AAMGA
American Association of Managing General Agents

An Update on TRIA/TRIPRA

Presented to the Honorable Commissioner Wayne Goodwin and the NC Property & Casualty Agents Advisory Committee by:

Bernd G. Heinze, Esq. – AAMGA Executive Director

November 21, 2013 – Boone, NC

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MEMORANDUM

To: Commissioner Wayne Goodwin and the North Carolina Property & Casualty Agents Advisory Board

From: Bernd G. Heinze, Esq. – AAMGA Executive Director

Date: November 21, 2013

Re: Update on the Terrorism Risk Insurance Act

Executive Summary

The AAMGA continues to monitor the respective positions within the market, Congress and among policyholders in regard to the reauthorization of Terrorism Risk Insurance Program Reauthorization Act ("TRIPRA"), (also often interchangeably referred to as "TRIA").

Following on-going research and analysis, the AAMGA Governmental Affairs Committee recommended, and the AAMGA Board of Directors has approved, the following position, which has been articulated to the US Senate and House of Representative Committees examining the propriety of reauthorizing the federal backstop for losses due to terrorism:

> The private insurance industry remains the best competitive marketplace to craft solutions for the rapidly changing risk exposures. Both private and commercial consumers benefit best when the vibrancy of the free market creates security through innovative products and services offered at competitive rates. In respect of securing homes, businesses and other enterprises from the effects of terrorism, the American Association of Managing General Agents believes the private insurance market should fully evaluate and exhaust the ability to offer coverage for these events, without a disproportionate impact on consumers and businesses.
>
> Where the private market is unable to offer reasonable insurance protection through risk sharing, the most appropriate and current solution is to reauthorize the Terrorism Risk Insurance Program Reauthorization Act with an appropriate sunset provision. This will allow the government and private markets to continue providing protection and stability to the markets while evaluating, modeling and creating the best solutions to respond to terroristic events and, thereby, provide the best protection for policyholders and the public.

How Terrorism is Different From Other Catastrophe Risks

The nature of terrorism risk is simply different from other perils, even natural catastrophe perils. To name just a few of the differences:

- Risk assessment for terrorism is very difficult – frequency and severity are extremely hard to predict;
- Only the Government has access to intelligence information regarding terror threats and it cannot share that information with industry, nor should it;
- As the recent tragic events in Boston demonstrated, the likelihood and the mode of attack are highly variable – which adds to the uncertainty around the potential maximum size of an event;
- Although modeling exists, it has limitations – in particular, due to the infrequency of extreme terror events, there is much less historical data available to draw upon than exists for natural catastrophes.

None of this means that terrorism risk cannot ever be underwritten – many foreign and domestic markets already do so to a limited extent. Nevertheless, all these factors act to substantially limit the appetite of the insurance and reinsurance industry to absorb this risk, particularly in major urban areas due to the density and accumulation of asset value.

Since TRIA, through the recoupment provisions, operates essentially as a post event cost-sharing mechanism, the high threshold for Federal involvement ensures that private capacity will absorb all but the most extreme losses. Without TRIA however, the aggregation of risk would quickly lead the industry to exclude coverage or withdraw capacity from key economic centers in the United States.

Background and Status

As a result of the disruptions in the insurance market in the aftermath September 11, 2001, the US government enacted the Terrorism Risk Insurance Act of 2002, (referred to as TRIA or, with the reauthorizations under the Terrorism Risk Insurance Program Reauthorization Act, "TRIPRA"), which creates the federal "backstop" for insurance claims related to acts of terrorism.

In enacting TRIA, Congress found that the insurance market could not support "reasonable and predictable prices" because the events of 9/11 hindered the conventional risk-spreading function of insurance. The insurance and financial markets faced "widespread financial market uncertainties" at the time, and the resulting withdrawal of insurance from the market and substantial premium increases were determined to be a serious threat to the market. Therefore, Congress found that the federal government should provide a temporary cost-sharing measure, to allow the private market to determine how best to deal with terrorism risk.

