CIAT COALITION TO INSURE AGAINST TERRORISM

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**PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS:
THE LONG-TERM AVAILABILITY AND AFFORDABILITY
OF INSURANCE FOR TERRORISM RISK**

COMMENTS OF

THE COALITION TO INSURE AGAINST TERRORISM

SEPTEMBER 16, 2013

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The Coalition to Insure Against Terrorism ("CIAT") files these comments in response to the request by the President's Working Group on Financial Markets ("PWG") published in the July 16, 2013 Federal Register. 78 Fed. Reg. 42588. 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 and real estate finance, stadium owners, manufacturing, transportation, as well as public sector buyers of insurance. The current list of CIAT members can be found at www.insureagainstterrorism.org/who.html. CIAT previously filed comments on terrorism insurance with the PWG in 2006 and 2010, and is pleased to have the opportunity to do so again.

CIAT has carefully reviewed the specific questions posed by the PWG and has identified four of the questions that call for policyholder comment.

I. RESPONSES TO SPECIFIC QUESTIONS

Question 1. Describe and explain in detail any and all possible ramifications from the termination of the Program on December 31, 2014[.]

CIAT Comment: As the principal commercial buyers of terrorism insurance, CIAT members will be the first to feel the market impact should the Terrorism Risk Insurance Act ("TRIA") not be extended beyond December 31, 2014. Our members remember all too well the economic environment that led to TRIA's enactment, and we are most concerned that a post-TRIA environment could be similar.

In the aftermath of 9/11, it was virtually impossible for commercial policyholders to secure coverage against terrorism risk; however, banks and other capital providers would not provide financing without it. According to a Real Estate Roundtable survey, over $15 billion in real estate-related transactions were stalled or even cancelled because of a lack of terrorism risk insurance in the 14 months between 9/11 and TRIA's enactment. Additionally, due to deferred construction investment, the White House Council of Economic Advisors estimated that there was a direct loss of 300,000 jobs during that period. In short, the lack of availability of terrorism insurance for commercial policyholders had a very real and far-reaching impact on the economy.

CIAT members have every reason to believe that, were TRIA to expire, terrorism insurance would no longer be available to commercial policyholders at the levels we need. This belief is based on a number of factors, the first of which is our own past experience with potential TRIA expiration. In both 2005 and 2007, our members saw policy renewals that included "springing exclusions" -- which would have voided terrorism coverage upon the expiration of TRIA. Based on this experience, as well as continued statements by the insurance industry about its ability to model terrorism risk, we anticipate that our members will again see "springing exclusions" as policy renewals that extend past December 31, 2014 begin to be negotiated over the next year.

Additionally, while our members are aware that some "standalone" terrorism coverage is available, capacity is limited, particularly in major cities.[1] Furthermore, while private reinsurance capacity for terrorism risk has grown somewhat, this has come at the same time as demand for terrorism coverage has grown in markets outside the United States.[2] Indeed, a recent study by Guy Carpenter noted that the "dramatic rise in political instability and civil unrest around the world" has "triggered a growing need for civil unrest and riot coverages in some international terrorism programs" which has impacted capacity.[3] Current private reinsurance capacity does not even meet the full demands of direct insurers to cover their current retentions under TRIA, which directly contradicts the notion that TRIA is somehow crowding out the private market. As noted in a recent study by Marsh & McLennan, "[c]oupled with limited availability of standalone reinsurance capacity and continued perceived limitations on the reliability of terrorism risk models, the insurance markets are not well positioned to be a viable alternative replacement to TRIA[.]"[4]

This assessment is shared by ratings agencies and other market analysts as well. For example, a recent study by Fitch Ratings concluded that it is "unlikely that substantial private market capacity would arise as a substitute to TRIPRA coverage if the program is allowed to expire."[5] Bloomberg Government's analysis also concurs, indicating "there is no reason to assume that reinsurers will re-enter the market if the TRIA program expires, and every reason to assume that the availability of coverage will fall."[6]

It is also evident from the insurers' regulators that the private market simply cannot handle the demand for terrorism insurance without TRIA. At the most recent meeting of the National Association of Insurance Commissioners ("NAIC"), its Government Relations Leadership Council adopted a resolution calling on Congress to extend TRIA. The NAIC resolution noted that "state insurance regulators have not seen evidence suggesting that the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing coverage for acts of terrorism." It went on to note that "unknown frequency, coupled with the potential for substantial severity of a loss makes coverage for acts of terrorism one that insurers would likely choose to avoid if given the opportunity."[7]

