

**UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON FINANCIAL SERVICES  
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT-  
SPONSORED ENTERPRISES**

*JULY 27, 2005*

**STATEMENT OF JAMES E. MAURIN  
ON BEHALF OF  
THE COALITION TO INSURE AGAINST TERRORISM**

Thank you Chairman Baker and Ranking Member Kanjorski for conducting today's hearing on the future of terrorism insurance. I also want to thank Chairman Oxley for his commitment to bring legislation regarding this issue to the floor of the House of Representatives in an expedited manner.

My name is James E. Maurin. I am the recent past Chairman of the International Council of Shopping Centers, and the founder and principal of one of the Gulf South's largest commercial real estate companies, Louisiana-based Stirling Properties. I am appearing today on behalf of the Coalition to Insure Against Terrorism, or CIAT, which includes the United States Chamber of Commerce and 75 other major trade and business organizations that rely on the current federal program for access to terrorism insurance for the future of their businesses.

To date, Stirling, with 15 offices and 280 people in Louisiana, Mississippi and Oklahoma, has developed more than \$300 million worth of property, including retail, office and residential projects. It is also a leading real estate services company in the region; it manages some 6.2 million square feet of commercial property, about 65 percent of which is retail, and also provides brokerage and market research services.

The shopping center industry, like many of the members of CIAT, relies on sophisticated financing models to obtain the capital necessary to keep the retail engine of this country humming. In 2004, there were 12.5 million retail and real estate leasing, or shopping center related jobs in the United States and during the first two quarters of 2005, shopping center industry employment has expanded by 102,000 jobs, accounting for 9.4% of total job growth. In 2004, shopping-center inclined sales accounted for slightly over \$2 trillion of retail spending power or 51.7% of total retail sales, 17% of nominal GDP. By the way, these sales raised approximately \$109 billion in sales tax revenue for state and local governments.

The members of CIAT were pleased to work with the members of this Subcommittee to help develop and enact the Terrorism Risk Insurance Act of 2002 (TRIA). We thank the members of this Subcommittee and the full Financial Services Committee for their continuing leadership in addressing this national problem.

We wish to emphasize the extreme importance of having a new terrorism insurance backstop in place as far ahead of the current scheduled expiration on December 31, 2005 as possible. As policyholders, our members have already been subject to a variety of "pop-up exclusions" and "sunset clauses" and other restrictions which the insurance industry has

begun to impose on renewal of policies running through December 31, 2005.<sup>1</sup> These exclusions are in anticipation of a possible disappearance of the TRIA backstop. Worse, these exclusions take effect even if TRIA is renewed or replaced, but the changes to it reduce the backstop protection to insurers. These gaps, or potential gaps, in coverage will begin to have an effect on construction lending and debt ratings the later in the year that we go without a replacement program being in place.

CIAT has strongly and consistently urged Congress to keep a terrorism insurance program in place for one overriding reason: the private insurance markets cannot and are not yet able to take on the job on their own. We know this because, as policyholders – the consumers of insurance – when the current program expires, so does our coverage. We know our coverage expires because more and more of our insurers tell us so every day, in the form of exclusionary notices and coverages that extend only to the end of this year. If the private insurance market was capable of dealing with this issue, it would be preparing to do so now. Unfortunately, we see no evidence of that occurring. As a result, the crisis that Congress and the Administration dealt with in 2002 looms again and requires immediate legislative action.

CIAT has supported and encouraged every effort in this Congress to continue a terrorism insurance program that would provide effective coverage. We expressed support for the only legislation introduced to date, H.R. 1153 and S. 467, which would extend TRIA in substantially its present form for another two years while setting up a commission to work out the details of a replacement program. We also have supported this Subcommittee's efforts to work with the Senate and the Administration to address problems and gaps in the current program, and are grateful for the commitment of the leaders of this Subcommittee to putting a new terrorism insurance program in place before the end of this year. The policy imperatives laid down in the Administration's June 30th letter to Congress also recognize that a new program may now require some additional features, which makes the task of legislating a new program in the next few months a real challenge.