The Act establishes:

> a temporary Federal program that provides for a transparent system of shared public and private compensation for insured losses resulting from acts of terrorism, in order to:
>
> (1) protect consumers by addressing market disruptions and ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk; and
>
> (2) allow for a transitional period for the private market to stabilize, resume pricing of such insurance, and build capacity to absorb any future losses, while preserving State insurance regulation and consumer protection.[1]

Because TRIA was intended to be a temporary stabilization measure, it was enacted with a sunset date of December 31, 2005. Before that sunset, and in response to lobbying efforts from insurance and business interests, the government extended the program through the Terrorism Risk Insurance Extension Act of 2005 ("TRIEA"), which extended TRIA for two years and modified some of its key terms.

Before the sunset of the 2005 Act, the program was again modified and extended for another seven years under the Terrorism Risk Insurance Program Reauthorization Act of 2007 ("TRIPRA"). Currently, the law is set to expire on December 31, 2014, which would result in the private market shouldering the responsibility for underwriting terrorism risks.

Requirements of TRIA – At a Glance

TRIA requires commercial property and casualty insurers to provide terrorism coverage on terms similar to non-terrorism coverage.

TRIA/TRIPRA Program Highlights

Current Law	Terrorism Risk Insurance Program reauthorization Act of 2007
Coverage	$100 Billion, covering foreign and domestic acts of terrorism
Participation	85% federal / 15% insurer
Insurer Deductible	20% direct earned premium, prior year
Expiration Date(s)	December 31, 2014 / December 31, 2019
Minimum Loss for Certification	$5 million
Minimum Loss for Indemnification	$100 million

[1] Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 101(b), 116 Stat. 2322–23 (2002), found in 15 U.S.C. § 6701 (2012) (statutory note including subsequent amendments).

Overview of the Pending Legislation

Bill	Summary
• **H.R. 508: *"Terrorism Risk Insurance Act of 2002 Reauthorization Act of 2013"*** • **Introduced Feb. 5 by Rep. Michael Grimm (D-NY)**	• 5-Year Extension (through 2019) • Extend recoupment period for any TRIA assistance from 2017 to 2019
• **H.R. 2146: *"Terrorism Risk Insurance Program Reauthorization Act of 2013"*** • **Introduced May 23 by Rep. Michael Capuano (D-MA)**	• 10-Year Extension (through 2024) • Extend recoupment period for any TRIA assistance from 2017 to 2024 • Requires President's Working Group on Financial Markets (PWGFM) to issue reports on long-term availability and affordability of terrorism insurance in 2017, 2020 and 2023 • Reports to be drafted with consultation from NAIC and representatives of the insurance and securities industries and policyholders
• **H.R. 1945: *"Fostering Resilience to Terrorism Act of 2013"*** • **Introduced May 9 by Rep. Benny Thompson (D-MS)**	• 10-Year Extension (through 2024) • Recoupment period changed to 2024 • Would transfer responsibility for certification of a "act of terrorism" to the Secretary of Homeland Security from Secretary of Treasury. • PWGFM to issue reports in 2017, 2020 and 2023 • Requires Sec. of DHS to provide insureds with "timely homeland security information, including terrorism risk information, at the appropriate level of classification and information on best practices to foster resilience to an act of terrorism."

Elements of the Current Legislation

- extends the federal backstop through 2019 or 2024;
- the definition of "act of terrorism" under TRIA is expanded to allow the certification of acts "domestic terrorism";
- the legislation clarifies the operation of the $100 billion annual program cap; and
- the new law changes the manner in which the mandatory portion of post-event policyholder surcharges would be collected.
- TRIPRA calls for the study of nuclear, biological, chemical, and radiological (NBCR) terrorism insurance as well as the study of the availability and affordability of terrorism insurance in certain markets

Talking Points on Current Status

- TRIA was first passed in 2002 and has since been extended and amended, twice. Each extension of the Act has led to tightened coverage by raising deductibles, increasing minimum losses, and reducing the pro-rata government share of losses (currently 85% of a $100 billion layer).

- Sponsoring members from both parties have proposed the upcoming 2014 extension three times in Congress this year. However, the evidence of opposition remains.

