MORTGAGE BANKERS ASSOCIATION
Investing in communities

# MBA Statement for the Record

## In Support of

## The Resolution Before the Committee on State and Federal Legislation Calling on the United States Congress to Pass, and the President to Sign, Legislation that would Extend the Terrorism Risk Insurance Program Reauthorization Act of 2007

## Council of the City of New York
## June 17, 2013

## INTRODUCTION

With the expiration of the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) looming at the end of 2014, the Mortgage Bankers Association[1] (MBA) strongly supports a long-term extension of TRIPRA. Accordingly, MBA offers its strong endorsement of the New York City Council's consideration of the Resolution calling for the U.S. Congress to extend TRIPRA.[2]

A long-term extension of TRIPRA is paramount to the health of the commercial and multifamily real estate finance sector and the nation as a whole. With $2.4 trillion in total debt outstanding, the commercial/multifamily real estate finance sector is an integral and large part of the national economy. This debt finances the vast majority of office, retail, industrial and multifamily rental properties that are spread across the fabric of the nation. These buildings house the businesses that are the engines for the nation's vibrant and diverse economy. The absence of available and affordable terrorism risk insurance would not only impact the commercial real estate finance sector, but would ripple through the economy as buildings became more difficult and costly to finance and purchase.

Since the Terrorism Risk Insurance Act of 2002 (TRIA) was under consideration by Congress over a decade ago, MBA has been a leading voice in supporting this legislation as well as the subsequent reauthorizations of TRIA in 2005 and 2007. In fact, MBA has produced several research reports and implementation guidance for TRIA and has testified before numerous governmental and insurance regulatory bodies.

## TERRORISM RISK INSURANCE IS ESSENTIAL TO THE COMMERCIAL/MULTIFAMILY REAL ESTATE SECTOR

Terrorism risk insurance is paramount to the $2.4 trillion commercial/multifamily finance sector. This is amply demonstrated when terrorism insurance became either unavailable or unaffordable. A look back to the 14 month period before TRIA was signed into law in November 2002 provides important insight for what the future holds, should TRIPRA be allowed to sunset on December 31, 2014.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] Resolution Calling on the United States Congress to Pass, and the President to Sign, Legislation that would Extend TRIPRA, The Need to Extend the Terrorism Risk Insurance Reauthorization Act of 2007.

In the aftermath of the September 11, 2001 terrorist attacks, terrorism insurance markets seized, resulting in $15.5 billion in new construction being either cancelled or delayed.[3] The impact on the 9/11 attacks also extended into existing commercial mortgages when $4.5 billion in commercial mortgage-backed securities (CMBS) securities were downgraded.[4] Clearly, the lack of terrorism insurance coverage impacted both new construction and the CMBS market.

Looking toward the renewal of TRIPRA, Fitch Ratings sounded this cautionary note if TRIPRA is not renewed:

> Failure to renew the Terrorism Risk Insurance Act (TRIA) could induce commercial insurers to retreat from larger metropolitan areas, reducing availability of coverage and raising premium rates. Lack of terrorism reinsurance coverage would leave individual insurers in the short term with commercial property and workers compensation exposure from a potential event above prior risk tolerance levels[5]

The failure to renew TRIPRA would have a negative impact on the availability of terrorism risk insurance, but also negatively impact insurance companies that had terrorism insurance policies in place when TRIPRA sunsets that will no longer be eligible for government loss sharing for terrorism-related losses.

## Why A Federal Government Role in Terrorism Risk Insurance is Essential

A fundamental challenge with accurately identifying terrorist threats is the lack of availability of information about such threats. In addition, there is informational asymmetry between the federal government and property owners/insurance companies. Because the most sensitive and up-to-date information on terrorism threats is contained in highly classified government documents, insurance companies and property owners do not have access to the sensitive information that would position them to better protect their properties. Given that – to the extent available – government entities have the most up-to-date information on terrorism threats, we believe it is logical and necessary for the government to have a focused and defined role in insuring against the vulnerability of a terrorist attack.

