BEFORE THE SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

Testimony of Christopher Nassetta
on behalf of
The Coalition to Insure Against Terrorism
May 18, 2004

Chairman Shelby, Ranking Member Sarbanes and Senators, good morning, my name is Christopher Nassetta. I am CEO of Host Marriott, which owns or has interests in over 230 hotels in 34 States and the District of Columbia, and is a publicly traded real estate investment trust. I am appearing today on behalf of the Coalition to Insure Against Terrorism (CIAT).[1]

CIAT Representing Consumers of Commercial Insurance

CIAT is a broad coalition of insurance consumers that was formed in the months following 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. As part of its effort, CIAT joined with the Administration and those in Congress who recognized that only the Federal government could provide the framework to make this coverage available to all those who required it. The diverse CIAT membership covers virtually every sector of the private economy as well as public sector buyers of insurance. For example, the U.S. Chamber of Commerce, 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,

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[1] I am also a board member of The Real Estate Roundtable (The Roundtable) and a member of the executive committee and treasurer of the National Association of Real Estate Investment Trusts (NAREIT). Both The Roundtable and NAREIT are CIAT members.

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), 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., the Baseball Commissioner, NCAA, NBA, NFL, and NHL). A full list of CIAT's member trade associations as well as other members accompanies my written testimony.

Collectively, the business and governmental organizations represented by the CIAT membership are the principal consumers of commercial property and casualty insurance in America, and therefore it is accurate to say that the voice we provide today is the true consumer voice with respect to the subject of today's hearing.

After 9/11, TRIA Became Indispensable

My own company Host Marriott does not come to this subject untouched by terrorism. We and our employees were deeply and personally affected by the terror attacks of September 11. Although we were not specifically targeted by the terrorists, we did not escape the terrible consequences of their acts. Host Marriott lost our 820-room Marriott World Trade Center Hotel which was completely destroyed, and our Marriott New York Financial Center Hotel was heavily damaged. Much more importantly, we suffered the loss of two hotel employees and eleven hotel guests were unaccounted for.

After first addressing the human issues, we needed to reassure markets that our properties were fully insured, and I spent many hours on the phone with shareholders and analysts. In each instance, they wanted to know whether our policies fully covered terrorist attacks. Fortunately, our property and casualty policies then in effect did cover losses resulting from acts of terrorism. After the horrific attacks, the insurance market changed dramatically. Terrorism risk was excluded from renewal offers on most of our policies, and the only coverage we could find was either "stand-alone" policies or "buy-back" endorsements, and such policies left us with considerably less protection than we had before 9/11.

All of CIAT's members were united in their support for the enactment of the Terrorism Risk Insurance Act of 2002. All remain equally determined to see the TRIA program continue for the intermediate term because the conditions that made it necessary still are with us. The threat of foreign terrorist acts in the United States has not diminished; if anything, it may have increased since TRIA was enacted. At the same time, the insurance market has not recovered, at least not with respect to this peril. While some limited reinsurance capacity has returned, nothing near what is needed to sustain the economy is foreseeable under current conditions.

In today's world, CIAT believes TRIA or something like it has become indispensable. That is because our economy and businesses are at risk for unique man-made catastrophic events of unknown dimension and frequency which the insurance industry is unprepared, understandably, to handle on its own. Our national leaders tell us repeatedly that terrorism will be a threat to us for the foreseeable future. At the same time, our nation is undertaking significant efforts both to prevent and to prepare for terrorism. We believe that TRIA is an important component of this national effort, as TRIA both helps the economy move forward in the face of terrorism and helps us prepare economically should there be another catastrophic event. Without TRIA we believe the wheels of commerce, including the active development of new businesses and the jobs they bring with them, will be slowed jeopardizing our nation's economic security.