- Opponents of a TRIA renewal label the legislation a "subsidy". They correctly point out that TRIA's federal guarantee has been provided—and insurer money collected—for over ten years without incident. U.S. insurance industry surplus has grown to roughly $510 billion —compared to only $290 billion at the time of the September 11, 2001 attacks. Opponents argue the insurance industry is sufficiently capitalized to absorb the losses from a catastrophic terrorist incident without government assistance.

- However, it would be wrong to assume that more capital leads to a dramatic increase in the overall appetite to write US terrorism.

    - Reinsurers need to manage risk aggregation and seek diversification.
    - It is important also to bear in mind that there has so far been no TRIA certified terrorist attack since the program began, let alone one that reached the trigger for Government support. Should such an event occur, it is likely that capacity and risk appetite would be affected – just as with other catastrophe perils.

- The argument against a further TRIA extension has fallen on the receptive ears of an electorate (and many freshman lawmakers) that has been galvanized by recent federal involvement in the health, financial and automotive sectors. In order to successfully counter this narrative, the parties' case must be reframed to include a discussion of the public benefits of terrorism insurance, of which there are many.

- To quantify TRIA's benefit, it is instructive to look to late 2002, when Moody's downgraded more than $4 billion of mortgage securities due to the shortage of terrorism coverage.

- Additionally, when the bill approached its first expiration in 2005, many property insurers inserted sunset clauses into their contracts, enabling them to alter or revoke terrorism cover in the event of a TRIA non-renewal.

- The demand for financial protection against terrorism is as undeniable as the insurance industry's reluctance to provide it.

- The impact of a TRIA non-renewal would be felt the most by cities perceived to be appealing terrorist targets. The RMS® Probabilistic Terrorism Model classifies the most terrorist-prone cities as New York, Washington DC, Chicago, San Francisco, and Los Angeles.

- Without TRIA, these cities can expect a shortage of terrorism insurance capacity and corresponding rate increases at the very least. At most, construction and lending activity will be compromised; and the economic consequences (lost jobs, stalled projects, missed opportunities) would surely follow.

- If the government does not renew this reinsurance backstop, the market dynamics for terrorism insurance will be disrupted and will likely result in increased pricing and capacity shrinkage, especially for risks in the central business districts of major cities. Commercial property lines are especially sensitive.

- TRIA must be viewed in the context of the government's broader role in the insurance industry. In addition to terrorism insurance, the federal government provides billions of dollars annually in subsidized coverage for lines of business including flood, crop, mortgage, pension, and health— sometimes as a direct primary insurer, other times as a reinsurer.

- Occasionally, as in the case of TRIA's recoupment provision, the federal government's role is similar to that of a bank, whereby losses are indemnified and then recovered, with interest, through future policy surcharges.

Benefits to Reauthorization of TRIA

- It ensures private sector involvement from the first dollar

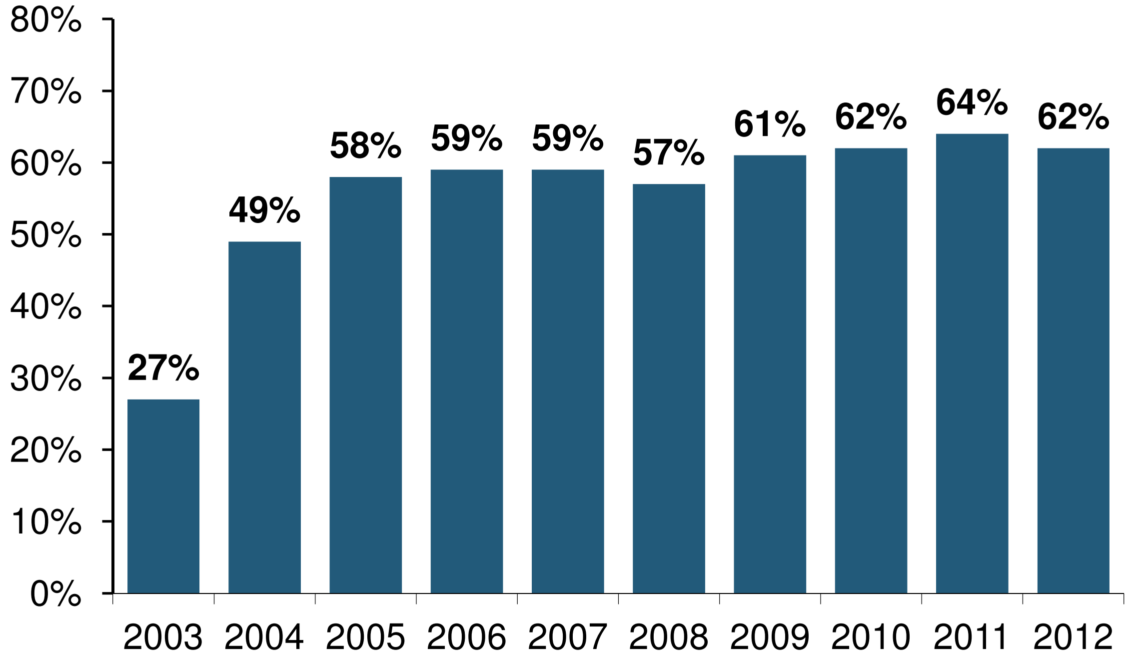
- It allows the expertise and innovation that have been developed in the context of the TRIA backdrop to evolve, rather than be discarded

