurance program. And it's do-able. It's do-able.

And you have to have some fall-back things, in case of projections being--But any kind of rate-making has a certain degree of risk. So you're not going to be precise. But it is a do-able process, and we did it with riot reinsurance. And you can do it, in my view, using the models that are available.

And I do believe that, if it is charged, unless you repeal the laws of economics, free reinsurance has to produce less mitigation incentive than reinsurance for a premium. It just has to.

DR. SMETTERS: I think that economists here, we all agree on this. But I would like to actually have all the industry people answer that question. I think it's a great question.

MR. MACDONALD: Yes, in 2003, we spent the whole year working on an AIA-hosted project with 13 other insurers, to try to create a voluntary worker's comp terrorism pool. And we discussed this issue a lot. Should it be pre-funded, or post-funded?

Frankly, the answer is, "Both." And that's sort of what Bob was implying. It makes a lot of sense. You have to establish certain surplus targets for growth in the pool or for growth in your reserves. You establish a pricing model around that. You amortize then the pricing to the degree that you achieve those goals. So I believe that's all how a pool really works in the U.K.

DR. SMETTERS: But that's a different issue. I mean, she's asking if TRIA is extended and they put some pricing in, you won't have a problem with that. Because TRIA is not a pool rating.

MR. MACDONALD: It's hard to debate the argument that some charge should be made. It's impossible to.

MR. DEBOER: Look, from our perspective, we've never argued this on a price point of view. It is an availability issue. I don't know anything about the riots, but the one thing that I do know, in any modeling that was done to model riots, there was never a riot in the United States that came close to bankrupting an insurance company. The comparison is night and day, frankly.

What Jim says is insurance companies are being asked to bet their company. Why should a company in any business in America, a private company, have to bet their very existence in response to a societal threat?

MR. ZIELEZIENSKI: I think that if the question is, "Should insurers pay premiums for the reinsurance?" I think the answer is, yes, we'd be open to that, as long as the prices are fair and we don't get our rates suppressed in the marketplace so what you end up with is paying and not getting back the money you've paid through premiums.

MS. ROBERTS: I'm going to ask this one last question, then I'll open it up to the floor. And then I have more if we have time, and I'll come back to you. But this last one for now is, how should NBCR be handled in TRIA, in practical terms? What's the extent of the current coverage in TRIA of the NBCR?

MR. MACDONALD: We strongly disagree with any statement expressed or implied that TRIA does not cover NBCR. Read the law. There is no NBCR exclusion in the law. It's that simple.

For worker's comp there is full and complete coverage from the feds, and we need it desperately. Where some confusion, I believe, is arising is over those exclusions which exclude NBCR for non-certified, so-called "other acts of terrorism." There are exclusions in the market that apply an NBCR exclusion to other acts of terrorism, but not to TRIA. I know of no policy that we underwrite that excludes NBCR for TRIA. If someone buys TRIA, they have the coverage.

MS. ROBERTS: Okay. Why don't we take some questions from the floor. Yes, sir.

AUDIENCE MEMBER: [Question Off Mike. The gist was that TRIA effectively subsidizes urban areas, since they are considered at higher risk of attack]

MR. HUNTER: That is what's happening. There's no question about it.

MR. DEBOER: Well, that's what's happening because that's where the last attack was. All right? People who believe that they can look in a crystal ball and tell us where the next attack is going to be--they ought to be doing something other than sitting in this room.

I would question whether the people who owned land in Pennsylvania, for example, thought that their property was going to be the victim of a terrorist attack. So, yes, maybe you can buy this product in Wisconsin tomorrow. Maybe next week, the attack is in Saint Louis or some place. So it just seems to draw a line in making policy based on, in effect, last year's problems. I don't think that it makes all that much sense.

Plus, I can't believe that, although there is some administrative cost--and keep in mind, that's all we're talking about--if there is no terrorist attack, and the Government therefore never has to pay anything out, there is no cost to the Government except for an administrative fee.

So I guess I would postulate that the administrative fee of covering Wisconsin is so minuscule compared to having an overall policy that covers the entire country, I--That's where I would be on this.

MR. MACDONALD: I'd like to make a comment. You know, I heard that right after December 7th, 1941, there were some people in America, before FDR gave his speech, who suggested that Hawaii, not the United States, had been the subject of the Japanese attack.

Let's listen to our President. We are at war with these terrorists. The concept that war has to be state-sponsored was developed in 1640 or so in the Treaty of Westphalia. It is an old concept. We are in a new century where non-state-sponsored war, effectively--call it terrorism--may be what we have to deal with, as far as we know, in this century.

No one here will debate war. Terrorism, we have a war against terrorists. When they attack New York, they attack the United States. What are we going to do? Throw in the towel? Everyone moves to Peoria? Then they'll attack Peoria. Right? This is our common cause. That's why it's more than just an economic issue.