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<sup>1</sup> In anticipation of TRIA's expiration, Insurance Services Office, Inc. (ISO) has filed three new endorsements with state insurance commissioners for use with commercial policies with inception dates from January 1, 2005, through December 31, 2005. These conditional endorsements will supersede other terrorism endorsements or coverages attached to the policy. They will become effective if any of the following circumstances occur:

- TRIA is not renewed; or
- a make-mandatory obligation is not made part of a TRIA extension, and there is:
  - an increase in the statutory deductible, which is set at 15 percent for 2005;
  - a decrease in the government's 90 percent reinsurance of the loss in excess of the insurer's deductible; or
  - a redefinition of terrorism within TRIA.

For property policies, the three filed endorsements either exclude terrorism, exclude terrorism if all losses exceed \$25 million, or provide a sub-limit for terrorism. According to Marsh's *Marketwatch: Terrorism Insurance 2005* (July 2005), the ISO property endorsements have been approved in 46 states and in Guam, Puerto Rico, the Virgin Islands, and Washington, D.C.; have not been approved in Florida, Georgia, and New York; and have been approved for certified acts only in Texas. Because Florida, Georgia, and New York have not approved the ISO conditional endorsements, property insurers are offering lower policy limits for accounts with exposures in these states, particularly for risks in New York City. Again according to Marsh, many insurers have adopted these endorsements—starting with January 1, 2005, renewals—where it is their intention not to continue terrorism coverage if TRIA is not extended.

We do not share the Treasury Report's confidence that the TRIA's expiration would likely lead to only a "short-lived adjustment in coverage and pricing." On the contrary, we can only repeat our concern that the American economy is already being adversely affected by the anticipated year-end expiration of TRIA. If we want to avoid a repeat of the near-paralysis of major construction and interruption of other business activity which we experienced in 2001-2002 before TRIA was in place, then Congress needs to act well in advance of year-end. We are also unconvinced, to say the least, that the private insurance and reinsurance industries are yet able to provide anywhere near adequate coverage or capacity for this peril without some sort of Federal backstop for the large catastrophic events. Moreover, there is little evidence in the Treasury Report to suggest that capital markets will respond any more positively – in the short run – than insurers or reinsurers in terms of filling the void that TRIA would create if not renewed.

A significant portion of the financing for commercial real estate is achieved through Commercial Mortgage Backed Securities, often referred to as CMBS. CMBS pool commercial mortgages and issue bonds that are backed by individual loans. More than \$444 billion of loans are pooled in CMBS, representing almost one-fifth of all commercial real estate mortgages.

CMBS are rated by rating agencies such as Moody's and Fitch, which is why we were concerned when each rating agency voiced apprehension regarding the potential effects that the expiration of TRIA could have on the CMBS market.

When ratings become volatile, bonds lose their attractiveness, existing bonds lose value, and reserves must be adjusted to reflect the ratings changes, limiting cash flow for everything from capital for new development to funds for pension benefits.

Pension portfolios are heavily invested in commercial real estate, through investment in CMBS, real estate investment trusts (REITs) as well as through direct investment. As of January 2005, \$166 billion in assets have been invested by defined benefit pension plans, with almost \$107 billion in real estate equity, which represents an actual piece of ownership.

As many of the members of this esteemed panel will be aware, the public pension funds from your state are substantially invested in commercial real estate. Some of the pension funds with substantial commercial real estate investment include CalPERS, the Florida State Board, New York State Employees and Teachers, Ohio State Teachers and Public Employees, Pennsylvania State and School Employees, Massachusetts PRIM, Alabama Retirement and Louisiana Teachers. Should terrorism insurance expire, billions of pension dollars belonging to workers across this country could be exposed to undue liability.

Having spoken to institutional investors in preparation for this testimony, some are beginning to take a "wait and see" approach to commercial real estate investment, especially on properties or projects where obtaining full terrorism coverage would be in doubt in a degraded market. This wet blanket on capital creation will slow down new development, economic growth and job creation.

