TESTIMONY OF JANICE OCHENKOWSKI

ON BEHALF OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS)

BEFORE THE

U.S HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

ON

"TRIA AT TEN YEARS: THE FUTURE OF THE TERRORISM RISK INSURANCE PROGRAM"

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2128 RAYBURN HOUSE OFFICE BUILDING

Good morning, Madame Chair Biggert and Ranking Member Gutierrez and members of the Subcommittees. My name is Janice Ochenkowski. I am a Managing Director with responsibility for global risk management for Jones Lang LaSalle, a global real estate and financial services company based in Chicago. I am pleased to be here this morning to testify on behalf of the Risk and Insurance Management Society, Inc. (RIMS). I also appreciate the Subcommittee's foresight and initiative to begin this very important policy debate regarding the reauthorization of the Terrorism Risk Insurance Act on the anniversary of September 11.

RIMS is a not-for-profit organization dedicated to advancing the theory and practice of risk management for the benefit of our member organizations. Our discipline is vital to the creation and protection of physical, financial, and human resources. A global organization and the largest organization of risk managers in the United States, RIMS is comprised of over 10,000 individuals from more than 3,500 entities. 81% of our members are Fortune 500 companies with approximately 1,000 members representing small businesses (less than 500 employees). Membership spans the entire economic spectrum from the high-tech sector, real estate, financial, healthcare, energy, transportation and defense. Members also include universities, hospitals, and public entities such as the City of San Francisco, Miami-Dade School District and Orange County, California.

However, as diverse as RIMS member organizations are, they share a common characteristic. That is, they are predominantly large consumers of property and casualty insurance and they have a abiding interest in the need for, and availability of, insurance to cover risk against acts of terror.

Application of the Risk Management Discipline to Terrorism Risk

Risk management is the practice of analyzing an entity's exposures to loss, selecting methods to mitigate the exposures, implementing the selected methods, and monitoring and adjusting the methods depending on the results. Applications for risk management cover all possible exposures to loss, ranging from estimating the number of employees who will be injured in a given period to how to effectively use arbitrage in a global business. The methods used to mitigate exposures are non-insurance transfers, insurance, control, retention, and avoidance. For terrorism exposure, most businesses use a combination of control, retention, and insurance as mitigation strategies.

For example, an owner of real property valued at $10 billion located in the central business districts of major cities, would have a risk management program that would include several different risk management methods to manage concerns about terrorism. Those efforts would include a security program with options such as guards, cameras, motion detectors and alarms, along with an employee and tenant identification program to control building access. Visitors would be limited to one entrance where security staff could log entry and departure. Redundancy and security would be built into all vital computer operations. If the size and potential risk to the property warranted it, the owner might also make physical improvements to the property as well as to the perimeter of the facility. In addition, the owner would purchase an all-risk commercial insurance policy to cover the property for physical damage risks, including terrorism. Property insurance policies have deductibles, and the owner will retain the risk of the deductible amount.

In my job at Jones Lang LaSalle, we purchase insurance for properties owned by our clients through several insurance programs. In total, for U.S. exposures, we purchase insurance for just under 70 million square feet of real estate with an aggregate insured value of under $9 billion. All are commercial properties, and include industrial, retail and residential, but most are office buildings. The locations vary from suburban to city center but are generally within major urban areas in populous states. Since the enactment of the first terrorism legislation, we have been able to purchase terrorism insurance at commercially reasonable limits and in forms acceptable to the properties' lenders. There are some limitations on high risk locations as well as some property types, but in general we are able to buy the coverage we need at premium that can be absorbed by our tenants or investors.

In the event that the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) is allowed to sunset on December 31, 20014, we believe that we will be unable to obtain the limits of coverage necessary to protect the properties and investors and to satisfy lenders. A more significant portion of the risk will be retained by owners, which would further impede the real estate market's financial recovery. I should also note that tenant leases now frequently require that the landlord maintain terrorism insurance and the inability to purchase the coverage could result in a default on the lease, renegotiation of terms, or loss of a tenant.