MR. HUNTER: In fact, the ISO rates of the Insurance Services Office, the rating organization, charge very high rates for four cities, and then sort of a middle-sized rate for five cities, and a very low rate for all the rest of the country. And in fact, if TRIA was removed, the rate would not change in the rest of the country, according to my analysis of the ISO rate.

And the idea that, if there are no claims, there's no cost to the Federal Government is just silly. You have the lost income that you would have had if you charged an actuarial rate. It's like me going to State Farm after I have ten years with no auto claims, saying, "Give me my money back. I didn't have any claims." They're not going to do it.

There is a risk that is being taken on by the taxpayer. The money should be in the Treasury. If another event occurs, that money should be already piled up for that purpose.

MS. ROBERTS: Okay. Let's move on to another topic. Do you have a question? Yes.

AUDIENCE MEMBER: [Question Off Mike.]

DR. SMETTERS: No, I think it's a good question. In fact, the person mentioned two things, the rating agencies and Marsh, who supposedly have unbiased positions in all of this. They don't. Absolutely not.

The rating agencies, they're not sure how to rate this stuff. So they're going to have to do a lot of investment that they would prefer not to do. Marsh, obviously, makes money off insurance purchases. And if the insurance that is purchased is subsidized by the Government, that, of course, is going to make them money.

Keep in mind – and this is a fact that's just often ignored in this debate -- it's not necessarily optimal that companies buy terrorism insurance. Companies are different than you and I as people. We buy life insurance, car insurance, home-owner's insurance, because we have a non-diversified asset that we can't diversify in the capital market. And so we can't sell shares in our body, or sell shares in our home, things like that. It would create huge moral hazard problems, slavery, and so forth.

But obviously, companies are owned by well-diversified shareholders. And many companies should not be buying insurance, because the shareholders are already diversified across lots of these losses. And so it requires lots of thinking to even think as to why companies would want to buy insurance for terrorism losses, because the shareholders are already diversified.

And so the fact that we've seen the take-up rate, for example, go up recently, well, that's largely because it's cheap stuff. They wouldn't necessarily buy it if it were actuarially fair pricing.

The second thing that's happened in the last year is that it's been a very soft market in terms of prices in the non-terrorism area. So what's happened is that corporate funds were allocated for buying insurance at the beginning of the year. Rates came down on other insurance. So what did the risk managers do? They had all this money left over; "We're not going to give it back to the board." No, they're going to buy a bunch of excess products that they otherwise wouldn't have bought. In fact, this is what a lot of risk managers have actually said.

In terms of the reinsurance market, I agree, there is a big issue there. And that is, reinsurers are reinsuring deductibles, retentions, in Europe. They are very hesitant to do it here. I have some kind of potential reasons for that. It's not 100 percent clear exactly what's going on with the reinsurers. My guess is that if we reduced some of these regulatory and tax things, that there would be more of a market there. But I agree, that just still requires a lot more thought.

MS. ROBERTS: Okay, thanks. Do we have another question? Yes.

AUDIENCE MEMBER: I think maybe this has been asked and answered in several different ways, but Mr. Zielezienski said, as far as premiums for terrorism insurance, "Yeah, we'd be open to that, as long as the prices are fair." So what would a fair price be? Or how would you structure that?

MR. ZIELEZIENSKI: I think the first point is that we are in a system of price controls, so we can't offer a rate in the market where the normal laws of supply and demand operate.

If that were available, I think, sure, you could charge for it, and you're making what the market will bear. But if you have a program where you're purchasing reinsurance, and you still have government price controls in place, and you're not assured of making money back in the marketplace, I think that's unfair.

MR. HUNTER: I have to respond to that. That's crazy. The idea that you have to override all of the state laws because of this little, teeny, 7/10ths of 1 percent surcharge--that is roughly what I would estimate it would be--makes no sense.

Because everybody is buying lots of reinsurance currently, and in whatever the system is. So the idea that, because we might add on this one-seven-tenths of a percent surcharge to people, that we need to therefore override all of the regulation passed by people in the State of California, and like that, totally overriding democracy because of this 7/10ths of 1 percent surcharge that might occur just on commercial accounts, which are heavily unregulated currently--witness the Spitzer investigations--just makes no sense.

MR. ZIELEZIENSKI: I really don't understand how democracy was founded on a system of government price controls. I think just the opposite is true in the United States of America.

MR. HUNTER: Because the people in the State of California passed it.

MR. ZIELEZIENSKI: Every single competitive industry in this country, except for the insurance industry, has free market pricing.

MS. ROBERTS: Well, that's a little off the path here today. Let's take the next question.

AUDIENCE MEMBER: [Question Off Mike.]