The uncertainty surrounding the future of federal terrorism insurance is impacting business today and growth for years to come. I cannot put a project together in 6 months, my lead time is 3-4 years at a minimum, but I need to have terrorism insurance in place before I buy the land and start rezoning, permitting or negotiating with tenants. The markets need certainty and the effects of this debate and the length it extends could impact the economy years out.

In addition, even with TRIA in place, most businesses have significant gaps in coverage for potentially catastrophic losses resulting from nuclear, biological, chemical, and radiological (NBCR) related terrorist attacks. Both the RAND Corporation and the Organization for Economic Cooperation and Development have issued reports over the last several weeks stating concerns with the lack of protection against this growing threat. How can we expect the private marketplace to cover NBCR attacks when they are not even covered with TRIA in place?

As consumers of commercial property and casualty insurance, policyholders are pleased with the success of TRIA and the terrorism insurance program it instituted. With virtually no cost to the taxpayer, the terrorism insurance program has worked largely as intended. It put the economy back on track after 9-11 and restarted the stalled construction industry putting some 300,000 people back to work. Since then it has allowed businesses across America to continue operating and growing, saving countless jobs in the process. Although there are still some gaps in coverage, TRIA has made terrorism insurance broadly available to all businesses that want and need this vital coverage.

The TRIA insurance program was intended to be a temporary measure to “backstop” the market until the private insurance markets could fully assess and price the risk. Unfortunately, the situation the Nation is in today does not make that possible. Our most senior government officials tell us that the threat of terrorism remains undiminished. Our Nation has had a great deal of success at dealing with and deterring terrorist threats over the past three years. Paradoxically, that success makes it impossible for the government, the insurance industry, or insurance policyholders like CIAT members to determine where, when, or with what frequency future terrorist attacks might occur.

The risk of further catastrophic terror attacks appears to be as acute as before. The recent attacks on our closest ally Britain remind us all of what may happen here. Earlier this spring CIA Director Porter Goss told the Senate Intelligence Committee that al-Qaeda is intent on finding ways to circumvent U.S. security enhancements to attack the homeland. He said, “the terrorist threat to the U.S. in the homeland and abroad endures . . . [i]t may be only a matter of time before al-Qaeda or other groups attempt to use chemical, biological, radiological or nuclear weapons.” And FBI Director Robert Mueller expressed concern to the same Committee about the risk posed by radicalized Muslim converts inside the United States and said that he worries about a “sleeping operative” who may have been in place for years, awaiting orders to launch an attack: “I remain very concerned about what we are not seeing,” he said.

Not surprisingly the insurance and reinsurance markets have not re-established an ability to handle this problem alone. Federal Reserve Chairman Alan Greenspan, in his appearance last week before this Committee, said he has yet to be convinced the private market alone can adequately insure against the continuing threat of terrorism. Saying terrorism and geopolitical risk have become enduring features of the global landscape, Chairman Greenspan

again made clear his view that private insurers alone can't handle the risk of losses resulting from terrorist attacks: "The type of terrorism that is arising in the context of increasing technologies which were not available before has created the possibilities of huge losses. And there is no way for a private system to handle that . . . I don't see how we can avoid the issue of a significant segment of government-backed reinsurance in this particular area." In an earlier appearance this spring, Chairman Greenspan said, "[t]here are regrettable instances in which markets do not work, cannot work," and "I have yet to be convinced" that the terrorism insurance market can be made to work. Even with the terrorism insurance program in place, the most severe risks cited by the CIA Director Goss —chemical, biological, radiological and nuclear attacks—are almost wholly uninsured today, aside from workers' compensation.

All these factors – the likelihood of future terrorist attacks; our success in thwarting more attacks to date; the impossibility of assessing where, when, and how terrorist attacks may occur; and the severe consequences for the economy without the continued availability of coverage – combine to make it imperative for Congress to act promptly to provide for the availability of terrorism insurance beyond this year.

