Protecting Americans from Catastrophic Terrorism Risk

September 27, 2006
Statement of Ira Shapiro to the House Financial Services Committee, Capital Markets, Insurance & Government Sponsored Enterprises Subcommittee and Oversight and Investigations Subcommittee

Thank you for convening this important hearing.

I am the CEO of Fisher Harris Shapiro, a risk management and insurance consulting firm specializing in the real estate business. I am here today on behalf of the Real Estate Board of New York, New York's leading association representing owners and builders of high rise offices and apartment buildings. Our firm currently serves over thirty major real estate portfolios and large construction projects, most of which are New York City based clients. The total insured values of the portfolios that we manage are approximately $45 billion, including 900 million square feet of commercial property and 71 thousand residential units.

The present state of the real estate property insurance marketplace in New York City is deteriorating almost on a daily basis, even with TRIA (TREIA) still in effect through 12/31/07. This year is the most difficult year I have seen, including the months immediately following 9/11, to place insurance on large portfolios. I expect that renewing or placing large portfolios in the New Year will mean serious problems in terms of coverage, capacity, availability and cost increases.

While New York City and other urban centers face serious concentration of risk issues, the problem is national in scope. Today, virtually all mortgages are securitized, and these securities are held by pension funds, mutual funds and individuals. Without TRIA, these commercial mortgage-backed securities (CMBS) are in danger of the underlying mortgages being in default, or the bonds being downgraded. This would impact millions of Americans.

The question is why is there such a problem in obtaining terrorism coverage in 2006 with TRIA (TRIEA) still in effect? The following is a summary of the issues that have impacted terrorism coverage in 2006:

- TRIA initially presented a reasonable program that was satisfactory to insurers and policyholders and it brought stability to the economy and the marketplace. Under TRIEA, the damage threshold under which the federal backstop kicks in was raised to $50M from $5M. Insurance industry modeling of the extent of damages resulting from terrorist attacks in various sized cities showed considerable damage, but 90% of the time below the TRIEA threshold. [1] TRIEA would not cover any of the damages from a nuclear, biological, chemical of radiological attack.

[1] American Academy of Actuaries, 3/31/06 and 4/27/06

- Insurers must retain 17.5% of their premiums written in 2006 and 20% in 2007. This is a huge number.

- Insurers have to share 10% in 2006 (15% in 2007) of any losses loaned by the Federal Government.

The combination of these three factors has caused insurers to back out of the marketplace or significantly limit their participation based on limits and location.

One of the most critical problems is the lack of builders risk insurance, which are multi-year policies for large construction projects. For example, one of our clients has been told that insurers would provide capacity for "all risk" coverage only if the developer would agree in advance to reject TRIA, forcing him to purchase the very minimal amount of stand-alone coverage that he was able to obtain. It was the lack of availability of terrorism coverage for builders risk policies that caused several large construction projects to nearly come to a halt immediately after 9/11. The stand-alone market for terrorism provides very limited coverage today.[2]

Both buyers and lenders, especially for securitized loans, require substantial ratings of their insurers. The rating agencies, having modeled various terrorist attack scenarios, are advising insurers that if their writings exceed the threshold models, they could be subject to lower ratings.[3] Insurers are very protective of their ratings since it is their bread and butter.

For example, one of the major insurers in New York City which used to provide terrorism coverage is terminating most of their relationships due to the fear of a ratings downgrade. Their participation is now extremely limited in capacity, and they are either refusing to renew policies or lowering their capacity from as much as $200M to no more than $25M and then only in selected areas. One client recently purchased insurance at a 70% increase in premiums with coverage that was severely inadequate for its needs. Another major insurer was also a participant in terrorism but has been told by the rating agencies to stop writing terrorism coverage for the balance of this year.

The very few insurers that are still providing insurance with terrorism coverage are lowering their capacity or dropping out because of concentration of risk or aggregation issues. With each policy that is written, coverage is restricted for the next buyer. For example, one of our clients had $815M of limits in the fall of 2005 with full terrorism coverage. The lender for the largest building of that portfolio decided to model the exposure because of other buildings within a few blocks of the building, causing the borrower to increase the limits to $950M. Additional insurance was effected April 2006. Now, upon the 2006 renewal $1.1B is required by the lender, which we are having great difficulty getting. Even achieving $950M is a problem. We may only be able to get as

[2] Best Wire Services, 06/02/06 - Attached
[3] S&P Alter Approach to Gauging Insurers' Terrorism Exposure, 06/8/06 - Attached

much as $650M of terrorism, and might have to resort to the stand-alone policies which provide inadequate protection.

