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LINDA ST. PETER
2012 COMMERCIAL COMMITTEE VICE CHAIR
NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY

HEARING TITLED

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

SEPTEMBER 11, 2012

INTRODUCTION

Chairwoman Biggert, Ranking Member Gutierrez, and members of the Subcommittee, on behalf of more than 1.1 million REALTORS®, thank you for inviting me to testify today on the future of the terrorism risk insurance program. My name is Linda St. Peter. I am the 2012 Vice Chair of the Commercial Committee for the National Association of REALTORS® (NAR) and I am the current operations manager for Prudential Connecticut Realty in Wallingford, CT. I have specialized in commercial and investment real estate brokerage, since 1988. I am pleased to testify of behalf of the NAR and its commercial affiliates: CCIM Institute, Institute of Real Estate Management, REALTORS® Land Institute, and Society of Industrial and Office REALTORS®. Together, members of NAR and its affiliates are involved in all aspects of commercial real estate – from real estate brokerage to property management.

RECENT ATTACKS &THREATS

We still live in an uncertain world and continue to fight the war on terror. Though we have been safe at home since September 2001, we only need to look to the 2011 suicide bombing at Moscow's Domodevo airport for terrorism's devastating potential. Additionally, conflict in many countries across the Middle East and North Africa has increased political and social tensions, factors that suggest terrorism risk will be a constant and potentially growing threat for years to come. It is in the interest of America's economic security to ensure that as much of our commercial real estate industry is covered by terrorism insurance as possible.

Through my experience working on some of Connecticut's most significant commercial real estate projects over the past several years, I personally understand the vital importance of terrorism insurance to accomplishing the economic goals of Connecticut. I can tell you that if the terrorism insurance program were to expire, many of my firm's community development projects would not be possible.

IMPORTANCE OF TERRORISM INSURANCE

It is no secret that immediately after the horrific 9/11 terrorist attacks, terrorism insurance coverage was virtually non-existent for commercial property owners. Only when Congress enacted the Terrorism Risk Insurance Act (TRIA) in 2002 did coverage for terrorist attacks resume. TRIA established a public-private risk-sharing partnership that allows the federal government and private insurance companies to share losses in the event of a major terrorist attack. Originally enacted as a 3-year program, TRIA has been reauthorized by Congress twice. In 2005, Congress passed the Terrorism Risk Insurance Extension Act (TRIEA). The most recent extension – the Terrorism Risk Insurance Reauthorization Act of 2007 (TRIPRA) – extended the program through December 31, 2014.

Today, there is concern that the uncertain future of TRIA may cause insurance prices to fluctuate. Further, this uncertainty may prompt insurers to drop terrorism coverage if a reauthorization of the program is not in place by the end of 2014. This became evident in 2005 when private insurers became more reluctant to offer terrorism coverage due to uncertainty regarding the program's extension. Ultimately, the uncertainty of insurance pricing impacts our net operating income, and the value of our properties. The potential unavailability of this coverage at the end of 2014 will impact our financing agreements and potentially hurt the fragile commercial real estate market.

Affordable and available terrorism insurance is a vital component of most commercial real estate transactions. It is estimated that 84 percent of outstanding commercial mortgage balances require terrorism insurance. Thus, if TRIA were to expire, and insurers subsequently dropped terrorism coverage, those loans would be in technical default. While the commercial real estate finance market is starting to show signs of life, any disruption in the availability of terrorism insurance in this sector would have serious consequences on its fragile road to recovery.

NECESSITY OF THE TERRORISM RISK INSURANCE PROGRAM

The passage of TRIA in 2002 helped stabilize commercial real estate markets following the disruptions of the September 11, 2001, terrorist attacks by making terrorism coverage available and, over time, more affordable. According to a 2010 President's Working Group on Capital Markets (PWG)[1] and 2008 Government Accountability Office (GAO) study[2], TRIA and its subsequent extensions have generally kept terrorism insurance affordable and available nationwide. Owners of high-value properties in urban areas, such as Manhattan, however, still face challenges in obtaining coverage at a reasonable price. Improved access and lower premiums are due in part to the continued improvement in an insurer's ability to model and measure their aggregate loss exposure, and thereby manage terrorism risk.