We recognize that Congress, the Administration, and stakeholders are now effectively faced with pursuing two basic options: (1) a short extension, say for two years, of the TRIA program structure, albeit with some changes which move in the direction of the criteria set forth in Secretary Snow's June 30<sup>th</sup> letter, or (2) developing now a more permanent solution perhaps in the form of a mutual reinsurance facility (pool) with government bonding or retrocessional support which could be the vehicle for development of significant private capacity over time.

Both approaches have some attraction to us. The short extension legislation should be relatively simple to negotiate and therefore may provide greater assurance of being completed in time for year-end renewals – which is our paramount concern. On the other hand, developing an intermediate private-sector layer of coverage would move us toward a long-term, market-based solution for a problem which we have every reason to believe will be with us for years to come. The new structure might also provide more opportunity to address some of the continuing problems that we have with the TRIA experience, e.g., unavailability of NBCR coverage, than would a simple extension with higher event-triggers and deductibles.

In creating a successor program under either model, the policyholders of CIAT request that the Committee keep in mind the following several principles:

First, the program should include a requirement for insurers to "make available" insurance against the terrorism peril in all lines of commercial insurance to all customers. Such a requirement is necessary to ensure that property owners and businesses will be able to secure sufficient terrorism risk coverage to adequately protect their assets and their employees who work there.

Second, in order to prepare the nation's economic infrastructure for the possibility of a catastrophic terrorist attack, the insurance program needs to be comprehensive in nature. Any new program must be designed with the goal of minimizing any exclusions or gaps which would undercut the whole purpose of the program. In particular, coverage for NBCR acts, as

well as acts of domestic terrorism, not certified under the current program, should be part of the private sector solution in exchange for any government backstop.

In addition to these key two points, CIAT believes that there are other aspects of the rewrite that are important. For example, care needs to be taken to fashion a backstop which attaches at the appropriate point (establishing the financial responsibility of both insurers and policyholders, as well as identifying the level of insured losses at which the government's participation would be initiated) to adequately protect insurance policyholders, insurance providers and the federal taxpayer from undue risk tied to a catastrophic terrorism event. Where and how the attachment point is established for each participant in the overall system will have a significant impact on the availability and affordability of terrorism insurance coverage.

Moreover, the new program should create a system which is sufficiently flexible that it allows the private sector to develop over time alternative forms of capacity to cover the terrorism risk, while still retaining the Federal reinsurance backstop during the life of the program. These alternatives might include catastrophe bonds, an industry reinsurance pool, or securitization products in addition to traditional insurance and reinsurance products. This is the surest way to maximize the development of private risk capacity which someday might be able to stand alone without the government backstop.

CIAT is committed to working with your Subcommittee and other stakeholders during the next month on parallel tracks to develop both options, if need be, so that we are in the best possible position after Labor Day to enact the solution which proves most viable.

We sense an emerging consensus within the Financial Services Committee, and hopefully the whole of Congress, that a continuation of some Federal backstop is needed at least in the near-term. For that reason we will not burden the record unduly with further evidence of the need for this program. However, as an Appendix to this statement ("Five Reasons Why America Needs a Terrorism Insurance Backstop"), we submit some additional observations about the unique characteristics of the terrorism risk, the nature of heavily regulated insurance market, the constraints on reinsurance capacity which went largely unexamined in the Treasury Study, and details of a range of Federal insurance and backstop programs both historical and current which may provide useful precedent for a longer term public-private structure.

## **CONCLUSION**

To close, I am not in the insurance business; I am in the commercial and residential development business. I cannot write my own insurance and I cannot decide what levels of risk or capacity my insurers can undertake and still be responsible to the fiduciary interests to which they are subject. I am the end-user and as a policyholder I am being squeezed by both sides in this debate regarding the future of federal terrorism insurance. On one hand, insurers do not want to take on this seemingly open-ended risk and on the other my investors cannot absorb that liability of being exposed. At the end of the day, my colleagues and I need to be able to buy terrorism insurance so we can continue to help grow the economies of every community in this country.