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[1] See, e.g., Marsh & McLennan Cos., *2013 Terrorism Risk Insurance Report*, 16 (2013).
[2] *Id*. at 17.
[3] Guy Carpenter, *Tensions Building: The Changing Nature of Terrorism Risk and Coverage*, 2 (2012).
[4] *Id*. at 21.
[5] Fitch Ratings *U.S. Terrorism Reinsurance: Looming Uncertainty of Program Renewal*, 1 (2013).
[6] Bloomberg Government, *Extending Terrorism Insurance: The case is strong for maintaining a federal backstop in a market too risky for private sector alone*, 5 (2013).
[7] NAIC Resolution to Support Reauthorization of the Terrorism Risk Insurance Act (Aug. 26, 2013) (available at http://www.naic.org/documents/committees_c_triawg_tria_resolution.pdf).

Furthermore, it is painfully clear to everyone that the threat of terrorism is not going away. While we are fortunate and thankful that there has not been a large-scale terrorist event to test the TRIA mechanism, we mourn the tragic events at this year's Boston Marathon and are mindful of the several reported incidents that were thwarted in recent years, such as the Times Square incident. These instances remind us that the threat of terrorism persists, and so long as it does our economy must be protected. It is our economy, after all, that terrorists wish to attack -- on this year's anniversary of 9/11, the al-Qaeda leader urged more attacks in order to "bleed America economically[.]"[8]

Given CIAT members' belief that the availability of terrorism coverage would be severely restricted were TRIA to expire, we remain fearful that this outcome would lead to severe economic disruption, particularly in the commercial real estate and other sectors that are just getting on the fragile road to recovery following the 2008-2009 financial crisis.

Commercial lenders will not make loans without terrorism risk coverage on the collateral. The commercial real estate debt market exceeds $3 trillion – mostly held by commercial banks and investors such as pension funds who own commercial mortgage backed securities ("CMBS"). In order to finance a commercial property, lenders require "all risk" insurance coverage to cover the risk of loss to the collateral. Property owners depend on their ability to obtain adequate "all risk" insurance coverage for financing. Clearly, terrorism insurance is a necessity in the current environment and is a requirement in commercial loan documents.

If TRIA is not extended beyond 2014, terrorism coverage will not be available, and borrowers would be in violation of their financing covenants requiring this coverage. Without terrorism coverage, risk is shifted to lenders, shareholders, pensioners and bondholders. Given the scale of this market, and the fact that most of this debt would be in technical default, were this coverage not available, there are serious safety and soundness issues with regard to the financial services system.

According to a Fitch Ratings report, "[t]errorism insurance coverage remains an important component of the U.S. CMBS market and Fitch expects all new U.S. CMBS loans to include coverage against terrorism attacks as part of their insurance policies. Furthermore, the loan documents require terrorism insurance over the life of the loan. When a borrower fails to obtain coverage, CMBS servicers have been able to ensure that properties have appropriate terrorism coverage by force-place coverage with their own carriers." The report went on to note that "[n]onrenewal of TRIPRA or material changes to the program that significantly influence price and availability would trigger a review by Fitch to determine if the absence or reduction in coverage was sufficient to affect ratings. In certain situations, Fitch could cap ratings at a certain level or may decline to rate a CMBS transaction that has inadequate terrorism insurance." [9]

