CIAT COALITION TO INSURE AGAINST TERRORISM

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ON BEHALF OF
THE COALITION TO INSURE AGAINST TERRORISM

BEFORE A HEARING OF

THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

ENTITLED

EXAMINING THE TERRORISM RISK INSURANCE PROGRAM

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Good morning, Chairman Dodd, Senator Shelby, and members of the Committee. Thank you very much for allowing me to testify today. My name is Arthur M. Coppola, and I am the President & CEO of Macerich Company, one of the nation's largest retail real estate investment trusts. Macerich has a diverse national portfolio that encompasses 73 regional shopping centers, as well as a dynamic mix of lifestyle, large-format retail and specialty centers. I also serve as the Chair of the National Association of Real Estate Investment Trusts (NAREIT), on the Board of the Real Estate Roundtable, and as a member of the International Council of Shopping Centers. I am testifying today on behalf of the Coalition to Insure Against Terrorism (CIAT).

CIAT is a broad coalition of commercial insurance consumers formed immediately after 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. CIAT joined Congress and the Administration in recognizing that only the Federal government could provide the framework to make this coverage available to all those who required it. The diverse CIAT membership represents virtually every sector of the U.S. economy: hotels, banking, energy, construction, entertainment, real estate, stadium owners, manufacturing, transportation, as well as public sector buyers of insurance. For example, the U.S. Chamber of Commerce, the Real Estate Roundtable, the National Association of Manufacturers, and the National Retail Federation are members. So are, to name a few sectors, transportation interests (e.g., the Association of American Railroads, the General Aviation Manufacturers Association, and the Taxicab, Limousine and Paratransit Association), utilities (e.g., American Gas Association, American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association), finance (e.g., American Bankers Association, America's Community Bankers, Mortgage Bankers Association of America, Commercial Mortgage-Backed Securities Association), real estate (American Resort Development Association, National Association of Realtors, Building Owners and Manufacturers International, International Council of Shopping Centers, and National Association of Industrial and Office Properties) and sports (e.g., Major League Baseball, NFL, NBA, NHL, and the NCAA).

CIAT is the true consumer voice on terrorism risk insurance, as we are comprised of the principal policyholders of commercial property and casualty lines of insurance in the United States. From this perspective we offer our testimony today.

We are gratified that Chairman Dodd and Ranking member Shelby have so clearly made this issue a priority today – as both of you have in the past – by scheduling this hearing as one of the Committee's first items of business in the year. As we have seen before in 2005 when the Terrorism Risk Insurance Act (TRIA) was set to expire, problems associated with the availability of terrorism risk insurance will increasingly get worse as the year wears on.

Frankly, we believe there is no need for delay in action by Congress. The facts are in – terrorism is clearly a risk that the private insurance industry alone can not and will not underwrite. The means and courses of future attacks are unknown, but we do know that the potential for loss in such an attack or in a series of such attacks is exceedingly large, potentially catastrophic.

Moreover, the Government Accountability Office (GAO) and the President's Working Group on Capital Markets (PWG) have recently issued reports that confirm that, other than for workers' compensation insurance mandated by state law, no meaningful amount of insurance against loss from weapons of mass destruction (nuclear, biological, chemical and radiological or "NBCR") is available in the market today – notwithstanding the fact that TRIA backstops such insurance.

To avert disruption in the "conventional" terrorism risk insurance market and to address the gap in coverage against NBCR terrorism-related risk, we encourage this Committee to follow this hearing promptly with the introduction and passage of a bill that will extend TRIA permanently and improve it to keep the economy running smoothly in the face of the ongoing threat of terrorist attacks.

TRIA HAS BEEN A POST-9/11 SUCCESS BUT MUST BE IMPROVED

There is no question that the Terrorism Risk Insurance Act (TRIA) accomplished its main objectives, which were to help stabilize the US economy following 9/11, to provide for the availability of terrorism insurance for commercial policyholders in the face of the ongoing threat of terrorism, and to also provide a system for the efficient recovery of the economy in the case of another severe attack. The situation was dire: in the 14-month period between 9/11 and the enactment of TRIA – over $15 billion in real estate related transactions were stalled or even cancelled because of a lack of terrorism insurance, according to a Real Estate Roundtable study. Furthermore, the White House Council of Economic Advisors indicated that approximately 300,000 jobs were lost over that period. Congress and the President worked together to enact TRIA, which required insurers to make terrorism coverage available in commercial lines, and in return provided a Federal backstop that allows the economy to recover quickly from a terrorist attack. Without it, not only was the economy slowed and at risk, but economic recovery following any further attack would have been retarded. The same is still true today.