CIAT is unanimous in its belief that the Federal government must continue to provide a reinsurance backstop beyond 2005 if we are to avoid major disruptions to the economy. Indeed, these disruptions are already beginning to occur as major insurers cut off coverage at year-end in absence of a clear signal from Congress. Only a seamless continuation of the Federal backstop in some form in the meantime will avoid the more severe economic impacts, some of which already are emerging with the widespread use of sunset clauses in current renewal policies.

Chairman Baker, Ranking Member Kanjorski, we at CIAT thank you for holding this hearing and for giving us the opportunity to testify. We look forward to working with you and the rest of the Subcommittee on this important subject in the coming weeks.

## **FIVE REASONS WHY AMERICA NEEDS A TERRORISM INSURANCE BACKSTOP**

### **The Unique Nature of the Risk**

Terrorism is a man-made risk -- intentional, organized and adaptive. It is unlike any of the other, usually natural or fortuitous, risks that the insurance industry typically underwrites. Terrorism is much more akin to war risk, both in its man-made characteristics (intentional, organized, and adaptive) and its potential for massive, unpredictable destruction. Experience has shown that war risk insurance is not (and will not be) readily available on most ordinary commercial property and casualty insurance policies; most such policies carry war-risk exclusions and have done so for decades. Thus, there is little reason to believe that insurers, or their reinsurers, will develop any time soon the ability, much less an appetite, to write terrorism insurance on a wide scale without some government role.

While war-risk exclusions on most policies have been tolerable to insurance buyers (and their lenders) because the advent of, or at least the proximity to, military operations is relatively uncommon and generally avoidable, exclusion of terrorism risk from commercial policies today would be a significant deterrent to economic activity because of uncertainty and unavoidability of the risk. This is what we saw in the months between the September 11<sup>th</sup> attacks and the establishment of the TRIA program. Lack of coverage in those months significantly impaired economic activity and chilled financial markets and lending sources for large-scale development, until TRIA created the ability for insurers to fill the gap (or most of it).

There is another reason the current terrorism risk is so difficult for private markets to handle without some government role. Insurers have few data points (e.g., the attacks on September 11th) by which to attempt to model the risk. With other potentially large catastrophic risks such as hurricanes and other natural phenomena, there is significant historical data on past events which can be used to model the frequency, severity, and locations (or paths) of future events. This modeling in turn can be overlaid with historical loss data and with policyholder location or density information to calculate each insurer's maximum probable loss for certain statistically probable events. With terrorism, however, there is a deficiency of data about potential attacks.

This deficiency of data is exacerbated by an important additional fact. The Federal government is the most informed source of information about terrorism risks; presumably assessing such risks are a primary focus of our national intelligence organizations. That is, the Federal government may well be in possession of such intelligence or other information regarding likelihood or nature of future terrorists acts, but it is unlikely that the government would share such information with the insurance and reinsurance industry as well as their customers.

Given the unique nature of the risk, the paucity of useful data to model future events and the controls in place on relevant information concerning terrorism, it is entirely



understandable that the insurance and reinsurance industries have not yet developed an ability to underwrite intelligently on their own the complete amount of terrorism insurance necessary for the U.S. businesses to operate effectively and the U.S. economy to achieve its full potential.

### **The State of the Insurance Market**

In the debate over a terrorism insurance mechanism three years ago, there was much concern expressed about government intervention in a "free market" of insurance. Free market principles are a laudable starting point for most economic policy discussions. The insurance industry, however, is a sector which the courts and legislatures have long recognized as "affected with the public interest" and therefore subjected to heavy government regulation. Indeed, it is one of the most pervasively regulated of all industries. Both entry into and exit from the industry is strictly controlled by government licensing and regulation. While there seems to be real competition for some of the easy-to-write lines of insurance, both the form of product and often the price in most lines of property and casualty insurance are subject to state-by-state regulation (and sometimes Federal creation). The latitude of insurer actions in many aspects of their business is to a large degree a function of state solvency regulation. It is also an industry where various government actions (both state and federal) require or encourage the pooling of certain risks, and where, in many cases such as workers' compensation insurance, the insurable risk is itself created and defined by government mandate. So, to assume that there is a market otherwise unaffected by government action or that unfettered market forces will somehow be prepared to respond to the threat of terrorism in the absence of a federal backstop seems to ignore the reality of that industry.