Another client renewed in July of this year. In 2004 we had terrorism limits of $1B, but in 2005 we were only able to obtain $850M. This year we were only able to secure $835M. Progressively (no change in the portfolio), the capacity is dropping.

Reinsures are not subject to TRIA and capacity in the reinsurance market is severely limited. This has caused insurers to lower their capacity as they lack the ability to lay off a portion of the risk.

By the end of this year, policyholders will encounter sunset clauses, as was the case in 2005. With fewer insurers providing lower insurance limits, combined with the inability to provide 12 month policies because of the sunset date, the situation is far grimmer even than last year.

TRIA does not cover CNBR (chemical, nuclear, biological, and radiological) except in very limited ways. There is extremely limited reinsurance available for CNBR, estimated at $1-2B – a fraction of what is needed. [4]

After 9/11 and before TRIA (11/26/02), there were major dislocations but the overall impacts were softened by several factors. 1) Many reinsurance treaties did not expire until 4/30/02 or 7/31/02. There were, therefore, only a few months between the treaty expirations and the enactment of TRIA. 2) We did not have the same capacity and aggregation issues before 9/11 that we face today. Unfortunately, there are only a few insurers today writing many buildings. Before 9/11 there were numerous insurers, which spread the risk. 3) Policies that were written in the latter part of 2001 still had their policies in effect for 12 months (with terrorism). Therefore, there were a limited number of buyers with serious problems before TRIA was in effect. 4) The ratings agencies weren't dictating to the insurers what they could write and what they could not. For these reasons, renewals at the end of this year and the beginning of next will be far more difficult that ever before.

Clearly, a long-term permanent solution is needed, and any workable solution will require government involvement. The insurance industry cannot predict terrorism losses, nor can it survive a significant event without a meaningful backstop. The European model of pooling risk is an alternative; the concept of a voluntary mutual reinsurance entity capitalized by insurer premiums is certainly worth exploring. Either model would provide a mechanism and an incentive for the development of a private capital pool. Gradually some of the federal backstop could be replaced by this layer of private capital. However, some sort of federal backstop is essential to maintain our economy on an even keel and to insure against the risk of terrorism. Private markets alone won't and can't do it.

Thank you for the opportunity to testify.

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[4] Big "I" Asks Policy Makers to Look Ahead on Terrorism Risk, dated 04/21/06 - Attached

PR Newswire
United Business Media

Actuaries Disclose Potential Terrorism Costs

WASHINGTON, March 31 /PRNewswire/ -- The American Academy of Actuaries disclosed on Wednesday that a future large terrorist attack in New York City could result in $778 billion in insured losses. Speaking at the National Association of Insurance Commissioners (NAIC) public hearing on "Terrorism Insurance Matters," Michael McCarter, chairperson of the Academy Terrorism Risk Insurance Subgroup, provided potential property and casualty, and group life insurance losses as a result of various types of terrorist attacks. His group estimated potential insured losses from a conventional truck bomb terrorist attack, as well as medium and large chemical, nuclear, biological or radiological (CNBR) events caused by terrorism.

"The largest CNBR event we modeled caused $696 billion in property and casualty losses and $82 billion in group life insurance losses," said McCarter, whose subgroup used catastrophe risk models by AIR Worldwide to generate insurance cost figures. The subgroup was created by the Academy after receiving requests from Congress for actuarial analyses as it considered the reauthorization of the Terrorism Risk Insurance Act of 2002 (TRIA) last year.

According to the models, a truck bomb attack in New York City could cost $11.8 billion and a medium CNBR terrorist attack could cost $446.5 billion. Models for three additional U.S. cities also were generated. In Washington, D.C., a truck bomb attack could cost $5.5 billion, a medium CNBR event could cost $106.2 billion and a large CNBR could cost $196.8 billion. In San Francisco the costs for those events were estimated to be $8.8 billion, $92.2 billion, and $171.2 billion, respectively, while in Des Moines, Iowa, the costs could be $3 billion, $27.3 billion, and $42.3 billion.

McCarter says that much of the property and casualty insurance market could be financially incapacitated in the event of a large terrorist attack. "Our largest modeled CNBR loss is more than two-thirds higher than the entire property and casualty insurance industry surplus," he said. "In the absence of TRIA or some other national framework for dealing with terrorism insurance losses, many commercial lines insurers would be devastated."

In early December, the Academy subgroup released a public statement about extending or replacing TRIA. It is currently preparing a report for the President's Working Group on Financial Markets, which will submit a report about the long-term availability and affordability of terrorism insurance to Congress by Sept. 30, 2006.