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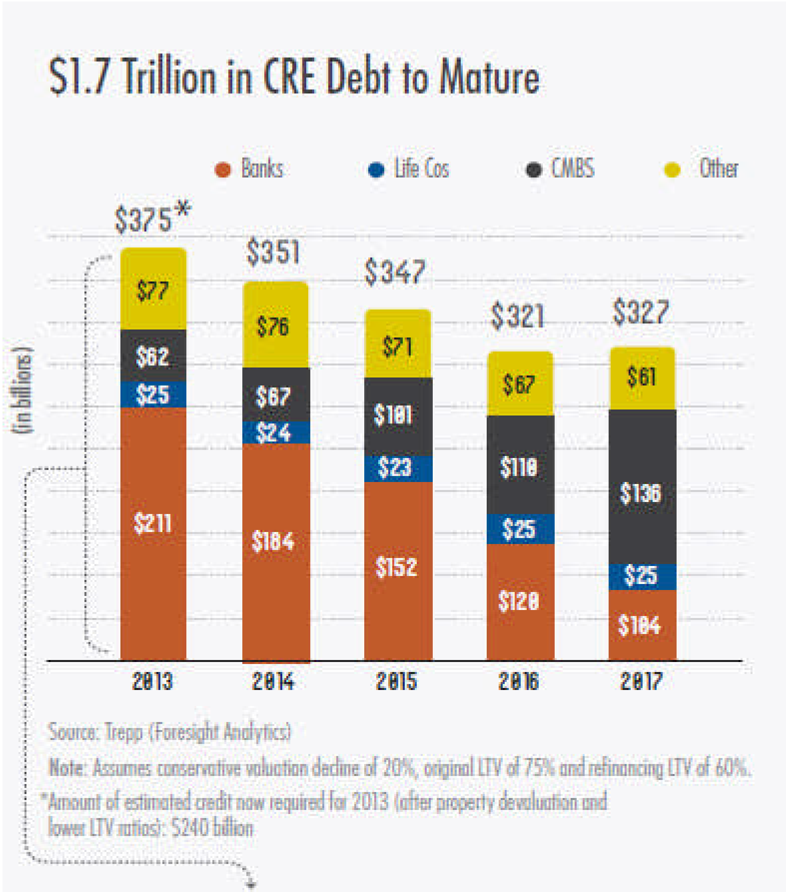
[8] Gordon Corera, *Al-Qaeda Chief Zawahiri urges 'lone-wolf' attacks on US*, BBC News (Sept. 13, 2013) (available at: http://www.bbc.co.uk/news/world-middle-east-24083314).
[9] Fitch Ratings at 7.

Approximately $1.7 trillion of commercial real estate loans are scheduled to mature over the next five years – over $300 billion a year. Without terrorism risk insurance, these loans face the risk of not being eligible for refinancing and will go into default.



Question 2. If the Program were to continue beyond December 31, 2014, describe and explain in detail any revisions or modifications to the Program that would promote the availability and affordability of terrorism insurance, including any accompanying challenges that might arise from any proposed revisions or modifications to the Program.

CIAT Comment: Overall CIAT members believe that the current structure of the TRIA program has much to be commended and we are not inclined to recommend any major structural changes to the program. Although we recognize the desire of policymakers to maximize private sector exposure under TRIA, we are not convinced that increases to the various private sector retention levels (*i.e.*, the program trigger, insurer deductibles, etc.) would promote availability and affordability of terrorism insurance, as we understand there is already limited reinsurance capacity for the existing retention levels.

While CIAT supports the general structure of TRIA, we do remain open to modifications and indeed believe some revisions could improve the program. For example, in the aftermath of the Boston Marathon bombings it has become clear that improvements could be made to the manner in which an act of terrorism is to be "certified" under TRIA. While the amount of insured losses in TRIA lines resulting from that attack probably would not reach the TRIA program trigger ($100 million), certification by the Treasury Secretary is still relevant because most commercial policies in the United States cover or exclude terrorism by reference to TRIA's definition of "act of terrorism," which includes the certification requirement. Because there has been no guidance from the Treasury Department to date on whether the Boston Marathon bombings constitute an "act of terrorism," we understand complications have arisen for claims adjusters. As a result, CIAT would support the inclusion in TRIA of some mechanism whereby policyholders and/or insurers could request a certification determination from the Treasury Secretary.

> *Question 4. Describe and explain, with supporting information where available, any additional insurance market considerations that could impact the long-term availability and affordability of terrorism insurance[.]*

CIAT Comment: CIAT members are generally not in the position to address issues that impact insurers' ability to underwrite terrorism risk; however, it is important for any analysis of insurance market considerations to take into account mitigation efforts by policyholders. Policyholders retain the incentive to mitigate risk under TRIA. Building owners and businesses across the nation have spent hundreds of millions of dollars on enhanced security measures and risk management since 9/11. In fact, reducing real estate's vulnerability to terrorism and other threats — through information sharing, risk mitigation, and building security emergency response planning — continues to figure prominently in the prudent management of commercial real estate. Such efforts include a full range of counterterrorism and target hardening techniques to reduce the vulnerability of real estate as part of the nation's critical infrastructure and key resources.