The state-by-state nature of insurance regulation and therefore market conditions means that, in the absence of Federal backstop, availability of coverage and industry response to a catastrophic event may be quite variable from jurisdiction to jurisdiction. In the event of a multiple-jurisdiction attack following TRIA's expiration, the regulatory patchwork could result in businesses in one location with effective coverage and those in another location without coverage or with coverage from an insolvent carrier.

This is not to say that there is no role for private capital or entrepreneurial spirit in this line of the insurance business. TRIA proved that the presence of some form of Federal backstop enables the private sector to respond in various ways to their customers' needs (if far from completely in the case of nuclear, biological, chemical and radiological risk). All of the responsible studies and reports produced since TRIA was put in place show that the private insurance and reinsurance sector do not have the capacity to underwrite this risk without the Federal backstop. Reinsurers this year have available terror-related capacity of only \$4 to \$6 billion dollars. To provide some context, the World Trade Center attack resulted in insurance payments exceeding \$32 billion. Moreover TRIA does not appear to have "crowded out" the development of private capacity. To the contrary, all data show that private reinsurance capacity has not even been able to cover the primary industry's collective deductibles and retention layers which the TRIA backstop leaves to the private sector. Any thought that reinsurers will commit additional resources now to terrorism coverage in the absence of a backstop defies logic. More time, and perhaps a re-thinking of the division of risk between the Federal backstop and the private sector, is needed in order to better develop private capacity for terrorism coverage.

One deficiency that we note in the Treasury Study is the apparent failure to consult professional brokers and especially reinsurance intermediaries. One of the world's largest brokerage and insurance consulting groups, Willis North America, points out that, on the most optimistic basis for the perils that reinsurers are most comfortable reinsuring; i.e., property natural catastrophe, the maximum worldwide reinsurance capacity is no more than \$25-30 billion. They go on to argue that surely the worldwide capacity for terrorism reinsurance will be a subset of this amount – that is, considerable less than the incurred losses from the World Trade Center attacks, much the potential attacks of the future.

### **The Proper Role of Government**

When terrorists target symbols of a nation's economic, political and military power, they are attacking the nation as a whole, not just the symbol itself. We need to recognize that the terrorism risk is different from other types of insurance for other reasons. By its definition, terrorism is an effort to effect changes in government policy and public attitudes. Terrorists target places and properties on American soil in an effort to change U.S. government policy and our behavior as a society. While we may not be able to truly understand the motivation of such actors, whether it is our way of life or our government policy which they attack, it does seem that the risk has little to do with the particular policyholders who need protection. How is a business owner in Baltimore or an insurer in Birmingham expected to cope with that threat without some role by the government? We look to the Federal government to protect us from this threat militarily; why not, in some limited way, economically?

Other leading nations on the forefront of the war against terrorism have found it necessary to adopt national programs to help manage this economic risk. Most involve a mix of both government and private sector roles. These include government programs in at least the following countries: the United Kingdom, Germany, France, Spain, South Africa, Austria, and Israel. Recently the Government Accountability Office released a report entitled, *"CATASTROPHE RISK: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risk,"* which gives a detailed description of the governmental guarantees provided for terrorism coverage in the first four European countries mentioned above. In every one of these cases, the program extends beyond the current expiration of TRIA.