On behalf of CIAT's members, let me thank this Committee and the entire Senate for enacting this successful law. But I would be remiss if I did not specifically acknowledge that the President provided critical personal leadership in getting the program enacted. President Bush recognized the importance of this effort, not just from the perspective of an insurance market unable to underwrite accurately and assume the whole risk, but because he knew our economy needed to be secure then and in the future. We thank you and him for these efforts. They succeeded well.

Importance of Immediate Extension of "Make Available"

Before I explain how TRIA has succeeded, I would like to address a pressing and related matter. The members of CIAT are increasingly anxious about the looming prospect that our ability to obtain comprehensive and cost-effective terrorism coverage will be diminished substantially in 2005 unless the Secretary of Treasury moves affirmatively to extend the so-called "make available" provision in TRIA. The Act provides that he is to make this determination by September 1, 2004. If the "make available" provision is allowed to expire this year, American businesses face the alarming prospect that terrorism insurance policies again will become scarce, if not unavailable altogether - a full year earlier than TRIA's termination date. Further, it is likely that financial markets will react negatively in the final quarter of 2004 to the prospect that insurance may not be available.

Absent an extension, primary insurers would no longer be mandated to make terrorism insurance available on the same terms and conditions as other insurance. Although we had hoped initially, like all who were involved in the passage of TRIA, that a significant private market for terrorism reinsurance would emerge in a post-9/11 TRIA environment, this has not happened. Consequently, we are seriously concerned that with the absence of a "mandate" in 2005 under TRIA and with the paucity of private market reinsurance available, primary insurers will not offer, or "make available," significant, comprehensive terrorism insurance for the 2005 marketplace. In fact, we know from the example of the continuing exclusion of biological, chemical, radiological and nuclear risks how markets will react if there is no mandate (and continuation of backstop).

Accordingly, I respectfully urge members of this Committee and indeed all of the Senate to recommend to the Secretary of Treasury that he extend the vital "make available" provision of TRIA this year. A bipartisan effort already is underway in the House in calling on Treasury Secretary Snow to extend the "make available" provision of TRIA for the third year of the Program. These House members have urged the Secretary to take that action as soon as possible rather than leave it for the September 1 deadline. This will ensure that the insurance industry will be prepared in 2005 to provide American businesses with one of the crucial tools necessary to help protect the American economy and American jobs from the ugly and harmful specter of terrorism.

How TRIA Helped The Market

Prior to 9/11, coverage for acts of terrorism was routinely included in all property and liability insurance policies. As I said, after those horrific attacks, terrorism risk was generally excluded from the renewal offers on all of these policies, and the only coverage that could be found was either "stand-alone" policies or "buy-back" endorsements, and even taking up what coverage was offered on those terms left us and others with substantially less protection of our assets and operations than had been the case before 9/11. Even when some coverage was available, it was not as broad or secure as before and the costs were dramatically higher. Moreover, there was no consistency or apparent rationality to the prices on various layers and programs of coverage.

With respect to Host Marriott's own program, our property insurance costs nearly tripled in the policy year following September 11th, even though on a property portfolio insured for $8.6 billion for other (non-terrorism) perils, we had stand-alone terrorism insurance for only about 3 1/2 percent of that portfolio value, and that now excluded biological, chemical and radiological risks.

I have no doubt that virtually all other commercial buyers in the market had the same experience as Host Marriott. The consequence of this was not just decreased coverage protection and increased cost for us and other buyers. In many cases, it also meant that we in the business community could not, for example, provide lenders and other business partners with evidence of insurance consistent with loan documentation requirements. This led to a slow-down of development activities, job losses and other consequences throughout the post 9/11 economy.