Moreover, terrorism has certain characteristics that prevent it from being a widely insurable risk. In an April 26, 2013 Congressional Research Service report, the impediments associated with insuring terrorism risk were described:

> One prominent insurance textbook identifies four ideal elements of an insurable risk: (1) a sufficiently large number of insureds to make losses reasonably predictable; (2) losses must be definite and measurable; (3) losses must be fortuitous or accidental; and (4) losses must not be catastrophic (i.e., it must be unlikely to produce losses to a large

[3] "Terror Insurance Drag on Real Estate and Still Climbing", Real Estate Roundtable, September 19, 2003.
[4] "Moody's Downgrades Securities on Lack of Terrorism Insurance", Wall Street Journal, September 30, 2002.
[5] Fitch: Higher Premiums if Terror Insurance Act is Not Renewed, Fitch Rating, May, 6, 2013.

> percentage of the risks at the same time). Terrorism risk in the United States would appear to fail the first criterion. **It also likely fails the third due to the malevolent human actors behind terrorist attacks, whose motives, means, and targets of attack are constantly in flux**. Whether it fails the fourth criterion is largely decided by the underwriting actions of insurers themselves (i.e., whether the insurers insure a large number of risks in a single geographic area that would be affected by a terrorist strike). [Emphasis added][6]

Terrorism risk does not meet key criteria to be a widely insurable loss (without a government role) and likely fails to be "fortuitous or accidental" because, by its very nature, terrorism is a malevolent act. Yet, terrorism risk remains very real.

In addition, the American Academy of Actuaries (Academy) has weighed in regarding the necessity for a government role in terrorism risk insurance. In an April 9, 2013 presentation, the Academy offered the following conclusions about the terrorism risk insurance program:

- To the extent that coverage for conventional terrorism risk is available and affordable, it is attributable to existence of TRIP (TRIPRA)
- Structure of program has encouraged development of reinsurance for layers of risk that insurers must bear themselves (deductible amounts and copays), which allows primary insurers to provide coverage
- Without TRIP (TRIPRA), insurers would be far less likely to offer terrorism risk insurance[7] [TRIPRA inserted for consistency]

The Academy's analysis provides a compelling testimonial for the importance of a federal government role in terrorism risk insurance.

Given the obstacles to widely-available and affordable terrorism risk insurance, we believe that the need for a federal government role in supporting the availability of terrorism risk insurance has not dissipated since the 9/11 attacks.

## THE TERRORISM RISK INSURANCE PROGRAM HAS WORKED

From the perspective of the commercial real estate finance industry, TRIPRA has been a profound success for increasing the availability and affordability of terrorism insurance. In fact, a May 2013 MARSH study indicated that the take-up rate for terrorism insurance was 62 percent overall and 76 percent for the real estate sector.[8] Clearly, by making terrorism risk insurance coverage widely available, the take up rate for the real estate industry has been very high. This is due, in part, to the lender requirement in many cases that borrowers have

[6] Terrorism Risk Insurance: Issue Analysis and Overview of Current Program, Congressional Research Service, April 26, 2013.
[7] NAIC's Center for Insurance Policy and Research Branch: Insurance for Acts of Terrorism, An Actuarial Perspective on the Future of Terrorism Risk Insurance, American Academy of Actuaries, April 9, 2013.
[8] Market Update - 2013 Terrorism Risk Insurance Report, MARSH, May 2013.

terrorism risk insurance in place for the life of the loan. In fact, if terrorism insurance coverage is not in place, it could lead to a potential loan default by the borrower.

The MARSH study also indicated that terrorism risk insurance has remained affordable for the real estate sector with terrorism risk insurance coverage priced at $40 per $1 million of insured property value in 2012. Without an extension of TRIPRA, there would be insufficient capacity to provide terrorism risk insurance on all commercial and multifamily properties at any price.

## CONCLUSION

MBA is in strong agreement with the Resolution supporting a TRIPRA extension. We commend the Council for advancing the public discourse on this vital issue and helping set the stage for a long-term extension of TRIPRA. Should you have any questions, please contact MBA's Thomas Kim, Senior Vice President of Commercial/Multifamily Policy at tkim@mortgagebankers.org or George Green, Associate Vice President for Commercial/Multifamily at ggreen@mortgagebankers.org.