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The Case for a Permanent Federal Terrorism Insurance Plan

Terrorism Risk Insurance Act (TRIA) Advisory Committee on Risk-Sharing Mechanisms Meeting
U.S. Department of the Treasury
March 31, 2017

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Washington, DC

www.rer.org

September 11, 2001

- The scale of loss inflicted by the Sept. 11, 2001 terrorist attacks shocked the world - causing significant loss of life and physical destruction
- Attacks also resulted in one of the costliest insurance events in US history – $40 billion* – most of which was paid by reinsurers
- Prior to 9/11, terrorism coverage was not typically excluded from commercial policies, nor was a premium explicitly charged for the risk
  - Most insurers did not perceive terrorism loss to pose significant risks – even after the 1993 WTC bombing

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9/11: Economic Aftermath

- Following the 9/11 attacks,
  - DJIA fell 14.3% - largest 1-week point drop in history
  - Reinsurers paid record claims but concluded they could not quantify risk; withdrew from terror market
  - Insurance carriers began to exclude terrorism coverage from commercial policies
  - Lenders require terrorism coverage for funding
  - Commercial property owners and businesses could not find adequate coverage; CRE lending in jeopardy
  - $15.5 billion construction projects in 17 states stalled*
  - Moody's downgraded $4.5 billion of CMBS

* Survey, The Real Estate Roundtable, September, 2002

TRIA: Bridge to an Uncertain Future

- TRIA enacted in 2002—
  - Temporary program designed to ensure that adequate resources are available for businesses to recover and rebuild if they become the victims of a terrorist attack
  - TRIA extended in 2005, 2007, sunset in 2014 before being extended in early 2015.
  - The difficulties experienced in each renewal creates uncertainty in lending and construction markets, which leads to delays, added risk and cost

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TRIA: Bridge to an Uncertain Future

- TRIA scheduled to sunset on Dec. 31, 2020
- Policyholders are concerned that the perennial threat of renewing this federal program creates an unacceptable level of uncertainty and potential cost for the economy – for real estate owners and investors in particular
- 12 day lapse undermined economic stability
- Some policyholders were forced to turn to stand-alone coverage to plug the gap, at unattractive terms

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Mitigating and Managing Risk

- Sixteen years after the 9/11 attacks, strengthening the security and resilience of the sector remains a top priority and is an important aspect of managing any facility where people live, work, shop and play
- Through our Homeland Security Task Force and Real Estate Information Sharing and Analysis Center www.reisac.org we continue to work with government officials and private sector partners to prevent, detect and respond to a multiplicity of key physical and cyber threats

Preparedness

- Presidential Policy Directive 8 (PPD-8) states that our national preparedness is to be based on core capabilities that support "strengthening the security and resilience of the United States through systematic preparation for the threats that pose the greatest risk to the security of the Nation, including acts of terrorism, cyber attacks, crime, pandemics, and catastrophic natural disasters”
- Effective risk management is a key part of such preparedness

Terrorism: *Economic Risk*

- Why does US economy need terrorism risk insurance?
  - 9/11 loss concentration: business interruption - 33%, property - 30%, liability - 23%
  - Protecting against economic dislocation imperative for resilience
  - Equitable sharing of burden of loss
  - Ultimately a national security issue – there is no national security without economic security
  - Long-term issue – not temporary peril

TRIA: *Economic Risk*

- Why does real estate industry need terror insurance?
  - Real estate houses the US economy
  - Real estate a remains a target
  - Lenders require coverage
  - Shareholders require protection
  - Real estate is owned by pension funds, private equity, insurance companies, others
  - Investors, pension funds are all at risk

TRIA: *Economic Risk*

- Commercial real estate debt market $3.8 trillion - mostly financed by commercial banks, commercial mortgage backed securities (CMBS), life companies and pension funds
- Without terrorism risk coverage,
  - Commercial lenders will not make CRE loans
  - Existing borrowers will be in technical default, violating financing covenants
  - Raises serious safety and soundness issues
  - Risk shifted to lenders, shareholders, pensioners, bondholders