TRIA, and its extension in 2005, the Terrorism Risk Insurance Extension Act (TRIEA), were part of a series of measures Congress passed to protect the US economy from terrorism threats, and continues today to be an integral part of our homeland security strategy. For instance, U.S. airlines are <u>directly</u> insured by the Department of Transportation (DOT) for both terrorism and war risk. The Federal Government, through the Overseas Private Investment Corporation (OPIC), also <u>directly</u> insures U.S. investors overseas for both terrorism and political risk outside the United States. It would be ironic and senseless if TRIA, which is the only similar protection of the domestic economy and which, unlike the DOT and OPIC programs, is <u>not</u> a direct liability of the Federal Government, were allowed to expire or even linger in limbo through the remainder of this year.

Terrorism is the major threat facing our nation today. We hear about it on daily basis from the Administration, our national security team and from almost every corner of Capitol Hill. Whatever one's view of the wars in Iraq and Afghanistan, the threat of attack to our country does not now seem to be diminishing. The threat of "enemy attack" is part of our daily lives and shows no sign of going away.

Terrorism risk remains an evolving picture that insurers and reinsurers have a difficult (if not impossible) time modeling. Primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses without adequate reinsurance, and the current private reinsurance market provides only a fraction of the capacity needed. This problem is evident in the fact that, as we once again approach the sunset of the TRIA program, many policies again are being issued with "pop-up" and "springing" exclusions that void terrorism coverage after termination of the Federal backstop. We witnessed the same sort of exclusions in 2005 before TRIA was extended for two years.

Quite simply, economic security is central to an effective homeland security strategy. American businesses must have adequate terrorism risk coverage. Without terrorism insurance, the nation's economic infrastructure is totally exposed to large-scale business disruptions after an attack, and to a retarded recovery from the damage that is caused by the attack. As our economic interests continue to be targeted by terrorists, it is appropriate, necessary and vital that the Federal Government play a role in maintaining the security of our insurance system which helps provide for recovery of the economy.

LONG TERM SOLUTION NEEDED

The conditions that necessitated TRIA and TRIEA – insurers that are not willing or able to quantify man-made risks which are potentially catastrophic and a withdrawal of all significant reinsurance capacity – have not gone away. We believe that the time has come for Congress to enact a long-term solution for insuring against terror – one that is either permanent or at least guaranteed to be in place until Congress declares that terrorism is no longer a risk. At least fourteen other major industrial nations have recognized that the private markets are unable to effectively manage terrorism risk and have adopted permanent national programs. The US market is no different. Terrorism risk is a national problem that requires a Federal solution.

We believe that the Federal role should focus most heavily on what the private markets have been unwilling or unable to do: enabling policyholders to purchase insurance for the most catastrophic conventional terrorism risks; ensuring adequate capacity in high risk, urban areas; and providing meaningful insurance for NBCR risks. A permanent program should also seek over time to reduce the Federal role in conventional terrorism markets and maximize long-term private capacity by facilitating entry of new capital. We believe that over time the private market may be able to develop enough capacity to address many terrorism risks, but the risk of truly catastrophic events – involving both conventional attacks in urban areas as well as NBCR terrorism everywhere– will continue to be virtually uninsurable without some sort of Federal program in place.

CIAT has developed a set of principles for a long-term solution, and I will devote the remainder of my testimony to describing this plan.

CIAT'S PRINCIPLES FOR TRIA MODERNIZATION

The CIAT proposal seeks to make sure there is adequate terrorism insurance capacity in the market in the future, particularly for high risk areas; to ensure that NBCR risks will be covered; and to ensure that the Federal government will have an insurance mechanism in place so that the nation can more easily and efficiently recover from a truly catastrophic attack—whether due to conventional or unconventional terrorism. At the same time our proposal seeks to minimize over time the role of the Federal government for conventional terrorism.

Conventional Terrorism Risk

For risk of conventional (i.e., non-NBCR) terrorism attacks, the CIAT proposal would leave in place the TRIA backstop, with the insurer deductibles, industry retention, and program trigger all maintained at no higher than their 2007 levels. This ensures that policyholders will continue to have access to coverage through the "make available" provision.