After TRIA was enacted the market very quickly normalized, for the most part. The combination of the Federal reinsurance backstop and the law's requirement that all participating property and casualty insurers "make available" terrorism insurance in every commercial policy, led to restoration in available limits in most cases and, importantly, a return to something like a rational or consistent pricing of this coverage in the market in the eighteen months since TRIA came into effect. To be sure, the process has been gradual as insurers, brokers and buyers have adjusted to the Act's requirements and considered the evolving prices and other terms. The most recent information from Marsh, Inc., the world's largest insurance brokerage firm, shows that the take-up rate for terrorism coverage continues to rise as this adjustment process continues. For example, a recent Marsh study of 2400 U.S. businesses found that, from the second quarter to the fourth quarter of 2003, the percentage of businesses purchasing terrorism coverage rose another 5.4%, from 27.3% to 32.7%. I believe that if you looked specifically at major businesses or at publicly traded companies with boards and managements subject to Sarbanes-Oxley responsibilities, you would find even higher rates of purchase.

In assessing the success of TRIA, Congress should keep in mind that it is early in the TRIA experience. Consider the comparative experience for other government-backed insurance programs dealing with specific-perils. Two examples are instructive. First, the California Earthquake Authority, which is a publicly-managed entity established by the California Legislature to ensure that earthquake coverage is offered to all residential policyholders, reports that just 14%-17% of eligible California homeowners have earthquake insurance.[2] Second, according to a recent GAO report, the Federal Emergency Management Agency, a unit of the Homeland Security Department, estimates that one-half to two-thirds of property owners in eligible flood-prone areas do not have flood insurance coverage under the National Flood Insurance Program (NFIP), even though NFIP coverage is mandated for all FHA or GSE-backed loans for homes in

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[2] *Summary Report to the CEA Governing Board: Stakeholder Comments at Roundtable Summit Meetings*, June 6, 2003, p. 5. Available: <www.earthquakeauthority.com/pdfs/FinalRndtblRept6-19-03.pdf>

special flood hazard areas.[3] This participation rate for the NFIP, which has been in operation since 1968, would be roughly comparable to the recent take-up rate reported by Marsh for the new TRIA-backed commercial terrorism insurance. Moreover, the NFIP flood insurance is not evenly distributed across the country. As of March 2001, Florida accounted for roughly 41% of total NFIP policies in effect nationwide.

Biological, Chemical, Radiological and Nuclear Risks

TRIA has certainly led to a general availability of terrorism coverage and has produced relative stability in pricing for that coverage. Unfortunately, however, it cannot be considered a complete success, from the perspective of CIAT's broad membership, because of the continued exclusion by insurers of biological, chemical, radiological and nuclear (or B/C/R/N) risks from the terrorism insurance being offered.

In the early months of TRIA, there was some confusion among various parties and even some commentators about whether the TRIA backstop was available for these B/C/R/N risks, whether as WMDs or otherwise. CIAT itself sought and obtained from the TRIA Office an unequivocal affirmation that B/C/R/N terrorism is an insurable risk which will be eligible for indemnification under TRIA.[4]

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[3] U.S. General Accounting Office, *Flood Insurance: Challenges Facing the National Flood Insurance Program*, GAO-03-606T (Washington, D.C.:April 1, 2003). GAO did not attribute the low NFIP participation rate to a lack of need for Federal flood insurance, but rather lack of awareness or information on the part of policyholders and complexity of the NFIP Program. Similarly the early participation rates under TRIA, in part, may reflect the newness of the program and inexperience or informational deficiencies for both insurers and customers. The increases in participation rates during 2003 reported by Marsh suggest this may be the case rather than lack of ultimate demand for the coverage.

[4] See Terrorism Risk Insurance Program Interpretive Letter, dated March 24, 2004, available on the Department of Treasury's website at: <www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/pdf/redactedci.pdf>

While this may clear up some misunderstanding that existed on the margins in the market, it is equally clear that most major insurers understand that the indemnification is available for these perils but that they, at least for now, have no plans to offer coverage of B/C/R/N perils because of the deductibles they retain and because of the lack of non-Federal reinsurance. State regulators have, since TRIA was enacted, approved specific exclusion clauses which allow exclusion of most B/C/R/N risks from most commercial lines property and casualty policies. The main exception is workers compensation where the coverage is defined by statute and is not allowed to exclude these perils.