Mitigating against the risk of terrorism today is a focus for all building owners and, whether a federal terrorism insurance plan does or does not exist, it will continue to be an important aspect of managing any facility where people gather to work, shop, play or simply enjoy recreational opportunities.

Real estate has a dominant influence on the nation's economy and is part of the Department of Homeland Security's Commercial Facilities (CF) Sector. Homeland Security Presidential Directive 7 (HSPD-7) provides the national approach for critical infrastructure and key resources (CIKR) protection and divides the Nation's infrastructure into 18 distinct CIKR sectors. The CF Sector is one of the few CIKR sectors that terrorists have attacked successfully. Commercial facilities are especially vulnerable due to the large inventory of buildings across the nation that are open to the public and are populated by large numbers of people on a daily basis.

The industry continues to foster more robust public-private partnerships at the federal and local level to allow for the enhanced exchange of threat and vulnerability information relevant to the security of specific soft targets. For example, The Real Estate Information Sharing and Analysis Center (RE-ISAC), a not-for-profit information sharing entity organized by The Real Estate Roundtable (a CIAT member) in February 2003, is a public-private partnership between the U.S. real estate industry and federal homeland security officials – serving as the primary conduit of terrorism and natural hazard warning and response information between the government and the commercial real estate industry.

The RE-ISAC (www.reisac.org) works closely with the Department of Homeland Security, law enforcement and intelligence agencies at the federal, state and local levels on risk mitigation and sharing threat information. Working with other critical infrastructure sectors, the RE-ISAC has also invested time and resources in U.S. government preparedness exercises, such as FEMA's National Level Exercises and DHS's Resilient Constellation Exercise Series to improve planning and operations for potential incidents. The RE-ISAC is leading coordination on behalf of the National Council of ISACs (NCI) for the NCI-Fusion Center Working Group, working closely with the NCI, the National Fusion Center Association and federal partners.

Despite considerable progress on homeland security since 9/11, the threat picture facing the nation is more complex and diverse than ever — a reflection of the constantly evolving nature of terrorism. The ability of federal, state and local governments to deal with such threats has a direct bearing on U.S. commercial property owners, whose office buildings, hotels, shopping malls and other densely-populated structures, like universities and sporting venues, offer would-be terrorists a target-rich environment, with more and higher value "soft targets" than any other economic sector.

The real estate industry continues working on multiple fronts to help real estate businesses better manage the complex challenges of owning and operating property in these uncertain times. Our industry's activities in this area include:

- Briefings at the National Counter Terrorism Center (NCTC) for key intelligence community analysts regarding the dynamics of commercial real estate properties that are of high interest to terrorist groups, with the goal of sensitizing them to the types of information that will better enable infrastructure owners and operators to protect these key assets;

- Participation in the Office of the Director of National Intelligence (ODNI) Trade Association Partners to establish two-way communication between the intelligence community and the private sector;

- Participation in the Department of Homeland Security's (DHS) Commercial Facility Sector Coordinating Council (one of 18 infrastructure and resource sectors identified as needing protective/mitigative action);

- Working with the Federal Bureau of Investigation (FBI), DHS and the Federal Emergency Management Agency (FEMA), along with industry leaders to discuss real estate's critical role in infrastructure security;

- Increasing coordination with counter-terrorism, law enforcement and emergency response officials at all levels of government to promote "allhazards" emergency preparedness and resilience across the various segments of the commercial real estate industry;

- Contributing to a groundbreaking report to the President in 2012 on Intelligence Information Sharing (via our participation in the National Infrastructure Advisory Council [NIAC])

By adopting a steadfast and vigilant posture and improving information-sharing networks, the U.S. real estate sector continues to play an important role as a so-called "force multiplier" — alerting law enforcement and counter-terrorism officials to suspicious activities and helping to thwart terrorist attacks.

Economic security is central to homeland security. It is what terrorists are targeting. Without adequate insurance coverage, America's economic stability is totally exposed. TRIA was part of an overall approach to protect the U.S. economy, including the USA Patriot Act and establishment of the Department of Homeland Security. Involvement here is the proper role for our government because national security is primarily a federal responsibility. Unless the federal plan is continued, terrorism risk will once again be uninsurable, and we would expect a period of profound economic havoc – posing a very real threat to our economic and homeland security.

Question 8. Describe and explain any other developments, considerations, or market issues that might affect the long-term availability and affordability of terrorism risk insurance.