### **A Matter of Fairness**

The Federal terrorism insurance backstop does not exist in a vacuum. TRIA was part of a comprehensive set of policies which comprise the war on terrorism which President Bush rightly declared after the September 11<sup>th</sup> attacks on our country. These in turn fit with already existing policies, some of which found heightened purpose in the post-9/11 world. The PATRIOT Act is one example of the new set of actions launched after 9/11. Like TRIA, much of the PATRIOT Act was originally authorized for three years, and the Administration is now calling for renewal of those provisions because the war on terrorism is far from complete. Just as the PATRIOT Act will be re-examined this year in light of three years' experience, we do not insist that an automatic extension of TRIA is the only appropriate response to the continuing insurance market failure. However, some Federal insurance backstop mechanism is surely a necessary component of this continuing war to protect America's economy from these enemies.

An example of a pre-existing government policy which has found new importance in the post-9/11 world is the Overseas Private Investment Corporation (OPIC). Founded in 1971, and recently reauthorized through 2007 by Congress, OPIC provides insurance against political risks – including terrorism – for U.S. businesses' overseas operations. Currently, OPIC provides insurance and financing to U.S. investors for projects in approximately 150 developing countries and emerging markets. Among the most recent projects insured by OPIC are the construction financing of \$250 million for a natural gas pipeline in Israel and a \$300 million development of Egypt's natural gas industry. To take another example, OPIC recently issued long-term government-backed political risk coverage (including for terrorism and other "political violence") for a commercial facility in Uzbekistan. It would be a sad and hard-to-explain irony if TRIA were to expire this year and no Federal terrorism insurance role was in place within the U.S. next year, but OPIC continued to provide next year Federally-backed terrorism insurance for U.S. businesses and facilities abroad. Such a development would mean that American businesses and facilities just down the street from the Capitol, as well as anywhere else in the Nation, could be left without sufficient and adequate terrorism insurance, but that, thanks in part to the Federal government, U.S. businesses doing business outside the U.S., ranging from operations in Afghanistan to Zimbabwe, would have all the terrorism insurance coverage that they require.

OPIC is an example of a long-standing program which serves continuing U.S. foreign policy objectives. To be sure, there are some domestic Federal insurance programs which deal with long-standing marketplace failures, most notably Federal flood insurance and some forms of crop insurance. However, there are also examples of Federal insurance programs which were authorized to deal with immediate and acute problems at the time, which were then de-commissioned when the emergency subsided. These include the Federal crime insurance and Federal riot reinsurance programs which were established in response to the insurability problems arising out of the urban disturbances in the late 1960s. Both of these programs were administered by the Federal Insurance Administration, an office within FEMA, but were allowed to expire by the 1980s.

The precedent which perhaps most closely parallels the current case of terrorism risk is the War Damages Corporation ("WDC") which was authorized by Congress within days after the December 1941 attack on Pearl Harbor. This government-owned corporation provided direct war risk coverage to both personal and business property owners throughout the United States and its overseas possessions for the duration of World War II. Approximately 8,700,000 policies were issued for property values totaling \$117 billion. WDC collected premiums of approximately \$221 million, returning most of this to the U.S Treasury as profit.

WDC conducted its business with remarkable efficiency by authorizing private insurers to attach the war risk rider to existing multi-peril insurance policies, and working with representatives of the industry to develop policy forms and pricing guidelines within a matter of months after its authorization; the first policies were issued effective July 1, 1942. The WDC premium insurance program was terminated in March 1946 and WDC assets were liquidated before June 30, 1949, although its capital stock was not returned to the United States Treasury until the 1950s. Net income of approximately \$211 million had been remitted to the Treasury by 1947-48, even after payment of all claims (mostly arising in the Philippines or from the 1944

explosion of the destroyer USS Turner in New York harbor) and after sharing commissions and profit-incentive payments with private insurance industry which had acted as its agents.

### **Sunset Clauses in Insurance Policies Are Already Hurting Our Homeland's Economic Security**

The threat of terrorism will be with us for the foreseeable future; in the words of President Bush, delivered on February 14, 2005, "We must not allow the passage of time or the illusion of safety to weaken our resolve in this new war."