One of the basic functions of risk management is to identify potential risks for a company in areas such as property, health and safety, and environmental and financial risk, and to identify options to mitigate those risks. Insurance coverage is a critical and necessary part of the process of protecting our companies from risk, especially risk that can produce catastrophic losses. Terrorism is one of those risks that presents catastrophic exposure to companies. Accordingly, it is vital that terrorism insurance continues to be available to buyers of commercial insurance in a comprehensive and affordable manner when the program expires in 2014.

Stability in Insurance Markets Promotes Economic Stability

RIMS considers the availability of adequate insurance for acts of terrorism to be not simply an insurance problem, but also an economic issue. The inability to acquire sufficient insurance for terrorism coverage could result in the inability to secure financing for future construction projects as well as potential impacts on existing construction projects that require evidence of terrorism coverage. Without TRIA, many companies would not be able to comply with various lender covenants within mortgages, which would impede the ability to fund real estate transactions and further limit the normal functions of the real estate market. Additionally, other businesses and public entities face terror exposures critical to the economic well being of our county. Public and private transportation, schools and hospitals, special and sporting events, and certain manufacturing exposures need terrorism coverage as well. Furthermore, as a direct result of 9/11 losses, worker's compensation insurers have restricted coverage for employers with aggregations of workers within a single facility or in large metropolitan areas.

Many businesses and our members in the United States rely on global insurance companies for coverage. These insurers decide where to underwrite risk based on their assessment of overall profitability in return to their shareholders. If the risk to write coverage is perceived to be too great or uncertain, U.S. businesses will be left without the coverage they need. This could complicate the already fragile economic recovery.

Terrorism Risk Poses Unique Issues of Loss Predictability

Unpredictability of losses is many times greater for terrorism risk than for natural disasters, as there are no credible historical data on losses. It is impossible to predict frequency with any degree of accuracy, and it is extremely difficult to estimate both the frequency and severity of a potential terrorist event, as the timing, location and target cannot be identified in advance. Without some form of backstop like TRIA, RIMS believes insurance companies will review their portfolios of business and will refuse to continue covering certain risks in areas where exposure is greatest. This would be true for workers compensation, property, and even third-party liability lines of coverage. Both large and small businesses would be affected.

Congressional Action and its Impact on Terrorism Risk Insurance Availability/Affordability

The last ten years have demonstrated that the private insurance market alone will likely not be able to respond nor provide adequate coverage for acts of terrorism. Following the events of 9/11 and prior to the passage of TRIA in 2002, the first long-term authorization, the required supply of commercial insurance coverage for acts of terrorism was not available. RIMS members with large concentrations of employees had difficulty in purchasing workers' compensation insurance as well as difficulty in purchasing property insurance coverage, including coverage for terrorism on buildings and construction projects.

Since 9/11, RIMS has conducted a series of intermittent membership surveys (formal and informal) related to member organizations and their access to terrorism risk insurance. In 2006, prior to the passage of TRIPRA, the vast majority of members indicated their policy renewals were conditioned upon Congress' long-term extension of TRIA. As an indicator of what might be expected if a TRIA-type program were not in effect, 75 percent said that prior to the passage of TRIPRA in 2007, their policies contained terrorism coverage conditioned upon the extension of TRIA. Seventy-six percent stated that they believe their terrorism coverage limits would have been decreased had TRIA not been extended, and 82 percent felt their premiums would have increased if TRIA had not been extended. In this regard, one of our members reported that the premiums for coverage of a property in a large metropolitan area went from $200,000 in 2005 to $500,000 in 2006, for one half of the policy limits they had in 2005. Furthermore, the member's broker stated that carriers were unwilling to commit to insuring projects inclusive of TRIA if the completion dates went beyond December 31, 2007, TRIA's original sunset date.