MR. ZIELEZIENSKI: Did you say that group life can't exclude terrorism? Because that would be similar to worker's compensation, I think. There's no reason why it shouldn't be included.

MR. HUNTER: For a very simple reason. First of all, the group life people went to the NAIC and asked them to exclude it. And they were refused because they--I was on the conference call. They were refused because they hadn't even done their due diligence to find out if they could handle it privately, A, with reinsurance and, B, with some kind of grouping--because it's a classic easy to group thing--and spread the risk. I mean, it's very classic. So first, the real experts, the NAIC, rejected that, after study.

Then Treasury was asked to study it by Congress. Treasury studied and demurred; said, "No, you didn't make your case." So you've had now two studies. In both cases, group life was found not--It didn't need it. I have yet to see any analysis, other than lobbying, that says that it's necessary.

AUDIENCE MEMBER: [Question Off Mike.]

MR. HUNTER: A, there is reinsurance. It receded some. But it's there. B, you have the ability privately to pool these and spread high group concentrations. And you haven't even studied it.

AUDIENCE MEMBER: Well, actually, I think the group life insurers actually did look at doing a group life pool [inaudible].

MR. HUNTER: That isn't only the way it works. You're wrong.

MS. ROBERTS: Okay. Any other questions? Yes.

AUDIENCE MEMBER: [Question Off Mike.]

MR. DEBOER: Sure. The question is, I guess, world-wide what other countries are doing. World-wide, other countries who have faced a terrorism risk have stepped up to the plate and enacted long-term programs that are either full insurance or reinsurance programs, or are partnerships with people doing business in their countries. We can go down the list: The U.K., Spain, Australia, Israel. There's others out there. They all have long-term terrorism insurance programs in place.

And this may in fact go to the reason why reinsurers provide reinsurance in this marketplace in other countries different than the way they behave here. They do have a long-term program that gives them comfort to come in and go out of the market.

And since you brought up what's going on around the world, it is a little bit ironic, I think--And this conference shouldn't go where you don't bring it up. And that is the Overseas Private Investment Corporation--or Insurance Corporation, I should say, OPIC; which was reauthorized by the United States Congress last year for another two years.

If you don't know what OPIC does, I'd suggest you go to OPIC's website. And one of the things that they do is, they provide terrorism insurance. Who do they provide terrorism insurance to? They provide terrorism insurance to United States businesses that are going to go do economic activities in other parts of the world. Uzbekistan, for example.

So if you want to do business over there, you can get the United States Government to provide terrorism insurance to operate over there. And what we're talking about is to not provide the same type of insurance program for American businesses operating here in the United States. Very ironic.

MS. ROBERTS: I think a good follow-up question to that answer is whether domestic terrorism should be covered in TRIA.

MR. DEBOER: From my perspective, absolutely, it ought to be covered. One needs only look at the anthrax attack in Florida. Nobody knows whether that was domestic or foreign derived. If we're going to have a program, why would we make a distinction between foreign and domestic? Why would we ask the Secretary of the Treasury and the Attorney General to be sitting there, without any more knowledge than what you read in the newspaper, to decide that the anthrax attack in Florida was foreign or domestic? Get rid of that fake firewall.

MS. ROBERTS: Doug, you had a point?

DR. HOLTZ-EAKIN: I just want to point the reader to Appendix "C" of the 2002 CBO report. There is an appendix here on New Zealand, Great Britain, Japan, their particular approaches to this problem.

MS. ROBERTS: Yes, thank you. And also, the U.K.'s program has been touted quite a bit as a long-term solution. And all of these foreign programs are covered in the papers that are on COFFI's website, as well, "www.coffi.org."

MR. HUNTER: I've got to comment on OPIC. I've heard this. OPIC was passed--I don't know, 25 years ago?--to try to encourage trade, and try to encourage American business to go into hard situations where funds might be expropriated, where there might be riots and terror type attacks, etcetera. That's been like that for 25, 30 years. And that's to encourage trade across the border. It was not like it's a terrorism program suddenly developed.

MR. DEBOER: Just last year, Bob--You might be surprised, but if you'd go ahead and take a look at it; and you suggested others do some homework. Just last year, OPIC came out with a new terrorism insurance program to supplement their ongoing program that had been in existence for years. Just last year, OPIC did that--

MR. HUNTER: But they've covered terrorism for 25 years--

MR. DEBOER: Just last year, the United States Congress extended it for two years.

MS. ROBERTS: Gentlemen, I think this is really not pertinent to TRIA. Any more questions from the floor on TRIA? Then I'll continue--Oh, I'm sorry. Go ahead.

AUDIENCE MEMBER: This might be a little too government-oriented, but any sense of possible turf battles? [Inaudible] any sense that they might try to [inaudible]? [The gist of the question was about possible battles between the various relevant committees and what the Chairmen might do.]

MS. ROBERTS: Doug?