We point this out not to criticize the insurers, or the State regulators, but to illustrate the still tenuous nature of the market and of the insurance industry's limited capacity or willingness to accept terrorism exposure. We believe this observation only reinforces the conclusion that the private insurance and reinsurance market is not yet ready, nor will it be by 2006, to offer terrorism insurance to the U.S. economy without some continued indemnification from the government under TRIA. The experience also illustrates that whether coverage is available is largely a function of the interplay of the continued Federal backstop and the mandatory offer or coverage requirements of both State and Federal law.

Critical Importance of Two-Year Extension of Overall Program in 2004

We are staring the calendar in the face. TRIA is currently subject to a scheduled "hard" expiration on December 31, 2005. It is a "hard" expiration in the sense that no terrorist event after that date will be Federally indemnified even under a policy which is still in effect on that date and which otherwise covers terrorism. The insurance industry has already proposed to State regulators, through the collective body, Insurance Services Office (ISO), to begin using policy forms beginning January 1, 2005 that would exclude or cut off terrorism coverage on January 1, 2006 on policies that run past that date. (While the calendar year is common in insurance programs, the majority of commercial policies have renewal dates other than January 1st.) Worse, our fear is that in many cases insurers may withdraw from particular lines or particular customers rather than bother with negotiating over these "sleeping" exclusions that have been proposed to regulators. Thus, commercial insurance buyers face potentially severe dislocations and availability problems not in 2006 but as soon as negotiations for 2005 insurance programs commence; that is to say, later this year, if the overall TRIA program is not renewed before then.[5]

Thus, we believe that Congress should enact that extension now, this year, to ensure that everyone who needs coverage can buy it. Only this will avoid gaps in availability during the 2004-2005 insurance renewal season. Any uncertainty during the coming year could impair economic activity - especially new commercial construction - and job growth, as clearly occurred between 9/11 and November 2002 when TRIA was enacted.

A Federal Role Remains Necessary

[5] TRIA calls for a comprehensive study and report by the Treasury Department to Congress in June 2005. Unfortunately, it is now clear that date will be too late for Congressional action, if serious market dislocations are to be avoided. We believe that Treasury study may provide valuable guidance for any eventual long-term solution but should not deter Congress from providing the two-year extension in the meantime.

From CIAT's perspective, TRIA has been not only a great success, but an economic necessity in helping to manage each industry's - and our nation's - economic risks from terrorism. Looking forward, we see no evidence that private insurance markets will be able to provide adequate terrorism insurance.

Some claim to know what U.S. cities or buildings are at risk and what areas are not at risk. Neither I nor other CIAT members pretend to have that kind of knowledge. The knowledge we do have is that the terrorist mind is dynamic. Its targets and methods of attack evolve with the conditions. As potential targets harden, other softer targets or geographical areas come into focus. Given this reality it seems shortsighted indeed to try to micro-design a program today for specific risks that we know will evolve in the future. To suggest that terrorism insurance is relevant to only nine U.S. urban areas is ludicrous. Host Marriott has hotels in 34 States and the District of Columbia, and the CIAT coalition has national membership active in all 50 States including rural organizations, such as the rural electric cooperatives, that are vitally concerned with the availability of this insurance coverage. What we need, and need urgently, is a continuation of TRIA, to help us be prepared for whatever might come.

Clearly, terrorism is a risk that arises from persons or groups who have declared war on the U.S. - making U.S. economic interests at home and abroad the new battleground. Recent attacks in Jakarta, Istanbul and Spain have demonstrated that terrorists remain intent upon waging this war. As Secretary of Homeland Security Tom Ridge said recently in a speech at the Port of Portland (Oregon):

> "[T]he terrorists in part targeted the free and democratic elections in Spain -- again striking at the elements of our

> society that they hate the most. As we enter a season dominated by these symbols --the Olympics, political conventions, and our own presidential election--we must remain on heightened alert so that these very foundations of our freedom do not become targets for the enemy."