While TRIA has been largely successful in making available private direct insurance coverage against conventional terrorism attacks, it has not been without some continuing problems of availability and affordability. There are major markets today, particularly high-risk urban areas with prescribed fire-following policy forms, where the combination of aggregation of risk, high retention rates and rating agency pressure are causing capacity problems for conventional terrorism coverage. Thus, Congress and the Federal government need to continue the statutory framework that is known as TRIA for conventional terrorism exposure, but this framework needs to be modernized to reflect the continuing market realities of capacity shortfalls in some areas. This is one of the reasons why CIAT favors raising the $100 billion annual program cap (which has not even been indexed for property values or general inflation in the five years since the TRIA program began).

However, CIAT also suggests Committee consideration of a privately-funded "Terrorism Risk Trust Fund" that would be maintained by Treasury and used to help cover a portion of the Federal share of insured losses under the TRIA program. The trust fund, for example, could be funded with both "pre-event" (i) assessments on insurers and (ii) matching surcharges on policyholders in an "above the line" amount separate and discrete from their property/casualty insurance premium (and therefore not be subject to state rate approval).

These collections could be forwarded to Treasury where they would be managed in a segregated, tax-free trust or maintained in a separate corporation similar to the FDIC. Treasury would get the benefit of the surcharged accounts which would have the effect of decreasing the government's exposure as the trust fund grew over time. For example, even a 1% surcharge on the premiums in the TRIEA covered lines – with a matching 1% insurer assessment – together with a conservative investment return (government bond rate) would grow to tens of billions of dollars in capital in the same amount of time that TRIA has already been in place.

We believe that, over time, this trust fund will accumulate enough capital through these pre-event surcharges and assessments that the likelihood of taxpayer exposure to terrorism risk will be limited to only the most extreme events. The result would be a public-private partnership that will reduce the Federal role and maximize private capacity. We also note that the use of "pre-event" surcharges in our proposal does not in any way effect the operation of post-event surcharges for purposes of recoupment that are already in the TRIA program.

NBCR Terrorism Risk

NBCR terrorism risk is a different matter. Even if the Federal backstop exposure to conventional terrorism can be reduced over time to all but the most catastrophic attacks, the challenges are different for NBCR, according to all of the expert actuarial estimates. As it presently stands, although TRIA covers NBCR perils, we have not seen any evidence that such coverage is being written except where mandated for workers compensation. Because TRIA only requires that terrorism coverage be made available on the same terms, amounts and limitations as non-terrorism perils, insurers are not required to make NBCR terrorism coverage available if NBCR coverage for non-terror events is not offered.

The GAO, the Treasury Department, and the President's Working Group have all recognized that markets simply cannot price the risks associated with NBCR perils. Accordingly, we believe that this is a crucial area that the long-term solution should address.

Our proposal would add NBCR perils to the "make available" requirement under TRIA and would call for lower insurer deductibles and co-pays with respect to NBCR risks, creating a separate formula to determine the industry retentions. The proposal would also remove the annual $100 billion program cap, to clarify that insurers are not liable for truly catastrophic attacks – whether NBCR or conventional. With such confirmation of protection against the most catastrophic attacks, private insurers should be able and willing to devote more of their existing capacity to conventional terrorism risks as well.

Other Changes

CIAT urges removal the distinction between foreign and domestic terrorism in the statute's definition of "act of terrorism." This distinction may force the Treasury Secretary to make determinations that may not serve our national security needs, and it serves no sound policy goal. As the London bombings demonstrated all to well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims.

Finally, in order to enhance the stability of our financial markets, the modernized program should be made permanent – or should be in place at least until Congress declares that terrorism is no longer a risk.

In all, we believe that the CIAT-endorsed modernization principles for TRIA will reduce the Federal role over time but ensure economic security by keeping a backstop in place for the most extreme and catastrophic attacks, whether conventional or NBCR. We think it is a fair measure and we urge the Committee and Congress to incorporate these features into the measure to be adopted this year.

CONCLUSION

Again, we applaud you for making long-term renewal of TRIA solution a priority early in the year, and we thank you for the opportunity to testify at this important hearing. We urge you to incorporate the CIAT principles in your renewal legislation. As always, CIAT is committed to working with you, the insurance community, and other stakeholders in crafting a meaningful long-term solution as swiftly as possible.