If TRIA is allowed to expire, and is not replaced with another form of Federal backstop, the nation will be more exposed economically than was the case after September 11<sup>th</sup>. There will be a scarcity of terrorism insurance and what is available will be at an exorbitant price. There is no doubt that without a Federal backstop, fewer businesses will have such terrorism coverage than today with TRIA in place or before 9/11. In fact, the evidence is already in front of us. Most major insurers already appear to be imposing "sunset" clauses in their policies being renewed this year. Appendix 1 to this testimony is a selection of the sunset clauses from many of the largest insurers in the U.S. and globally. All of these documents come from renewal quotation packages actually received by policyholders or their brokers in recent weeks. These sunset clauses make it clear that there will be no terrorism coverage under the policy after 12/31/2005 unless Congress renews TRIA. In some cases, there is no promise to provide the coverage even if Congress acts – presumably the policyholder and insurer will have to take some action in these cases to restore the coverage if TRIA is renewed between now and year-end. With each passing week, more and more of these "sunset" disruptions are being built into the nation's business insurance picture, and more economic effects are being felt. The extent of the problem is illustrated by Appendix 2, a chart showing the actual results of an April renewal program of \$1 billion of property insurance for a major real estate company with assets throughout the U.S., which shows substantial holes in its terrorism coverage after December 31 of this year.

Multi-year construction and financial markets which depend on commercial mortgage-backed securities are being affected adversely by the year-end sunset of terrorism coverage. Appendix 3 is a chart showing a limited sampling by the Real Estate Board of New York of construction project in just two areas of the country – metropolitan New York City and South Florida. In all eighteen projects sampled, the builders' risk insurance either was subject to a sunset clause, renewal was overdue/delayed, or the policyholder was required to secure dramatically more expensive stand-alone terrorism cover from a limited market to satisfy lender requirements.

Aon is the world's second largest insurance brokerage firm. Aon has been actively tracking the terrorism insurance market and, in particular, TRIA coverage with the potential expiration of TRIA on December 31. In an update to Aon's 2004 *Terrorism Mitigation & Risk Transfer Overview*, based upon first quarter 2005 data, Aon estimates that 80% to 90% of the available TRIA property insurance capacity will resort to the use of absolute TRIA exclusions or low sub-limits for top-tier metropolitan areas/target risks effective January 1, 2006. In short, insurance market behavior during the first quarter 2005 indicates that there will be a

substantial shortfall in terrorism capacity both for existing properties and for new projects. At the same time, Aon confirms that lenders are requiring terrorism coverage for the full loan values or for a stipulated amount within loan covenants – whether or not TRIA is reauthorized. We will be pleased to provide the Committee with copies of the Aon report when published.

The important commercial mortgage-backed securities (CMBS) marketplace (\$444 billion outstanding) is also at risk of credit downgrades. As one prominent publication put it, "the possibility [of TRIA non-renewal] re-ignites the threat of downgrade for certain CMBS transactions and has the more macro and ominous potential of reducing property valuations and the attractiveness of commercial real estate as an investment vehicle. Without TRIA and with little confidence that reinsurers and primary property and casualty insurers will offer affordable terrorism coverage without a Federal backstop, it's highly probable that at least two of the major rating agencies will place certain CMBS transactions on watch for possible downgrade." The extension of TRIA would serve to remove a significant credit risk from the CMBS marketplace. Moreover, it would help the market avoid the ratings volatility experienced from late-2001 through 2002 as it related to terrorism insurance.

This sunset problem not only dampens economic activity now and for as long as the non-renewal persists, but, in the event of another attack, there will be substantially less insurance coverage in place – and therefore fewer and less insurance industry payments than were available for the 9/11 losses. This means, most likely, that – in the absence of a program like TRIA – the government's costs, one way or the other, following a new event similar in size to 9/11, would actually be greater than after September 11<sup>th</sup>. Continuation of some form of Federal backstop which maximizes the involvement of the private insurance and reinsurance industry is in fact the policy which is best able to encourage economic activity in the near term while minimizing the government's own exposure in the event of another catastrophic event.

Planning the day before for the day after an attack should be viewed as equally important to efforts to protect ourselves against such an attack.