Terrorism Risk: A National Peril

Terrorism risk remains a threat to the homeland –

- Since 9/11, there have been at least 73* terrorist plots against the homeland
- Increasing frequency: 22 successful or interrupted terrorist plots since 2015
- Of the 73 plots, at least 49 could be considered homegrown terror plots**
- New York, Washington remain targets, but non-gateway cities are at risk
- Recent targets range from military facilities, mass gatherings, nightclubs, bars, and shopping malls

**Federal Bureau of Investigation*

***Heritage Foundation*

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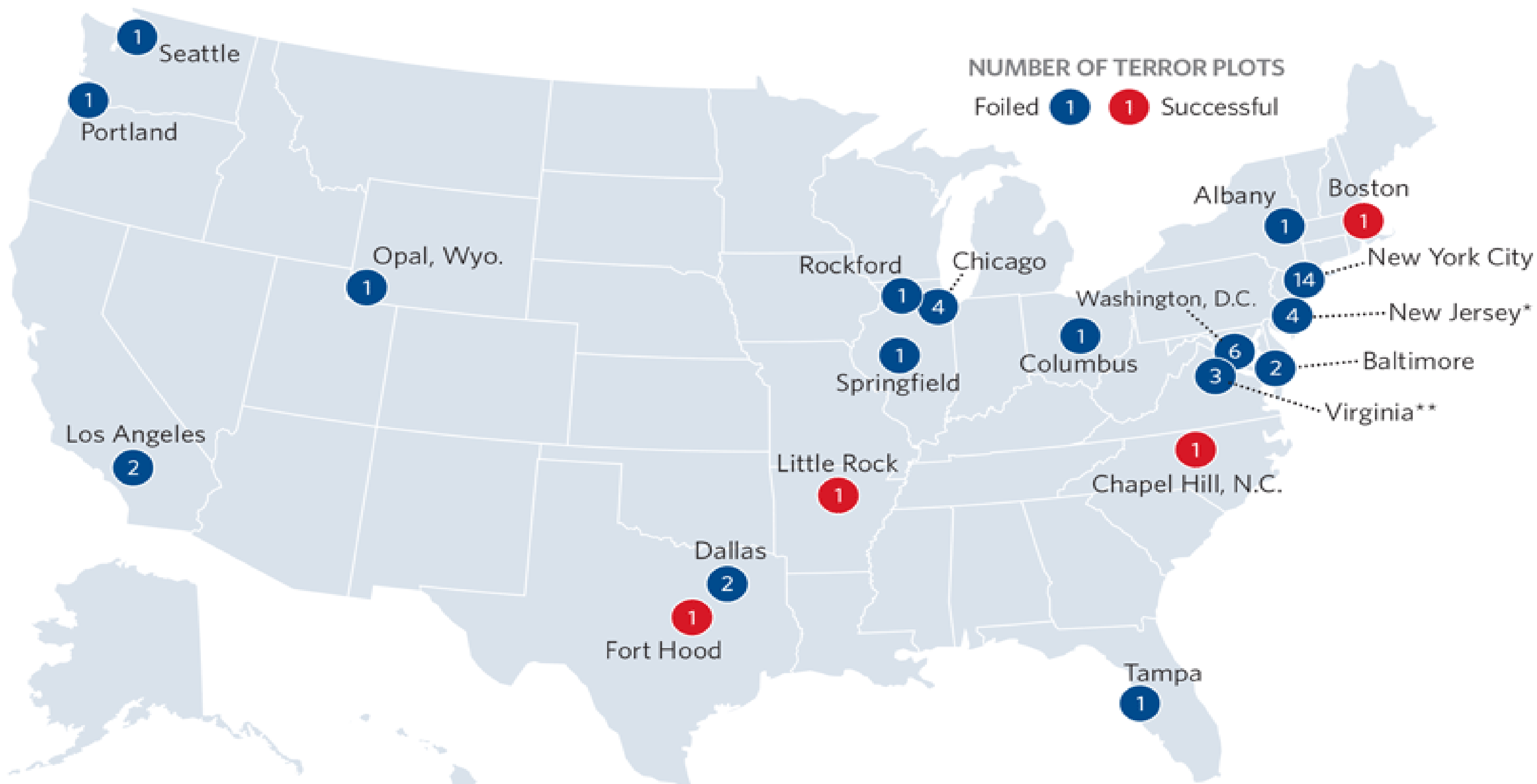
MAP 1

Terrorists Have Targeted Locations Across the U.S.