For more information or to arrange an interview, please contact Andrew Simonelli, Media Relations Manager, at 202.785.7872. A copy of the statement of Michael McCarter before the NAIC public hearing, and the subgroup's statement about replacing or extending TRIA (Dec. 2005) can be found at http://www.actuary.org/.

The American Academy of Actuaries is a national organization formed in

1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.
SOURCE American Academy of Actuaries

BestWire - 06/02/2006 03:41 pm

BestWire Services

Aon: Five Years After 9/11, Little New Capacity Offered to Terror Risks

WASHINGTON June 02 (BestWire) — Per-risk capacity for stand-alone terrorism insurance would need to rise by 263% before insureds would be able to exercise any "pricing power," according to an analysis of the global terror risk market by U.S. broker Aon Corp.

Some stand-alone terrorism markets have increased their maximum lines in the nearly five years since the Sept. 11 attacks. However, per-risk capacity has remained relatively stable at about $500 million, excluding capacity offered by units of Berkshire Hathaway Inc., Aon found. Including Berkshire capacity, the stand-alone market offers maximum terrorism insurance capacity of roughly $1.52 billion, Aon said.

The report was offered in the form of written comments submitted to the President's Working Group on Financial Markets, which includes representatives of the U.S. Treasury Department, the Federal Reserve, the Securities and Exchange Commission and the Commodity Futures Trading Commission. The group currently is preparing a report on the long-term availability and affordability of terrorism insurance.

Under the Terrorism Risk Insurance Extension Act, the group must present its findings to Congress by Sept. 30. Passed late last December, the act extended the federal reinsurance backstop for terrorism risks through year end 2007.

Aon's report found that, in 2005, the global commercial property market offered maximum per-risk capacity to U.S. insureds of $8.12 billion, with a median limit of $300 million and average limit of $570 million.

However, 23% of that capacity was offered on the condition that terrorism would be excluded completely had the original Terrorism Risk Insurance Act expired at year end. An additional 49% of capacity relied on substantial sublimits for terrorism coverage, or the right to reprice coverage should TRIA either expire or be scaled back, Aon found.

Of the remaining $2.34 billion of full-term terrorism capacity, $1 billion either was offered by Berkshire Hathaway or was "duplicate" capacity offered by units of American International Group Inc., Aon found.

The broker said it generally chose to exclude from its analysis Berkshire capacity — most of it offered through the conglomerate's National Indemnity unit — because of the relatively high cost of the coverage and because the potentially large line size of Berkshire risks would tend to overstate the available overall capacity. Furthermore, should the federal terror backstop expire, Aon expects Berkshire to reallocate most of this capacity to higher-return terrorism reinsurance lines.

AIG offers full-term capacity for energy and chemical risks through its AIG Global Energy unit, as well as all-risk property coverage through AIU Insurance Co. and Lexington Insurance Co. But according to Aon, the capacity wouldn't be combined on a per-risk basis because of distinctions made in the underlying exposure.

Despite an attractive pricing environment, the report notes no insurers have entered the market since 2001 to offer monoline, stand-alone terrorism capacity. Instead, Aon found that risk capital has been allocated by existing multiline commercial insurers either on the basis of forced entry — such as TRIA's mandate that insurers offer coverage — or through specialist, stand-alone programs that remain part of an overall, multiline business plan.

The company cited the limited availability of reinsurance capacity as a major barrier to entry for insurers in the terror risk market. The report found total private reinsurance capacity for terrorism risks remains in the range of $6 billion to $8 billion, with an additional $2 billion to $3 billion in risk-transfer capacity made available by hedge funds. Should the $100 billion in capacity offered by the federal TRIA program expire, it would reduce the total available market capacity for terrorism risk by more than 35%, Aon concludes.

"Logic would appear to dictate that the potential loss of TRIA reinsurance capacity as of 1/1/08 would add further barriers to new capital entry as any new markets would have to rely on limited, private market reinsurance for risk transfer capacity. This significantly decreases the likelihood of substantial new capital entry into the market in the long-term," the company wrote.

S&P Alters Approach to Gauging Insurers' Terrorism Exposure

June 8, 2006

Standard & Poor's Ratings Services said it is changing its process for evaluating the terrorism exposure of insurers and reinsurers.

The updated process is partly a response to the increased insurance retentions under the two-year extension of the Terrorism Risk Insurance Act of 2002, and it is also to quantify further the exposure and risk-management capabilities of the insurance industry. The process change will affect insurance and reinsurance companies globally and is consistent across sectors, as Standard & Poor's said it will be using the same approach and questionnaire for all property/casualty companies.