Subsequent to passage of TRIPRA, a 2010 survey of RIMS members indicates that for the most part, capacity is generally not an issue, but continues to be a challenge for risks located in major metropolitan areas, including New York, San Francisco, Chicago, Boston, and Washington, D.C. Based on our members' experience in these densely populated urban areas, the typical situation is that when insurers monitor their aggregate liability in these particular areas, the purchase of adequate insurance can be difficult. Passage of TRIA in 2002 was followed by a demonstrable increase in the number of insurers willing to write the coverage and provide higher limits needed for these high-risk areas. However, this does not hold true for all areas, even today. The amount and cost of coverage available for high-risk locations continues to vary greatly based on the location of the insured and the aggregation of risk in that particular area. If the federal backstop were withdrawn altogether, these urban areas considered high risk, and those more susceptible to terrorist acts and most in need of terrorism risk insurance, would likely be most vulnerable and negatively impacted.

Elements of Legislation in the 113th Congress

As to an appropriate Federal role in terrorism reinsurance, RIMS strongly supported bipartisan efforts of this Subcommittee and others to create a Federal Insurance Office (FIO) and worked in coalition to secure its incorporation into the Dodd-Frank Wall Street Reform and Consumer Protection Act. RIMS support for an FIO was based on the belief in the need for federal coordination on international matters as well as the necessity for a Federal expertise on insurance issues which became apparent in the aftermath of the 9/11 attacks. As part of this growing recognition that the Federal government has an appropriate role in insurance matters, Congress gave the FIO and Treasury joint authority to administer the Terrorism Insurance Program.

A July 2012 survey of RIMS membership indicates, once again, the strong belief in the necessity of a federal backstop. Nearly 85% of RIMS respondents indicated that Congress needs to reauthorize TRIPRA and that without another long-term extension, issues of affordability and availability will resurface. As the Subcommittee and Congress move forward into the next Congress, RIMS supports the following principles in development of another long-term solution:

- A completely private market solution in the long term is probably not feasible because of the difficulty in predicting acts of terrorism and thus being able to price the risk properly. Businesses, as part of their corporate governance, need to be able to assess what the business risks are and how they can be quantified and treated. Without a TRIA-type program, many entities will simply be self-insured due to lack of availability or affordability of coverage or both—leaving their companies and their workers exposed to an event that could bankrupt the company.

- As risk managers, we believe that a program should always be in place to ensure an orderly and efficient response to minimize any market disruptions and ensure benefits are available to any victims—individuals or companies from a catastrophic loss scenario.
- A private/public partnership provides the best alternative to addressing the long-term needs of availability and affordability of insurance to cover acts of terrorism. Some form of risk pooling may be an appropriate approach. Regardless of the extent of private market involvement, the federal government will likely be required to continue to be involved in a reinsurance capacity at some level with the level of involvement decreasing over time.

- The solution needs to address the long-term availability and affordability of insurance coverage for nuclear, biological, chemical, and radiological (NBCR) events caused by terrorism. RIMS believes it is critical that a program be developed to insure continued coverage for acts of terrorism, including nuclear, biological, chemical, and radiological acts. The federal government has stated that potential acts of terrorism from these sources are likely. RIMS believes that NBCR represents some of the most problematic areas in the ongoing terrorism debate. The stand-alone terrorism insurance market continues to be extremely limited, in that it really only exists for the property line and is very limited in terms of capacity and price. Rating agencies are increasing the capital requirements for reinsurers, which means that they cannot write the same limit of coverage as last year without increasing their capital reserves. The practical impact is that available limits of coverage will be reduced. RIMS believes that it is critical that a long-term solution be developed to insure that terrorism insurance will be available.

- All commercial property, workers' compensation, auto and general liability lines should be included in any new plan.
- Insurance companies writing commercial lines should be required to participate in the program and be required to make coverage available for acts of terrorism.
- Tax incentives and eligibility for participation in the program should be considered to encourage creation of private insurance capacity.

RIMS appreciates the opportunity to testify and thanks the Subcommittee for beginning this very important discussion in advance of TRIPRA's expiration. We stand ready to serve as a resource as you begin your work to develop legislation next Congress. Should you require additional information or have any questions regarding RIMS policy positions, please do not hesitate to contact Kathy Doddridge, RIMS Government Affairs Director, at kdoddridge@rims.org.