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Office of Financial Institutions Policy
Attn: President's Working Group on Financial Markets
Public Comment Record, Room 3160 Annex
U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220
(submitted via electronic mail to: PWGcomments@do.treas.gov)

April 20, 2006

Re: President's Working Group on Financial Markets: Terrorism Risk Insurance Analysis

Dear Sir or Madam:

On behalf of the more than 1.2 million members of the National Association of REALTORS® (NAR), I am pleased to provide comments to the President's Working Group on Financial Markets on the long term availability and affordability of insurance for terrorism risk.

The National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS®. NAR applauds the efforts of the President's Working Group (PWG) to obtain comments concerning a long term terrorism insurance solution from various sectors of the economy, including consumers who purchase terrorism risk coverage. Although the questions published by the Department of the Treasury on behalf of the PWG primarily seek the input of insurance providers, NAR welcomes this opportunity to provide the PWG with its perspective on creating a long term terrorism insurance solution.[1]

The availability and affordability of terrorism coverage greatly impacts the health of the commercial and multifamily real estate markets because it is often a key component of the financing of multiuse developments. A change in the availability or affordability of terrorism coverage can both potentially disrupt the real estate markets, force property values to decline and prompt a decline in the number firms voluntarily acquiring terrorism insurance, potentially leaving pockets of vulnerable underinsured properties. NAR asks that the PWG strongly consider the merits of a continued federal backstop if necessary to ensure the continued affordability of terrorism coverage.

[1] In response to a request for comments—"Analysis by the President's Working Group on Financial Markets and the Long Term Availability of Insurance for Terrorism Risk" published in Vol. 71 No. 44 of Federal Register on March 7, 2006, pp. 11460-11461

Background: The Importance of Terrorism Insurance to REALTORS®:

The passage of the Terrorism Risk Insurance Act of 2002 helped stabilize the commercial real estate markets following the disruptions of the September 11, 2001 terrorist attacks by making terrorism coverage available and, over time, more affordable. Commercial property owners, brokers, managers, leasing agents and lenders throughout the country have all benefited from having sufficient affordable terrorism insurance in place. Development projects and related loans are no longer held up due to inadequate coverage; leasing of office, industrial and multi-family properties has gone uninterrupted; and lenders no longer have to "force-place" coverage for their clients in order to satisfy loan agreements.

Yet, while TRIA has been effective in stabilizing the insurance markets in recent years, a private reinsurance market has not demonstrated the capacity to fill the breach if TRIA's federal backstop were to expire. Initially driven by a concern that the private insurers would not be able to provide terrorism coverage on their own, in June 2004 the Treasury Secretary extended the make available requirement of TRIA ensuring that insurers would continue to offer terrorism coverage in the final year of TRIA's three year program.[2] During 2005, it became evident that private insurers would be reluctant to provide terrorism coverage should TRIA sunset and the reinsurance market had not yet become strong enough to cover insured losses. In June 2005 the RAND Corporation released a study which suggested that if TRIA were permitted to expire, premiums would likely rise and "take up rates", i.e. the number of businesses purchasing coverage would decline.[3] Yet, this decline in coverage would come at a time of continued uncertainty about the specter of terrorist attacks in the United States. At the same time, a Treasury Department report recommended that TRIA be allowed to sunset to enable the market to develop without the interference of a federal backstop.[4]

The Terrorism Risk Insurance Extension Act of 2005 (TRIEA) strikes a balance between the two views. TRIEA extends the federal backstop program for an additional two years and increases reliance on the private sector. TRIEA specifically increases the trigger point at which the federal government will provide assistance from $5 million in 2005, to $50 million in 2006, and $100 million in 2007; while also raising insurer deductibles to 20% by the end of 2007. TRIEA also mandates that the PWG provide a report to the President on the long term availability and affordability of terrorism insurance, including group life and NBCR (Nuclear, Biological, Chemical, Radiological) coverage.

Responses to Selected Questions:

I. Long-Term Availability and Affordability of Terrorism Risk Insurance:

1.1 In the long term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage?

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[2] The Treasury Secretary extended the "make available" provision of TRIA through 2005 on June 18, 2004. http://www.treas.gov/press/releases/js1734.htm
[3] RAND Center for Terrorism and Risk Management Policy, "Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act."
[4] United States Department of the Treasury, "Assessment: The Terrorism Risk Insurance Act of 2002."