However, despite improvements in these measurements, the frequency and severity of terrorism attacks cannot be reliably assessed by insurance companies. Primary insurers remain largely averse to exposing themselves to potentially catastrophic terrorism losses and continue to have limited availability to reinsurance. Reinsurance plays a critical role in insurance markets by allowing insurers to transfer some of the risks they assume in offering, permitting them to offer additional coverage. Similar to the challenges faced by primary insurance companies, reinsurers have limited ability to predict the frequency and magnitude of future terrorist attacks, which has hindered reinsurers from sufficiently managing the industry's current terrorism risk exposure.

Thus, without the federal backstop for potential insurance losses related to terrorism, we believe coverage availability could decline significantly. In fact, without TRIA providing reimbursement for insured losses that exceed the amount of an insurer's deductible, coverage could decline by more than 95 percent, according to one insurance company cited in the GAO report.

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[1] Market Conditions for Terrorism Risk Insurance 2010, Report of the President's Working Group on Financial Markets.

[2] GAO, Report to Congressional Committees, Terrorism Insurance – Status of Efforts by Policyholders to Obtain Coverage (GAO-08-1057, Sept. 2008).

RECENT MODIFICATIONS TO TRIA

As mentioned earlier, since its enactment in 2002, TRIA has been modified and extended twice. We believe many of the changes made have enhanced the program by providing more access to affordable terrorism insurance for businesses, while lowering the potential cost to taxpayers in the event of a major terrorist attack.

This includes the removal of the foreign vs. domestic terrorism distinction. Without this change, the Treasury Secretary may be forced to make determinations that may not serve our national security needs, and more importantly, the distinction served no policy goal. As the 2005 London bombing demonstrated all too well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims.

PRINCIPLES FOR A LONG TERM SOLUTION

Quite simply, an effective homeland security strategy is central to the nation's economic security. 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.

Extension & Structure of Program

We believe the time has come for Congress to enact a long-term solution for insuring against terrorism – one that provides the needed market certainty to allow for continued economic growth and development. We envision a two-part structure that would finance both conventional terrorism risks and nuclear, biological, chemical, and radiological (NBCR) risks.

Conventional Terrorism Risk. For risk of conventional (i.e., non-NBCR) terrorism attacks, we believe the current TRIA backstop should be kept in place, with the insurance deductibles, industry retention, and program trigger all maintained at no higher than their current levels. This ensures 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 still major markets today, particularly high-risk urban areas, where the combination of aggregation risk, high retention rates, and rating agency pressure are causing capacity problems for conventional terrorism coverage. Therefore, 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.

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, TRIA covers NBCR perils; however, we have not seen any evidence that such coverage is being written except when mandated for workers compensation. Because TRIA only requires that terrorism insurance 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 and the PWG reports 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. NAR believes NBCR coverage and pricing can be improved if Congress adopts measures that would lower insurer deductibles and co-pays with respect to NBCR risks. It is also necessary for Congress to clarify that the federal government is solely liable for NBCR terrorism losses above insurers' individual NBCR retentions, thus encouraging insurers to provide more capacity. Finally, we urge Congress to add NBCR perils to the "make available" requirement under TRIA so that policyholders would have an optional endorsement giving them coverage for NBCR terrorism that would otherwise be excluded by the nuclear hazard or pollution exclusion contained in certain commercial lines policies.

CONCLUSION

Affordable and accessible terrorism insurance is an integral part of the health of the commercial real estate markets. Given that the reinsurance industry has not yet been able to develop a long-term solution that would eliminate the need for some form of federal assistance, NAR is concerned that the potential sunset of TRIA will result in a spike in terrorism coverage premiums, and cause coverage to become unavailable in numerous markets.

NAR believes the TRIA program has been a success because it provides for the sharing of risk between government, private insurers, and policyholders. Ultimately, it is critical for the U.S. economy that commercial policyholders be able to obtain coverage for terrorism risk. Therefore, TRIA must be extended beyond its current 2014 authorization.