- While current modeling methodologies do give some ability to individual insurers to manage their own exposure to terrorism risk, they do not offer any assurance that sufficient cover will be available to meet overall demand. In that scenario, the consequences can be dramatic – as demonstrated by the economic paralysis we saw in late 2001 and 2002.

- The best way to increase private participation and benefit from the expertise that TRIA has enabled the industry to develop, would be through incremental changes over the course of a long-term extension of the program

    - Well-defined incremental changes over the course of a long-term extension of the program may provide a transparent process of reductions in the risk borne by the taxpayer. This would also be consistent with supporting gradually increasing industry appetite and capacity to underwrite terrorism risk.

Terrorism Insurance Take-Up By Year – 2003-2012



Source: Insurance Information Institute.

The Terrorism Risk Insurance Program does not apply to the following lines of insurance:

- federal crop;
- livestock;
- farmowners multiple peril;
- commercial auto;
- surety;
- burglary and theft;
- professional liability;
- private mortgage;
- title;
- financial guaranty;
- medical malpractice;
- health;
- life;
- federal flood insurance; and
- reinsurance

How TRIA Works

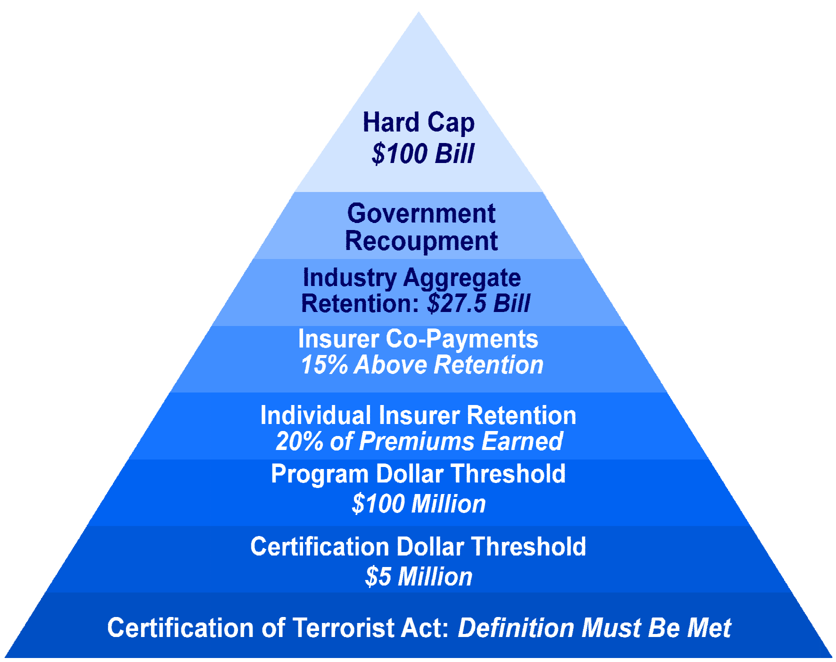
As used in TRIA, the term "act of terrorism" means any act that is certified by the Treasury Secretary, in concurrence with the Secretary of State, and the Attorney General of the United States.

