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American Resort Development Association Resort Owners' Coalition
American Society of Association Executives
America's Community Bankers
Associated Builders and Contractors
Associated General Contractors of America
Association of American Railroads
Association of Art Museum Directors
The Bond Market Association
Building Owners and Managers Association International
Boston Properties
CCIM Institute
Chemical Producers and Distributors Association
Commercial Mortgage Securities Association
Edison Electric Institute
Electric Power Supply Association
The Food Marketing Institute
General Aviation Manufacturers Association
Helicopter Association International
Hilton Hotels Corporation
Host Marriott
Independent Electrical Contractors
Institute of Real Estate Management
International Council of Shopping Centers
The Long Island Import Export Association
Marriott International
Mortgage Bankers Association of America
National Apartment Association
National Association of Home Builders
National Association of Industrial and Office Properties
National Association of Manufacturers
National Association of REALTORS®
National Association of Real Estate Investment Trusts
National Association of Waterfront Employers
National Association of Wholesaler-Distributors
National Basketball Association
National Collegiate Athletic Association
National Council of Chain Restaurants
National Football League
National Hockey League
National Multi Housing Council
National Petrochemical & Refiners Association
National Restaurant Association
National Retail Federation
National Roofing Contractors Association
National Rural Electric Cooperative Association
The New England Council
New York City Partnership
Office of the Commissioner of Baseball
Public Utilities Risk Management Association
The Real Estate Board of New York
The Real Estate Roundtable
Six Continents Hotels
Society of American Florists
Starwood Hotels and Resorts
Taxicab, Limousine & Paratransit Association
Travel Business Round Table
UJA-Federation of New York
Union Pacific Corporation
U.S. Chamber of CommerceWestfield

STATEMENT

OF

JOSEPH P. DITCHMAN, JR.

SENIOR VICE PRESIDENT, COLLIERS OSTENDORF-MORRIS

ON BEHALF OF

THE NATIONAL ASSOCIATION OF REALTORS®

AND

THE COALITION TO INSURE AGAINST TERRORISM

BEFORE A HEARING OF

THE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

REGARDING

POLICY OPTIONS FOR EXTENDING THE TERRORISM RISK INSURANCE ACT

APRIL 24, 2007

Thank you Chairman Kanjorski, Ranking Member Pryce and members of the Subcommittee for inviting me to testify today on policy options for extending the Terrorism Risk Insurance Act. My name is Joseph P. Ditchman, Jr. I am a past president of the Ohio Association of REALTORS®, past liaison to NAR's leadership for commercial REALTORS® and am currently a partner at Colliers Ostendorf Morris in Cleveland Ohio. I am pleased to testify on behalf of the National Association of REALTORS® which, through the REALTORS® Commercial Alliance includes the Institute for Real Estate Management IREM, CCIM Institute, the Society of Industrial and Office Real Estate (SIOR) the REALTORS® Land Institute (RLI) and the Counselors of Real Estate (CRE). Together, members of the REALTORS® Commercial Alliance are involved in all aspects of commercial real estate – from real estate brokerage to property management.

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

We still live in a world of uncertainty. We are still fighting the war on terror. Though we have been safe at home since September 2001, we only need to look to London and Madrid for terrorism's devastating potential. We cannot pretend to know what motivates terrorists and how and in what form they may act to severely disrupt our economy and shake our sense of security. It is in the interest of America's economic security to ensure that as much of our commercial real estate sector is covered by terrorism insurance as possible.

Through my experience working on some of Cleveland's most significant commercial real estate developments over the past several years, I personally understand the vital importance of terrorism insurance to accomplishing Cleveland's economic development goals. I have been fortunate to work on the Cleveland Browns stadium, Jacobs Field, the Rock and Roll Hall of Fame and the Cleveland convention center. I can tell you that if the terrorism insurance program were to expire, projects like these that transform neighborhoods and communities could not go forward.

Our firm also owns and manages several office buildings. The real estate we own is home to thousands of office workers and also provides a critical hub for our information technology infrastructure – in fact we own the real estate that houses switching stations for a large telecommunications firm. Over the years we have seen our terrorism insurance premiums fluctuate and rise – in part due to the concern that TRIA may have expired at the end of 2005, and in part due to the greater burden the private sector has to bear under the Terrorism Risk Insurance Extension Act. 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 this year impacts our financing agreements, and potentially hurts the commercial real estate market.

Though we are significant players in the Cleveland market, we do not have the market diversity of some of the larger REITS and developers. We cannot leverage the high operating expenses of one building in one market, with the lower expenses of another building in a different market. The basic real estate fundamentals matter to us. NAR's members are in every major and secondary commercial real estate market in the country. They are property managers, they are real estate brokers, they are real estate counselors and they are property owners. They may not own or manage the trophy office building downtown, but chances are they brokered the lease that brought the building its major tenant. Chances are they manage the retail center nearby. And chances are they own the office park on the outside of town. We are the engine of commercial real estate. I understand that 80% of commercial real estate debt requires terrorism coverage. If the terrorism insurance program were allowed to expire, coverage would become largely unavailable and unaffordable – the gears of commercial real estate could grind to a halt.

We are encouraged that this subcommittee and Chairman Frank and Ranking Member Bachus have made this issue such a clear priority, and we hope that the Committee will act soon to advance legislation to the full House. Frankly, we believe there is no need for delay in action by Congress. The facts are in – terrorism is clearly a risk that the private insurance industry alone cannot and will not underwrite. As we saw before in 2005 when the Terrorism Risk Insurance Act (TRIA) was set to expire, problems associated with the availability of terrorism risk insurance will increasingly get worse as the year wears on.