However, unlike hurricanes, earthquakes, and floods, we do not know how another attack will manifest itself - we do not know where, when, or how catastrophic an attack will be - all we know is that another attack is likely coming. Despite early attempts by modeling firms to produce terrorism risk models that can accurately predict terrorism events in the United States, they are unable to model accurately for the frequency or severity of such attacks, absent more reliable data. Unfortunately, even as we make every effort to eliminate the threat of terror, the terrorists themselves may substantially influence those variables.

The private sector has not been idle in the meantime. For example, serious work has been done exploring alternatives to TRIA, such as the possibility of a privately funded terrorism reinsurance pool for the workers compensation insurance market. This is a line of coverage crucial to every employer. The preliminary conclusions, however, suggest that even this may be beyond the capability of the private economy without some government assistance. At a minimum, more time is needed to develop solutions, and only an extension of TRIA will provide that time.

Whether or not private markets are able to meaningfully price in the future the risks associated with this war, we need to think about what condition insurance markets will be in after another such attack. Insurance is a critical element in the business of this nation. As we spend billions creating the Department of Homeland Security, we need to consider also the experience and example of other nations, such as the UK, France, Germany, Israel, Austria, South Africa, and Spain -- and recognize that this is not solely a "market" issue - clearly, this is a matter of managing the nation's economic risk and preparing our nation's economy for war of this nature. Each of these countries, and others, have established ongoing government-aided terrorism insurance (or reinsurance) programs. Attached is an addendum briefly describing each of these foreign programs.

It would be ironic if Congress declined to give the domestic economy the security of knowing next year that the government will continue to support terrorism insurance risk. That is because Congress has provided long term insurance protection for U.S. investors against terrorism and other forms of "political violence" when U.S. business invests overseas. The Overseas Private Investment Corporation (OPIC), a Federal government agency, has been providing this protection to U.S. investors for their overseas projects since 1971.[6] It certainly seems consistent to us that the U.S. government, while it continues to provide multi-year insurance coverage for acts of terrorism overseas, should also at the very least provide a short-term extension of reinsurance coverage for terrorist events on our own soil. TRIA should be extended at least through the current authorization of the OPIC program, that is 2007. As President Bush has repeatedly reminded us, the war on terrorism is a long-term endeavor, with little expectation that the situation will improve with any certainty before TRIA's currently scheduled expiration date.

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[6] OPIC is currently authorized through 2007 - two years after TRIA is currently set to expire - but has project commitments, including insurance coverage, for up to twenty years into the future.

Terrorist attacks are not attacks on individual companies or buildings but rather on our national policies and the way of life in America. When considered in this way, it is only natural that a national policy of shared risk be established - and be maintained -until the threat is removed. A major reason that terrorists attack us is to disrupt our economy. Having mechanisms, such as TRIA, in place that allow our economy to continue in the face of threats and to recover from actual attacks, enhances our economic security. This is no time to retreat from what we resolved to do after 9/11. As a country we must maintain the efforts which will secure our economy. TRIA is an important part of that national resolve. For these reasons, CIAT urges you to act quickly to extend TRIA for two additional years.

Conclusion

TRIA has been a success, and we commend the Chairman and Ranking Member for holding this very important hearing today. We remain concerned, however, that an adequate private reinsurance market for terrorism has not emerged in the 18 months since TRIA's enactment, and for this reason as well as the other reasons stated above, action this year is imperative in two respects:

1) the Treasury Secretary should extend the "make available" provision as soon as possible; and

2) TRIA should not be allowed to sunset in 2005; rather, Congress should provide a seamless, two-year extension of TRIA, which contains the "make available" requirement, before adjournment this year.

Neither we in the private sector nor Congress should sit idle during the time after TRIA is extended. This two-year extension will give policymakers , insurance markets and their regulators and we customers the extra time needed to revise or modify the program or to develop a wholly new and more permanent solution to this critical need of the economy. Thank you, Mr. Chairman. I would be happy to respond to the Committee's questions.