CIAT Comment: For reasons described above, CIAT believes that the private market is not in a position to fill the void were TRIA to expire at the end of 2014, and this assessment is shared by other observers and analysts, such as Bloomberg Government, who noted that "the argument that a private market can provide sufficient terrorism coverage doesn't have wide academic support."[10] CIAT also acknowledges the challenges that insurers have in providing terrorism coverage generally, due to difficulties in predicting losses. As Fitch Ratings noted, "terrorism risk underwriting efforts pose considerable challenges as insurance traditionally protects against accidental or negligent acts rather than intentional acts of destruction."[11] CIAT shares their skepticism "that insurers have sufficient underwriting information and modeling capabilities to underwrite terrorism exposure with the same level of technical expertise that is used to underwrite other natural catastrophe risks."[12]

The real issue of terrorism insurance is more absolute availability, *i.e.*, capacity, rather than affordability. The reason for the TRIA framework is to make sure businesses and building owners are able to purchase adequate levels of terrorism coverage -- not to subsidize cost reductions. There is no evidence that private markets can develop adequate insurance market capacity without some type of federal participation. Without TRIA in

[10] *Id*. at 5.
[11] Fitch Ratings at 4.
[12] *Id*. at 5.

place, terrorism risk coverage will evaporate – insurers will simply exclude the coverage as we saw in the aftermath of 9/11. Commercial property owners and businesses would then have little alternative to breaching lender agreements *en masse*. A study conducted in 2009 by Aon, a large insurance broker, found that if TRIA is changed or unfunded, 70 to 80 percent of the commercial property insurance market would revert to absolute terrorism exclusions.[13] This scenario could be played out preemptively in the secondary markets in the form of ratings downgrades and price volatility for existing bonds. We also expect new issuance of CMBS would be disrupted or halted in the absence of available insurance coverage, creating more volatility leading up to the expiration of the existing statute.

Additionally, even though CIAT believes the current reinsurance capacity is not sufficient to take the place of TRIA, it is worth noting that the capacity that has developed has done so under particularly favorable circumstances -- *i.e.*, without any significant terrorism losses in the U.S. since 9/11. The tragic Boston Marathon bombings are a reminder that the threat of terrorism remains all too real, and a future attack causing significant losses could seriously restrict the modest amount of private standalone and reinsurance capacity that exists today. We should not be lulled into complacency as the memory of 9/11-scale losses becomes more distant. The 9/11 Commission indicated that those attacks revealed a "failure of imagination" on the part of the United States; we should not repeat that failure by blindly assuming the private sector can realistically go it alone in recovering from a future attack.

While TRIA was originally intended to be a temporary measure – a bridge to a time when reinsurers returned to the market place – reinsurers remain unable to accurately measure the type, frequency and potential losses due to a large-scale terror attack. Unfortunately, there have been no developments over the last 12 years that have changed this basic fact.

II. CONCLUSIONS

We remain convinced, as we indicated in our previous comments to the PWG in 2006 and 2010, that TRIA has been a success. It is a comprehensive plan to provide for economic continuity and recovery in the wake of a major terrorist attack, and it ensures that a significant portion of the costs of recovery will be borne by the private sector. Contrasting this to the ad hoc nature of prior federal disaster responses, it is reasonable to conclude that having TRIA in place likely lessens taxpayer exposure to terrorism risk.[14]

We believe that having in place a system that covers and adjusts claims arising from such a strike through the insurance system serves the taxpayers better than *ex poste*,

[13] Aon Risk Services, *Global Risk Alert--TRIA in Jeopardy*, 7 (2009).
[14] See, e.g., Peter Chalk et al., *Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act*, 58 (2005) ("TRIA's sunset, without additional Congressional action, will both slow recovery after a future attack and magnify the economic consequences of an attack," as it will "raise the risk of widespread uninsured losses.")

ad hoc appropriations that frequently (and predictably) follow catastrophic events. In TRIA, the merits of the system live well past the event itself, into the actual funding for the federal government via policy assessment within the budget window. We believe that the certainty afforded having a mature, dedicated system in place serves well the taxpayers and policyholders alike.

As it is clear that the private market is simply not capable of providing terrorism coverage at levels businesses require, and it is equally clear that a lack of terrorism coverage available would have serious adverse implications on the economy, CIAT continues to believe that TRIA must be extended beyond 2014.