Standard & Poor's said it expects minimal rating changes to occur as a result of this process change and data-collection enhancement. However, the new terrorism evaluation will highlight the companies that have better risk-management systems, capabilities, and controls for measuring terrorism risk, and this will be factored into the rating qualitatively, according to the organization.

Standard & Poor's also said it has been qualitatively evaluating terrorism risk for companies, so this risk has largely been factored into ratings already.

To help it better evaluate each company's terrorism exposure and risk-management capabilities, the firm has developed a new questionnaire that is specific to terrorism risk. The questionnaire will be distributed in the second quarter of 2006 to Standard & Poor's interactively rated insurance companies.

The questionnaire is designed to solicit the data necessary for an evaluation of gross and net terrorism exposure (by line of business), with specific questions regarding various types of events and within various ring distances (such as between an insured location and a potential target).

In the case of stand-alone terrorism policies, full limit detail is also requested as well as details on single-address exposure.

The questionnaire also requests premium data.

Lastly, the questionnaire has a number of qualitative questions focused on evaluating each company's risk profile and underwriting focus. However, Standard & Poor's says the questionnaire is flexible in that it allows companies to provide data that matches their particular risk profile and exposure set, and Standard & Poor's says it will work with each company's level of data to ease the completion of the questionnaire.

Currently, Standard & Poor's charges terrorism risk within the premium and reserve factors applied within the risk-based capital model, so terrorism risk is not separated out individually with stand-alone terrorism premium or reserve charges. At this point, this new questionnaire is only an update to the firm's data-collection process, but there are no changes to its capital model risk charges used to measure the capital adequacy ratio.

As part of the ongoing rating review process and surveillance, Standard & Poor's expects each company to provide it with this additional data and have detailed discussions regarding this process change.

Source: www.standardandpoors.com.

BIG "I" TESTIFIES NATURAL DISASTER LEGISLATION NEEDED
Association calls for "national solution to national problem"

WASHINGTON, D.C., Sept. 13, 2006—The Independent Insurance Agents & Brokers of America (the Big "I") testified today before a subcommittee of the House Financial Services Committee on the crucial need for natural disaster legislation.

J. David Daniel, president of Daniel & Eustis Insurance in Baton Rouge, La., and a member of the Big "I" Executive Committee, represented the association before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises. Daniel testified that there needs to be a federal role in natural disaster preparation, and that Congressional attention is needed for several pieces of legislation that have been introduced to deal with this issue.

"Put simply, insuring against natural disasters is a national problem that requires a national solution," Daniel testified. "Despite our longstanding position that the insurance market is best served by limited federal involvement, we believe that a federal solution is necessary to help provide capacity and fill a void that the private market cannot and will not service. However, it is important that the day-to-day regulation of insurance remain at the state level, where state insurance departments are best equipped to serve the special needs of local consumers in local markets."

Daniel noted Big "I" support for H.R. 846, the Homeowners' Insurance Availability Act, introduced in 2005 by Rep. Ginny Brown-Waite (R-Fla.). Her bill would allow private insurers to purchase, at auction, reinsurance contracts directly from the U.S. Treasury to cover natural disasters that are equal to, or greater than, a 1-in-100-year event.

"We believe this is a strong proposal," Daniel testified, "because it will encourage more companies to enter at-risk markets, thus increasing availability and market stability, while limiting federal involvement to only the most devastating catastrophes."

Daniel also mentioned other pieces of pending natural-disaster legislation, including the following bills:

- **H.R. 2668, the Policyholder Disaster Protection Act,** introduced by Rep. Mark Foley (R-Fla). This bill would permit insurers to create tax-free reserve funds for natural disaster claims.
- **H.R. 4836, Catastrophic Savings Account Act,** introduced by Rep. Tom Feeney (R-Fla.). This bill would create tax-free, personal catastrophic savings accounts.
- **H.R. 4366, the Homeowners Insurance Protection Act of 2005,** introduced by Reps. Ginny Brown-Waite (R-Fla.) and Clay Shaw (R-Fla.). This bill would make state catastrophe funds eligible for federal reinsurance.
- **H.R. 4507, the Natural Catastrophe Insurance Act of 2005,** offered by Rep. Carolyn Maloney (D-N.Y.). This bill would establish a federal program to provide reinsurance for state natural disaster insurance programs.
- **H.R. 5891, the Catastrophic Risk and Insurance Commission Act,** introduced by Reps. Debbie Wasserman Schultz (D-Fla.), Mike Castle (R-Del.), Patrick McHenry (R-N.C.) and Charlie Melancon (D-La.). This bill would help Congress address ways to reduce the costs of disasters by establishing a national commission to examine proposals

and make recommendations to assist the federal government in preparing for and managing natural disasters.