The development of private reinsurance capacity to spread catastrophic risk is necessary to adequately insure against terrorism risks. Although Treasury's June 2005 study acknowledges the role of reinsurance in an insurer's capacity to absorb losses, the study did not adequately address the issue of developing long-term private reinsurance capacity. Nevertheless, the study seemed to assume that private market capacity would grow in the absence of a federal backstop. Insurance industry experts believe that the federal reinsurance backstop provided under TRIA is responsible for the existing private market capacity. There has been no evidence to suggest that private market capacity will increase following the expiration of TRIA. In the continued absence of such evidence, the PWG should consider long-term solutions to the availability and affordability of terrorism risk insurance which involve a combination of private insurance industry, private sector and federal participation in covering terrorism losses. In fact, the American Insurance Association noted that "[g]iven the continued grave uncertainty and potentially catastrophic levels of loss, insurers simply lack the tools to underwrite and price this risk without a new mechanism to provide capacity." [5] The federal government possesses substantially more expertise concerning terrorism risks than the insurance industry. Accordingly, federal participation in a long-term solution is appropriate.

1.4 How, if at all, were primary insurers' pricing decisions affected by the anticipated expiration of TRIA at the end of 2005, particularly for insurance policies extending into 2006 that cover terrorism risk?

In the summer of 2005, NAR received some reports from members indicating that terrorism coverage would have increased dramatically if TRIA were not extended. The increased costs of would have impacted property values as insurance costs often cannot be passed on to tenants, particularly in the case of triple net-leased properties. Several members have indicated that the expiration of TRIA would have jeopardized the development of a large scale multi-family project. What NAR heard from its members was that TRIA was a key component in keeping terrorism insurance available and affordable, that its expiration may place their financing in technical default, and that it should be extended to mitigate any significant increases in premiums or dropped coverage.

Long-Term Availability and Affordability of Coverage for CNBR Events Caused by Terrorism

There is currently little affordable coverage for CNBR events caused by terrorism. It appears most terrorism risk insurance coverage excludes CNBR events, except where such coverage is expressly required under state law (e.g., with respect to workers' compensation coverage). When NAR asked members whether CNBR was included in their terrorism coverage, most indicated that it was not.

Insurance industry representatives believe that CNBR events are not conducive to modeling, and likely to trigger greater losses than conventional terrorist acts. The AIA notes that "[i]nsurance models suggest that the potential loss is so enormous that accumulation management techniques—essential to managing conventional terrorism risk—are of little practical value." [6] In fact, the American Academy of Actuaries (AAA) noted that "after anthrax was sent through the U.S. mail in 2001, the cost of cleaning up the postal

[5] Testimony of Debra T. Ballen, American Insurance Association at "NAIC Public Hearing on Terrorism Insurance Matters" March 29, 2006.
[6] Ibid.

facilities alone exceeded the structural value of those facilities."[7] Because the value of the insurance claims would exceed the value of the real estate affected, and due to the near impossibility to appropriately measure risk and price coverage, insurers are unlikely to offer coverage without federal assistance.

The PWG should consider whether a separate federal reinsurance program should be established for non-life insurance CNBR losses or whether coverage for CNBR peril should be included in a multi-tiered financing structure involving private insurance industry, private sector and federal participation. The PWG's analysis should also address appropriate program triggers in the CNBR context.

Conclusion:

NAR believes that affordable and available terrorism insurance is an integral part of the health of the commercial real estate markets. Given that the insurance industry has not yet been able to develop a long term solution that would eliminate the need for some form of federal assistance, and that CNBR coverage appears to be well beyond the capacity of insurers, the PWG may want to consider creating a federal backstop for CNBR events, and keep in place a federal mechanism to ensure that terrorism coverage continues to be affordable.

Should you have any further questions, please do not to hesitate to contact Tom Heinemann at (202) 383-1090 or theinemann@realtors.org.

Sincerely,

Joseph M. Ventrone
Managing Director, Regulatory and Industry Relations

[7] Statement of Michael G. McCarter, FCAS, MAAA Chairperson of the Terrorism Risk Insurance Subgroup, American Academy of Actuaries, before the Terrorism Insurance Implementation Working Group of the National Association of Insurance Commissioners.