The term "act of terrorism" is defined as:

(i) to be an act of terrorism;
(ii) to be a violent act or an act that is dangerous to
  a. human life;
  b. property; or
  c. infrastructure;
(iii) to have resulted in damage within the United States, or outside the United States in the case of
  a. an air carrier or vessel . . .; or
  b. the premises of a United States mission; and
(iv) to have been committed by an individual or individuals, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion.

If the total damages resulting from an "act of terrorism" exceed $100 million, TRIA will reimburse insurers for 85 percent of their losses above a deductible of 20 percent of the company's direct earned premiums from U.S. commercial property and casualty business during the prior year. The 20 percent deductible is based on an insurer's consolidated direct earned premiums, which include the earned premiums from any parent company, affiliates and subsidiaries. TRIA caps federal reimbursement at $100 billion.

Under the Dodd-Frank Act, Director McRaith of the Federal Insurance Office (FIO) is tasked with administering the TRIPRA. The FIO is also taking a lead role in drafting the President's Working Group on Financial Markets 2013 report on the long-term availability and affordability of terrorism risk insurance.



Terrorism Risk Modeling

Individual companies are increasingly using data management systems and modeling tools to understand the relationship between vulnerable sites and the likelihood of impact from terrorist acts — or other risks — on their operations and profitability. These models aim to calculate the potential economic losses stemming from a terrorist event and support financial quantification of these risks to help companies:

- Achieve greater understanding of their financial exposures, insurance program design, and risk financing options.
- Assess the appropriateness of insurance deductibles and limits.
- Rate their terrorism risk to negotiate adequate insurance premiums.
- Prioritize risk mitigation strategies.
- Develop an efficient business continuity plan.
- Understand the correlation and potential benefits of diversification among sites, locations, and regions.

Recent Developments

A research paper issued by the libertarian Cato Institute has opined that the private market is capable of underwriting terrorism risk, and that terrorism risk is not more severe than other insurable risks such as natural catastrophes. Therefore, the Cato Institute does not support extension of TRIA past December 31, 2014. Early indications from the private market, however, are that it will not underwrite the risk without the government's support, regardless of whether the capacity in the market is there.

In April, 2013, March McLennan released its 2013 Terrorism Risk Insurance Report which surveyed customers and provided terrorism coverage take up rates by region and industry sector. The report also noted that a significant number of captives provide terrorism coverage. The Marsh report concluded that TRIA's expiration will affect existing TRIA coverage and pricing on the direct and reinsurance market.

On May 24, 2013, the Congressional Research Service issued a report, *Terrorism Risk Insurance: Issue Analysis and Overview of Current Program,* to Members and Committees of Congress, noting that in the 113th Congress, three bills were introduced to extend TRIA, one called for a five year extension, and two called for a 10 year extension.

On August 29, 2013, the NAIC's Government Relations Leadership Council adopted the NAIC Resolution to Support Reauthorization of the Terrorism Risk Insurance Act which noted that state insurance regulators have not seen evidence suggesting that the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing coverage for acts of terrorism. Therefore, by the resolution, state insurance regulators supported the reauthorization of TRIA "to help ensure market stability through the availability of terrorism coverage and urge[d] prompt Congressional action prior to the program's expiration at the end of 2014 in order to minimize disruptions to the commercial insurance markets."

By letter dated September 16, 2013, the NAIC responded to the Department of the Treasury's request to provide comments to assist the President's Working Group on Financial Markets in composing its report to Congress on the long-term availability and affordability of insurance for terrorism risk. The NAIC letter emphasized the NAIC's continued support of TRIA, and the NAIC's recent adoption of the resolution supporting reauthorization. The NAIC letter noted the concerns of state insurance regulators regarding availability of coverage if TRIA is not extended and highlighted the more significant potential for disruption in the workers' compensation market since terrorism cannot be excluded from individual workers' compensation policies. By letter of that same date, the New York Department of Financial Services provided similar comments.

In its written comments to the Department of the Treasury, Aon stated that "market intelligence" indicated that more than 85% of insurers will no longer insurer terror risk if the federal backstop goes away. Aon did concede that more capital would likely enter the market in the form of specialty standalone terrorism insurers if TRIA expired. However, the capital from the new market entrants "would not come close to approximating the $100 billion of contingent reinsurance capital provided by TRIA."

On September 18, 2013, the Federal Advisory Committee on Insurance ("FACI"), an advisory body to the Federal Insurance Office (FIO), met in Washington, D.C. to discuss TRIA and received comments from industry representatives. On September 19, 2013, the U.S. House of Representatives Committee on Financial Services had a full committee hearing regarding TRIA. On September 25, 2013, the Senate Committee on Banking, Housing and Urban Affairs also conducted a hearing on the reauthorization of TRIA. At the FACI meeting, and the House and Senate hearings, industry representatives made clear that the existence of terrorism coverage in the private market was because of the existence of TRIA.[2]

Most recently, on November 13, 2013, the US House of Representatives Subcommittee on Housing & Insurance of the House Financial Services held a hearing entitled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure." At the subcommittee hearing, representatives from Lloyd's offered testimony, along with Former South Carolina Insurance Commissioner Ernest N. Csiszar (also former President of the NAIC), and Robert P. Hartwig, President of the Insurance Information Institute. John Seo, a co-founder of Fermat Capital Management, LLC, also offered his comments on the potential role of the Insurance-Linked Securities market in privatizing terrorism insurance in the United States.

Representative Jeb Hensarling (R. TX), chairman of the House Financial Services Committee, is likely to be a significant obstacle in getting TRIA extended as he has made his skepticism of TRIA, especially in the wake of the current debt crisis, well known. The November 13 hearing was held in response to Representative Hensarling's demand that the insurance industry advance ideas for restructuring the program to encourage greater private sector participation and a way for government to transition out of the terrorism marketplace.

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[2] In 2007, the Congressional Budget Office concluded, however, that "in the absence of a federal mandate, insurers have a strong incentive to offer terrorism coverage to their commercial customers because to do otherwise risks their losing business on other property and casualty lines. Congressional Budget Office, *Federal Reinsurance for Terrorisk Risks: Issues in Reauthorization* (Washington: CBO, 2007 at p. 6).

Without exception, all of the industry representatives that testified at the hearing supported the continuation of TRIA.

- Sean McGovern, Director, Risk Management and General Counsel of Lloyd's offered support for the renewal of TRIA, noting that any changes in TRIA to "facilitate greater private insurance and reinsurance capacity should not sacrifice the stability TRIA has already achieved." He also noted that a longer term solution was needed, as "[h]anging the sword of Damocles over the entire edifice every few years creates instability and damaging uncertainty" – for industry, policyholders and taxpayers alike.

- Mr. Hartwig testified that "[t]he unambiguous success of TRIA demonstrates that the Act has become an invaluable component of the country's national security infrastructure."

- Former Commission Csiszar testified that the private market is not ready to bear the entire burden of losses from one or more major terrorism events, particularly those committed by NBCR means or a cyber attack and that a "failure to renew TRIA in the face of the continuing unabated threat of terrorism . . . would lead to severe disruptions in availability, exclusion, and pricing."

    - He also pointed out that new entrants into the private market have not been tested yet and it is not clear yet whether "it is of the 'quick in and quick out hot money' type drive by investors out for yield in an otherwise zero interest and nominal yield environment."
    - Mr. Csiszar offered some concrete suggestions for the modification of TRIA, which included raising the horizontal deductible from its current 20% to 40% of the past year's directed earned premium for the commercial lines and raise the quota share cost-sharing arrangement for insurers from 15% to 25% of losses that exceed an insurer's deductible, "in recognition of the increase in capacity in the industry since 2002 and in the evolution of the private stand-alone market since then."

Since TRIA has not been extended as of this date, provisional exclusions are being approved by state insurance regulators for renewal policies on a widespread basis. As noted above, if TRIA is not extended, there is the potential for reduced capacity especially in the workers' compensation market. With the 2014 renewal cycle already well underway, there is greater uncertainty in the marketplace regarding available terrorism coverage.

Most government insiders agree that there will be no way to get TRIA extended before the end of 2014. The bigger question appears to be whether the industry was successful, or can be successful in the future, in convincing the House Financial Services Committee that some form of the program, even with modifications, should be in place going forward.

Insurance Industry Positions

CIAB:

In the November 2013 issue of Leader's Edge, Joel Wood, Senior VP of Government Affairs examined the path to extending TRIA and the influence of Rep. Jeb Hensarling in the process. In November of 2011, had CIAB testified before the Senate Banking Committee and urged extension of the TRIA program, stating that the private marketplace was not prepared to take on the full risk posed by potentially catastrophic terrorism losses.

NAPSLO:

Official statement: "NAPSLO believes a role exists for the federal government in certain areas the nonadmitted market would be unable to cover, such as workers compensation and nuclear, biological, chemical and radiological exposures. NAPSLO will advocate the open market should be exhausted before the federal government or residual markets are considered."

Big I:

On February 5, 2013, IIABA released the following statement by Charles Symington, Big "I" senior vice president of government affairs, regarding the introduction of a TRIA reauthorization bill in the U.S. House of Representatives:

> The Big 'I' thanks Reps. Michael Grimm (R-N.Y.) and Carolyn Maloney (D-N.Y.) for focusing attention on the important issue of terrorism insurance. The current TRIA program has worked well to ensure that this essential coverage is available to policyholders throughout the country. Jump starting the debate on the future of the TRIA program now is especially important with its expiration just around the corner at the end of next year.

PCI:

PCI issued a statement in connection with the September 19, 2013 House Financial Services Committee Hearing:

> Having a federal terrorism insurance plan in place prior to another catastrophic terrorism event is critical to protecting America's economic resiliency. PCI strongly supports the current terrorism insurance program and encourages the Committee to consider a long-term reauthorization.

PCI also submitted testimony to the House Financial Services Committee. In its testimony, PCI states that

> One of TRIA's best attributes is that it keeps commercial insurers participating in the terrorism insurance market, thus protecting taxpayers from most terrorism losses. When federal payments are made, taxpayers are protected by a mechanism that allows federal

payments to be recouped from the insurance marketplace. TRIA is a fiscally responsible and effective national terrorism risk management plan. PCI will continue its leadership in promoting broader awareness, proper understanding, and working towards reauthorization with all stakeholders, from the Executive Branch to both sides of the aisle and both sides of the Capitol.

AIA:

In the October 2013 issue of Roll Call, Leigh Ann Pusey, President and CEO of the AIA, opined that TRIA should be continued because

1) terrorism is fundamentally different from other types of risks;
2) terrorism can't be properly modeled or predicted;
3) the program hasn't cost the government anything (other than administrative costs) since it was enacted and any attack in the future would have to exceed the losses of September 11 before taxpayers would have to pay anything under TRIA; and
4) the economic recovery could be threatened if TRIA were not extended.

PIA:

Issue Paper dated February 2013:

- Supports an extension of the Terrorism Risk Insurance Program Reauthorization Act;
- Supports a Terrorism Risk Insurance Program that provides economic certainty and fills a private market void;
- Supports a Terrorism Risk Insurance Program that allows for wide industry participation.

Final Thoughts

Terrorism insurance has become more widely available and at significantly more affordable rates since TRIA was established in 2002. Demand has spread to markets other than the typical urban-centered industries as businesses recognize that any terrorist attack will have significant impacts across the global business world. At the same time, capacity has increased as insurers enter the market. The largest providers of stand-alone terrorism coverage have been larger commercial property insurers such as AIG, Berkshire Hathaway and Lloyd's.

If TRIA is not extended, demand for private market insurance will likely increase, as many businesses will simply be unable to continue (e.g. construction projects located in targeted urban sectors) without coverage. As a result, premium rates will likely rise. Despite the presence of the private market, no one in the industry is of the belief that the market will be able to provide sufficient capacity if TRIA is not renewed.