“Our members support exploring ways to reduce the costs of disasters, such as mitigation efforts, Daniel said. “For instance, enhancing building codes and using financial incentives to mitigate risk are among proposals worth exploring in order to protect both consumers and taxpayers across the country.”

Daniel stressed that, despite the Gulf coast hurricanes getting most of the attention in 2005, natural disasters affect all areas of the country, which means that national solutions are required for a national issue. And natural disasters affect every single taxpayer in the nation, no matter where they live.

“Our members live across the country, serving and living in a wide variety of communities—large and small—and so many of them have been impacted by natural disasters,” Daniel testified. “Certainly, the most devastating natural disasters in recent years have resulted from hurricanes, which have had the greatest impact on the homeowners’ insurance market. However, hurricanes are only one of the many catastrophic risks our nation faces. Whether it is tornadoes in the Midwest, earthquakes in California, or ice storms in the Northeast, we all face some risk of natural disaster, and it often takes only one or two events in a particular area for the homeowners’ insurance market to be dramatically affected.”

Founded in 1896, IIABA (the Big “I”) is the nation’s oldest and largest national association of independent insurance agents and brokers, representing a network of more than 300,000 agents, brokers and their employees nationally. Its members are businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents and brokers offer all lines of insurance—property, casualty, life, and health—as well as employee benefit plans and retirement products. Web address: www.independentagent.com.

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The Real Estate Board of New York, Inc. 570 Lexington Avenue, New York, N.Y. 10022
TEL. (212) 532-3100 FAX (212) 779-8774.

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BIOGRAPHY
Ira H. Shapiro
880 Third Avenue
New York, NY 10022

QUALIFICATIONS: Over thirty years as principal of a quality mid-sized Insurance & Risk Management Brokerage, involved in all aspects of servicing, management & supervision. Two plus years as Senior VP & member of Senior Management Team of one of the largest mid-sized brokerage firms. Since 10/94: Agency/Brokerage, Insurance & Business Consultant; Insurance and Risk Management Consultant for Insurance Buyers; Instructor and Author of courses for NY Continuing Education and other areas of professional development.

SKILLS: Expert Technical Insurance Professional. Risk Management expertise specializing in Risk Analysis, Contractual Risk Transfer, Risk Mitigation and Program Design.

EXPERIENCE:

10/94 - Present

1. **FISHER HARRIS SHAPIRO - principal & chief executive officer**
   IRA SHAPIRO CONSULTING SERVICES, INC - president

2. **REAL ESTATE BOARD OF NEW YORK (REBNY)**
   Member of insurance and risk management committee for REBNY

3. **A. D. BANKER**
   In conjunction with Banker, an accredited insurance teaching facility (the largest classroom provider), I have written continuing education seminars on various insurance subject (over 115 hours of seminars) which I deliver personally within the industry. The seminars cover a wide range of subjects

06/92 - 10/94

KAYE INSURANCE ASSOCIATES. LP - senior VP
Orchestration, implementation and integration of a $12 million revenue brokerage acquisition. Negotiated several smaller contractual arrangements involving acquisitions, sales, or “partnership” formations. Managed eight departments involving 125 employees (28% of staff). Member of Senior Management Steering Committee and involved in all facets of top management. Created and managed internal Professional Development Program

01/62 - 06/92

THE JLS GROUP INC - Executive VP (principal)
Held many positions over thirty years developing virtually all business & technical skills necessary to operate one of the most highly regarded Insurance and Risk Management Brokerage firms. Heavily involved in Risk Management, Program Design & Implementation, Client Servicing, Office Management, Educational Program Design & Implementation and Quality Control Performance

EDUCATION: **BROOKLYN COLLEGE**
BA Economics, 1961

iscs/resume/isbiog6

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name: IRA SHAPIRO	**2. Organization or organizations you are representing:** Fisher Harris Shapiro Inc. representing the Real Estate Board of New York
3. Business Address and telephone number: 880 Third Avenue New York, N.Y. 10022 212-588-8320	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2004 related to the subject on which you have been invited to testify? ☐ Yes ☑ No	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2004 related to the subject on which you have been invited to testify?** ☐ Yes ☑ No
6. If you answered "yes" to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
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Please attach a copy of this form to your written testimony.