This map locates 49 specific sites targeted for terror attacks since September 11, 2001. More than 10 additional plots with no clear target were also foiled.



* Newark, Perth Amboy, and Trenton ** The Pentagon (2) and Quantico Marine Corps Base

Source: Heritage Foundation research based on media reports and court documents.

SR 137 heritage.org

Terrorism Risk: Impossible Bet

- Risk models only work where there is extensive loss experience, but terrorism acts are man-made, infrequent, potentially catastrophic and coordinated to overcome loss mitigation efforts
  - Impossible to accurately estimate and model the likelihood of future attacks
  - Reinsurers withdrew from market after 9/11
  - GAO, PWG concluded that “acts of terrorism” are uninsurable risks; private market still lacks capacity
- Reinsurance markets have expanded capacity but still lack the capacity to insure the US economy, meet policyholder needs

RAND

- Terrorism risk models based on historical events or theories of terrorist decision making are limited: They cannot extrapolate to estimate the likelihood of future attacks from terrorist threats beyond those that have been already recognized

- The $27.5 billion (pre 2015 reauthorization amount) threshold for aggregate insured losses in TRIA ensures that the insurance industry, rather than the taxpayer, is ultimately responsible for paying for incidents that are within the realm of the industry's modeling capability

RAND

- 2014 RAND study found that terrorism remains a threat to the US
- If TRIA expires and the take-up rate for terrorism insurance falls, the US would be less resilient to future terrorist attacks
- RAND concludes that a failure to reauthorize TRIA backstop program could have negative consequences for US national security

TRIA Protects Taxpayers

- According to a RAND Corporation study, taxpayers are better served if TRIA remains in effect rather than being allowed to expire
- Without TRIA, there would be less insurance coverage and greater uninsured loss, hence greater demand for disaster assistance, leading to increased federal spending
- In the absence of a terrorist attack, TRIA costs taxpayers little, and in the event of a terrorist attack, it is expected to save taxpayers money

TRIA: Sensible Compromise

- Federal government remains exposed to terrorism peril: cannot take an ostrich-like approach
- Not clear that a robust private market alternative exists
- Permanent program would provide certainty about resources in the event of another attack
- TRIA provides a sensible compromise between government and economy
  - Limits federal involvement to only severe acts
  - Policyholders, insurance industry cover significant first loss position

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Permanent Program Essential

- A permanent program is essential
  - At least 14 other nations recognize that private markets cannot quantify terrorism risk, and each has a permanent terrorism insurance program
  - Markets need certainty
  - Market disruption around renewals
  - Risk accentuated by 12 day lapse
  - Long term assets do not mesh with short term solutions

Elements of a Permanent Program?

- Important to develop a strategy for a permanent national terrorism insurance program that would make coverage available, enabling policyholders to secure the terrorism risk coverage they need without facing periodic renewals by USG
- Two basic conceptual approaches:
  - Post-funded program, which could be extending the current TRIA program
  - Pre-funded pooling structure

Elements of a Permanent Program?

- Extending the existing program provides a solution that the market understands, and therefore offers simplicity
- A pool based program would likely entail additional complexity (including some accounting changes) but would allow the industry to build dedicated reserves to address the risk
- In the long run, the pool might also provide an opportunity for the use of reinsurance
- Policyholders are willing to pay into to a pre-funded structure in exchange for permanent program

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Working with the ACRSM, Insurance Industry, FIO

- Appreciate the opportunity to participate today
- Since 9/11, policyholders have had a constructive partnership with insurance industry and the Treasury Department
- A successful program must work for insurers; it must also work for policyholders
- We look forward to working with the ACRSM, FIO and the insurance industry toward development of an effective long-term solution

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