[Laughter.]

DR. HOLTZ-EAKIN: In the interests of full disclosure, if I knew, I wouldn't say here.

[Laughter.]

MS. ROBERTS: Okay. Okay, any other questions from the floor? We're almost out of time.

[No Response.]

MS. ROBERTS: One of my last questions I think may be of interest to everyone here. It is, should we clarify who pays if an event occurs that exceeds the $100 billion annual limit?

MR. MACDONALD: I think I'll take a stab at it. You know, personally, do you remember the phrase "Thinking the unthinkable," for those of you who remember the Cold War? When we start looking at catastrophic, end-of-mankind-as-we-know-it loss scenarios, like Herman Kahn considered, clearly, none of us knows the cost, the consequences.

What I think Treasury wisely--or what the legislators in the Federal Government wisely said is, "If you have this type of catastrophic, Armageddon loss, we'll have to just take a look at things, and figure out what we're going to do." What more can anyone say?

MS. ROBERTS: Doug, does the CBO have any further comments on this?

DR. HOLTZ-EAKIN: No, we haven't pursued that piece of it in general. The notion really is to focus most directly on the degree to which there are identifiable aspects of the world around us that have changed in a way since TRIA was initially put in place and re-optimize. It's the right time to step back and think about it. There are enough things on that list that I think we can go a long way before we get to that upper end question.

MS. ROBERTS: Following on that, do you think all the operational problems have been addressed, the way TRIA is set up right now?

DR. HOLTZ-EAKIN: Operational problems?

MS. ROBERTS: Operational issues. Is TRIA totally prepared, is the staff there totally prepared, in the event that an actual event would take place, and everybody knows what to do?

DR. HOLTZ-EAKIN: There has been no particular evidence that somehow operationally there is a problem with TRIA. The real issue is in its design. Is it the case that we have done the right things, from a policy point of view?

This is repeating some things that have come up so many times, but, yes, we're at war. When we fought World War II, we reconfigured our economy to be in the right position to fight that war. We're at war with terror. We should rethink how we configure our economy for a war on terror.

What is the appropriate mix of the kinds of financial burdens people will bear? As people pointed out, not all firms are going to buy terrorism insurance. Not all firms should. Fifty percent of those in New York don't.

What's the role of the taxpayer in picking up the residual risk here? Will that risk be priced? Those are key issues. Operational issues I don't think have risen to that level.

MS. ROBERTS: Okay.

MR. ZIELEZIENSKI: Debra, let me take a stab at answering that.

MS. ROBERTS: Okay.

MR. ZIELEZIENSKI: I think operationally Treasury has done a terrific job of working with industry and sort of testing, without actually having a live event, how the claims mechanism will work.

For example, the way the law was written, the rules were written, there was a disconnect between when payouts occurred and then payments from the Federal Treasury went to insurers. We worked out together a system where they could be almost simultaneous.

MS. ROBERTS: Right.

MR. ZIELEZIENSKI: That where you're paying claims, you're getting reimbursed. I think that's sort of the effect of cooperation, and I commend Treasury for doing that.

MS. ROBERTS: Right.

MR. ZIELEZIENSKI: This also gets back to your earlier question, though, about should the program include domestic terrorism. Because operationally, that's one of the issues Treasury can't answer, because of the way the "act of terrorism" definition is written.

Because it excludes domestic, you have this bifurcation between what's certified and not certified. And so going back to the anthrax attacks, we still don't know.

MS. ROBERTS: Right.

MR. ZIELEZIENSKI: And life goes on in the insurance industry. You've got to pay claims according to state law. And so what do you do?

MS. ROBERTS: I think that is a critical question. It is, what if an event happens that it's not clear whether it's a certified event or not?

MR. ZIELEZIENSKI: I mean, in my mind, that is one of the strongest arguments for including "domestic" under the heading of "act of terrorism."

MR. MACDONALD: And just as a note, I mean, that is why we often prefer to include "other acts of terrorism." The modeling people tell us: 90 percent probability, foreign act of terrorism. That's what TRIA covers. We would rather sell the full cover on many lines. And that's why we do.

Why? Because we don't want the gray area. What about the sympathizer who is not acting on behalf of a foreign person or organization, which the law requires? What about the LAX shooter? U.S. citizen; Islamic faith; goes and shoots people standing in line at Tel Aviv. What if he had been a bomber? Would it have been covered?

Tremendous areas for ambiguity. We'd rather not have them. We'd rather make it clear as to whether there is coverage. Clarity is a good thing.

MS. ROBERTS: Any more questions from the audience?

[No Response.]

MS. ROBERTS: Do you have any final words, Doug?

MR. ELLIOTT: No, just to thank you very much. I think the panel did a great job. I appreciate everyone coming here.

[Whereupon, at 4:00 p.m., the forum concluded.]