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

To avert disruption in the "conventional" terrorism risk insurance market and to address the gap in coverage against NBCR terrorism-related risk, we encourage the

Committee to follow this hearing promptly with the introduction and passage of a bill that will extend TRIA permanently and improve it to keep the economy running smoothly in the face of the ongoing threat of terrorist attacks.

In conjunction with the American Insurance Association (AIA), CIAT has developed a set of Joint Principles that we believe should be made a part of any TRIA modernization effort. I will discuss these principles in the last portion of my testimony.

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

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

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

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

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

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

LONG TERM SOLUTION NEEDED

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

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

We also believe that the program should seek to encourage greater take up rates among commercial property holders – particularly in markets that do not have the most high-profile targets. The Rand study indicated that al Qaeda, sensing that the traditional marquee property-type targets may be too well fortified, may opt to strike at softer targets that can cause more psychological damage than economic – such as striking a suburban retail center. Congress should direct the Treasury Department to affirmatively seek advice on how to encourage greater take-up rates to better spread and finance the risks, which are societal in nature.

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

JOINT PRINCIPLES FOR TRIA MODERNIZATION

The Joint Principles seek to make sure there is adequate terrorism insurance capacity in the market in the future, particularly for high risk areas; to ensure that NBCR risks will be covered; and to ensure that the Federal government will have an insurance mechanism in place so that the nation can more easily and efficiently recover from a truly catastrophic attack—whether due to conventional or unconventional terrorism. At the same time, we hope that these principles will allow for the minimization over time of the Federal government's exposure for conventional terrorism losses.

DURATION

In order to enhance the stability of our financial markets, the modernized program should be made permanent – or should be in place at least until Congress declares that terrorism is no longer a risk. Simply put, the uncertainty of having to renew this program every few years can be harmful to the economy.

FOREIGN V. DOMESTIC ACTS

The Joint Principles urge removal of the distinction between foreign and domestic terrorism in the statute's definition of "act of terrorism." This distinction may force the Treasury Secretary to make determinations that may not serve our national security needs, and it serves no sound policy goal. As the London bombings demonstrated all too well, there can be serious difficulties in distinguishing between foreign and domestic terrorism, and the distinction makes no difference to the victims. We commend this Subcommittee and the House as a whole for adopting that change in 2005 in H.R. 4314, although the feature did not survive in the final legislation.

PROGRAM STRUCTURE

The Joint Principles urge that the covered lines in a modernized TRIA be no narrower than those included in the current TRIEA program, and that the program trigger be raised no higher than the current $100 million level – with a possible special provision within the trigger for smaller insurers. As for the program structure itself, the Joint

Principles envision a two-part structure that would finance both conventional terrorism risks and NBCR risks.

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

While TRIA has been largely successful in making available private direct insurance coverage against conventional terrorism attacks, it has not been without some continuing problems of availability and affordability. There are major markets today, particularly high-risk urban areas with prescribed fire-following policy forms, where the combination of aggregation of risk, high retention rates and rating agency pressure are causing capacity problems for conventional terrorism coverage. Thus, Congress and the Federal government need to continue the statutory framework that is known as TRIA for conventional terrorism exposure, but this framework needs to be modernized to reflect the continuing market realities of capacity shortfalls in some areas.

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

The GAO, the Treasury Department, and the President's Working Group have all recognized that markets simply cannot price the risks associated with NBCR perils.

Accordingly, we believe that this is a crucial area that the long-term solution should address.

The Joint Principles would embrace several features from the 2005 House-passed extension bill, H.R. 4314 including lower insurer deductibles and co-pays with respect to NBCR risks and creating a separate formula to determine the industry retentions. The proposal would also 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, it would 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.

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

OTHER REFORMS COULD ALSO HELP COMMERCIAL POLICYHOLDERS

Extending and reforming TRIA, in our view, should be Congress' top priority in the commercial property-casualty insurance arena. However, there are at least two other measures that would help America's businesses cope with the terrorism risk insurance problem, although both also have value beyond terrorism risks.

First, CIAT urges Congress to pass the Nonadmitted and Reinsurance Reform Act (NRRA), now H.R. 1065, which would facilitate access to surplus lines capacity for commercial policyholders as well as simplify some of the patchwork of conflicting State rules which inhibit the reinsurance market. The same bill was approved by the House last September by a unanimous roll-call vote of 417 to 0 but the session ended before the Senate could act of the bill. We recommend the Committee take up the NRRA measure after you have completed work on TRIA extension.

Second, NAR and CIAT believe you should consider expanding the Liability Risk Retention Act of 1986 (LRRA) to include commercial property insurance lines of business. LRRA helps private companies and non-profits organizations in a common sector of the economy to organize and finance group solutions to the lack of affordable insurance; it does this chiefly by providing that qualifying "risk retention groups" will need to be licensed as an insurer in only one State rather than having to apply for and maintain a separate insurance license in every State where it has member, requirements which can otherwise make a group project unfeasible. Unfortunately, LRRA is currently limited to liability insurance lines – because it was originally conceived to address the so-called liability insurance crisis of the mid-1980s. However, since 9/11 – and exacerbated by natural catastrophes such as Hurricanes Katrina and Rita – commercial property insurance is now probably the sector which is most consistently challenging to corporate risk managers and insurance purchasers. Expanding LRRA to allow sophisticated businesses to form multi-state groups to pool and finance similar kinds of property risks – and such State-licensed risk retention groups would be eligible for the backstop under TRIA --could be an additional part of the solution to address some of the remaining short-comings in the terrorism risk market, and would also empower the business community to more efficiently finance other natural and man-made property hazards. Again, we urge the committee to give attention to this issue after it has completed the urgent task of passing TRIA extension legislation.

CONCLUSION

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