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NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

April 21, 2006

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Emil W. Henry, Jr.  
Assistant Secretary of the Treasury  
Treasury's Office of Financial Institutions Policy  
Attention:  
President's Working Group on Financial Markets  
Public Comment Record  
Room 3160 Annex  
Department of the Treasury  
1500 Pennsylvania Avenue, NW.  
Washington, DC 20220

RE: President's Working Group on Financial Markets:  
Terrorism Risk Insurance Analysis

Dear Assistant Secretary Henry:

The purpose of this communication is to provide information that was requested of the National Association of Insurance Commissioners (NAIC) and other interested parties by the Department of the Treasury in the *Federal Register* (Volume 71, No. 44, March 7, 2006, pages 11460 and 11461).

You will find attached to this letter, the NAIC's response to the questions posed in the *Federal Register*. These were developed by the NAIC's Terrorism Insurance Implementation Working Group, chaired by New York Superintendent Howard Mills, III.

The NAIC has been concerned about both natural and man-made disasters for quite some time. Terrorism is a peril that has a human element of an unpredictable nature. In addition to responding to your specific inquiries, the NAIC wants the Treasury to know that its Terrorism Insurance Implementation Working Group will continue to meet and discuss long-term solutions to address the risk of loss from terrorist acts. The Terrorism Insurance Implementation Working Group is considering some innovative ideas. