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Terrorism Reinsurance

The Work Ahead

Not a penny has been paid out from the federal Terrorism Risk Insurance Program (TRIP), and we all hope there never will be.

Nonetheless, there is a lot of work in maintaining the forms and rating that allow insurers to participate in the program.

For the fourth time in 12 years, AAIS is gearing up for a potential rush in terrorism filing activity, as Congress deliberates over the extension of TRIP, scheduled to expire on Dec. 31, 2014.

There are currently four bills in Congress to extend TRIP. Three of them, introduced in 2013, would make no changes in how the program works, save for one provision that would substitute the Secretary of Homeland Security for the Secretary of State in the process for certification or terrorist events.

More attention has been paid, of late, to a bipartisan bill introduced in the U.S. Senate in April 2014 that would extend TRIP for seven years, largely in its current form, but with a graduated increase in the level of private insurance "co-pays" over five years.

Insurance trade associations balked at the proposed increase in private sector co-pays, but were generally supportive of the Senate proposal, which was being debated in committee as this publication went to press.

There is greater concern over a series of proposals by Republican leaders of the U.S. House Financial Service committee. Those "talking points," not yet incorporated into a bill, would renew the program for only three years, and with substantially changed conditions.

Filings

AAIS compliance and product development staff are already estimating the scope of filing activity that may be required to bring commercial lines programs into compliance with a renewed and revised TRIP.

In all, AAIS maintains more than 250 multistate and state-specific endorsements and policyholder notices to allow its commercial lines members to comply with the conditions established under TRIP.

AAIS maintains a roughly equivalent number of manual documents providing the rules and rating information, and issued nearly 1,300 program bulletins in recent years to support the last extension and revision of TRIP, enacted in 2007.

Forms filing activity under the bipartisan Senate bill would be relatively light. Under that proposal, two endorsements and one policyholder notice would have to be modified to reflect a reduction in the federal share of "co-pays" from 85% to 80%. ➤

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>
> **RAND Corporation**

Even that adjustment, however, could at least theoretically require that the endorsements and notices be filed in 52 jurisdictions each year for the next five years, as the proposed reduction in the federal share would be phased in through one percent increments each year.

Rate Levels

AAIS actuaries are also at work estimating the scope of work they may face under a renewed terrorism program, says Rich Yocius, AAIS vice president of actuarial services and chief actuary.

Without knowing the nature and timing of changes to TRIP, AAIS actuarial staff is analyzing potential scenarios for pricing the private insurance share of terrorism exposure depending on the final level of TRIP’s event trigger, company deductibles, required co-payments, and types of losses covered under the program.

AAIS actuaries are also evaluating advances in terrorism catastrophe models, which may drive expectations for refinement of terrorism rate levels on their own, even if TRIP were renewed with no changes at all.

Terrorism is a challenging exposure for rating purposes,” says Yocius. “Historical loss data does not reflect the magnitude of loss potentially created by a terrorist attack.”

Since TRIP was enacted in 2002, AAIS has evolved in its rating of terrorism exposure from a complete reliance on rating relativities derived from quantitative and qualitative considerations to the incorporation of modeling-based loss costs in its Artisans, Businessowners, and Commercial Properties programs.

Protection

Much of the recent discussion of TRIP centers on how much “skin” private insurers should have in the “game.” In light of that, it helps to remember that the operational costs of complying with TRIP are mostly borne by private insurers, on their own or through organizations like AAIS.

Most observers acknowledge that the public interest is served when private insurers deploy capital and risk management expertise to limit losses from an attack and help fund recovery of a stricken community.

As the RAND Corporation stated in a recent report, “TRIP ensures that the insurance industry, rather than the taxpayer, is ultimately responsible for paying for incidents that are within the realm of the industry’s modeling capability.”

The report adds that “recovery and rebuilding will be more rapid and efficient when it is clear how much compensation will be available after a terrorist attack and how it will be distributed.”

All but the most ardent opponents of TRIP essentially agree with these assertions, and there appears to be little doubt that TRIP will be renewed in some form.

When that happens, AAIS is prepared to act—on short notice, if necessary—to enable its commercial lines affiliates to participate in a renewed partnership between the insurance industry and the federal government to protect our country.

And we, like all Americans, hope the coverage provisions we prepared will never be needed. ■

This page was modified after original publication to reflect a new bill introduced in the U.S. House.

TRIP Renewal Proposals

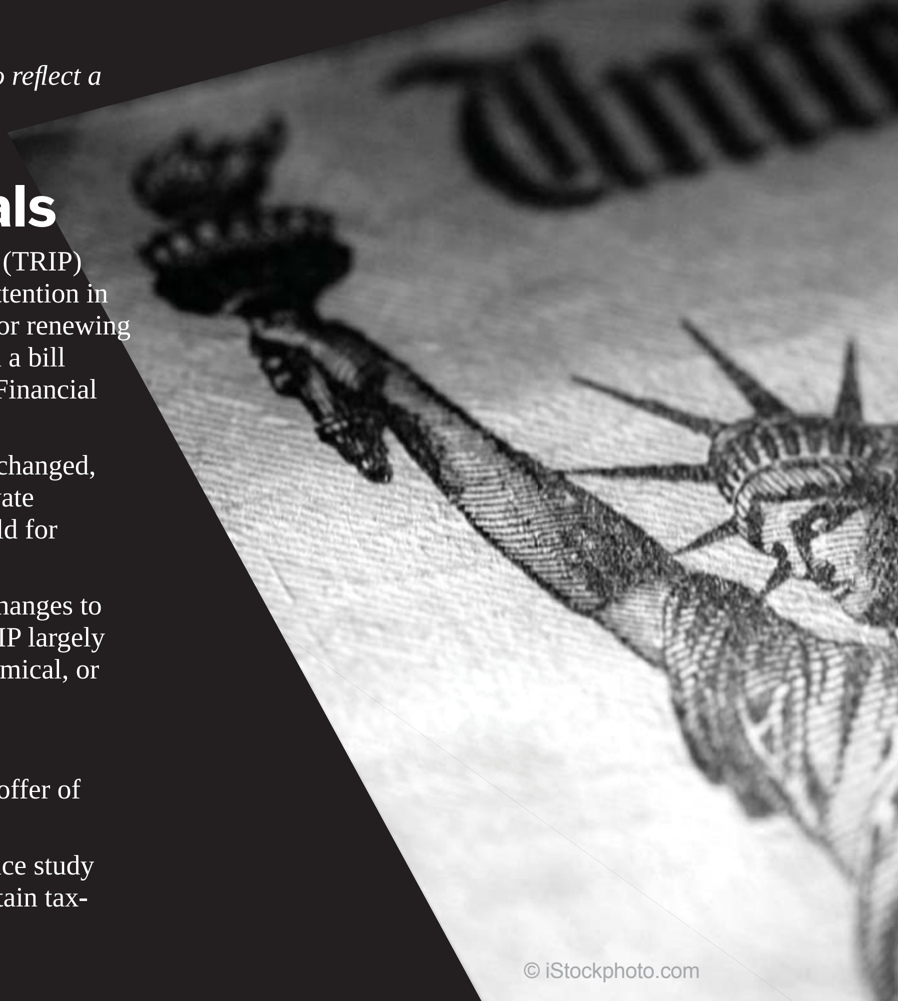
With the federal Terrorism Risk Insurance Program (TRIP) scheduled to expire on Dec. 31, 2014, Congress's attention in the summer of 2014 is focused on two recent bills for renewing the program: a bipartisan bill in the U.S. Senate and a bill proposed by Republican leaders of the U.S. House Financial Services committee.

The Senate bill would leave the program largely unchanged, except for a progressive increase in the level of private insurance co-payments for losses above the threshold for triggering coverage under the program,.

The House Republican bill would introduce more changes to TRIP than the Senate bill,, but would also leave TRIP largely unchanged as it applied to a nuclear, biological, chemical, or radiological (NBCR) attacks.

Also, the House Republican bill would:

- Allow small insurers to opt out of mandatory offer of terrorism coverage.
- Provide for a Government Accountability Office study of the feasibility of requiring insurers to maintain tax-advantaged terrorism reserve funds.



	Current TRIP	Senate Bill (SR 2244)	House Bill (HR 4871)
Expiration	Scheduled to expire on Dec. 31, 2014	Would renew the program through Dec. 31, 2021	Would renew the program through December 31, 2019
Size of event needed to trigger coverage under the program	Insured losses of at least $100 million	No change proposed	Increase the program trigger for non-NBCR acts of terrorism by $100M/year up to $500M by Jan. 1, 2019. For acts involving NBCR terrorism, the program trigger would remain at $100M
Private insurer deductible	20% of direct earned premium	No change proposed	No change proposed
Private share co-pay after federal coverage is triggered	15% of losses above industry deductible	Would increase 1% a year for five years, becoming 20% of industry losses above deductible in 2019	Annually increase to 20% for non-NBCR acts of terrorism by 2019. For acts involving NBCR terrorism, it would remain at 15% of losses above industry deductible
Mandatory recoupment level and percentage	Mandatory recoupment of federal losses at 133% if industry losses are less than $27.5 billion in a year	Level of industry losses subject to recoupment rises by $2 billion increments per year to $37.5 billion in 2019. Recoupment percentage remains at 133%	Increase the level of industry losses subject to recoupment to equal the sum of insurer deductibles for the preceding program year for all participating insurers
Program cap	$100 billion annual cap on covered terrorism losses	No change proposed	No change proposed

RAA Model Helps Estimate Terrorism Exposure

Given the substantial differences between proposals in the U.S. House and Senate for renewing the Terrorism Risk Insurance Program (TRIP, see main article), it appears likely that there will be long, complicated negotiations over the future structure of the program.

If that is the case, policymakers will need a tool for quickly and efficiently assessing the financial impact of even slight program changes that emerge from congressional negotiations.

It appears that they have such a tool, thanks to the Reinsurance Association of America (RAA).

Early in 2014, the RAA released its Terrorism Risk Insurance Program Model, an online application for estimating the amount [and percentage of losses] of retained costs accruing to private insurers and the federal government (through TRIP) from terrorist events of specified sizes in specified locations.

The framework of the model and its output are dependent on the parameters of the TRIP program, including any changes made by Congress.

RAA notes that its model is distinctly different from those developed by catastrophe modeling firms.

Scott Williamson, vice president of financial analysis at the RAA and developer of the model, notes that "probabilistic, stochastic terrorism models developed by cat modelers utilize risk exposure data to estimate the amount of damage and insured losses in a specified area by a certain type of attack (e.g., a truck bomb in an urban center).

"In contrast, the RAA model starts with an assumed level of losses in a specified area, and estimates how those losses will be allocated among companies and lines of business based on the parameters of the TRIP program."

Illustrations

The RAA cautions that the loss estimates generated by its model are only "hypothetical illustrations" and that, among other things, it "does not take into account individual company risk mitigation factors such as management of risk aggregation, risk avoidance or reinsurance utilization."

The purpose of the model, says RAA, is to allow stakeholders in the debate over TRIP to come to a general understanding of the implications of changes to the program.

To do that, the RAA model provides a series of steps illustrated in separate web-based interactive data views.

First, users establish the "event parameters," which consist of:

- The state where a hypothetical event occurs;
- The year in which the event occurs (as conditions for coverage under TRIP could vary from year to year);
- The event's total insured losses for lines of insurance covered under TRIP; and
- The estimated percentages of those losses under those lines (aircraft, commercial liability, commercial property, inland marine, products liability, workers compensation, and other liability and property coverage).

From these entries, the model can immediately calculate estimated losses for the industry as a whole as well as for industry groups, derived from annual statement data gathered by SNL on earned premium.

Pro-rata

Next, the RAA model estimates the dollar amount of private insurer losses from a hypothetical event, and those amounts as a percentage of policyholder surplus, on a pro rata basis according to company shares of premium in the lines covered under TRIP.

The model generates these estimates as they would likely be under different proposals for renewing TRIP.

In one demonstration, the RAA model projected the allocation of estimated losses for a $44 billion event in New York (an event roughly equivalent to the Sept. 11th attacks, adjusted for inflation) under four different program scenarios:

- TRIP's current provisions for the event "trigger," company deductibles, shares of private and federal co-payments, and recoupment of federal losses;
- Potential changes to TRIP under a U.S. Senate bill that would gradually increase of the private sector allocation of shared losses, but otherwise leave the program largely unchanged;
- The response of TRIP under a U.S. House proposal to a nuclear, chemical, biological, or radiological (NBCR) event, in which case TRIP would respond much as it does today; and

- The response of TRIP under a U.S. House proposal to a “conventional” terrorist event, in which case the share of costs would shift substantially to private sector insurers.

Losses for the event would be projected for all companies included in the model, depending on their direct earned premium for the affected lines and states.

Users can create parameters for a hypothetical event of any size in any state, and have the option of selecting a limited number of companies to share the loss.

Scorecard

The RAA tells users that the model’s default distribution of losses on a pro rata share of direct earned premium tends to spread losses more broadly than is likely to happen in reality, and that a customized selection of individual carriers with exposure in the affected area will produce more realistic results.

With the capabilities of the model, users can estimate an individual company’s retained losses from an event under different legislative proposals as they are incorporated into the model.

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> **Scott Williamson**
> Vice President of Financial Analysis
> Reinsurance Association of America

Among other things, the model demonstrates that small companies considered to have little exposure to terrorism may find their surplus substantially exposed to a terrorist event if the program trigger is raised.

In a bigger sense, however, the RAA model provides a dynamic scorecard for understanding the impact of complex legislative proposals whose implications will not be understood by most people until the nation is subjected to the trauma of a devastating attack. ■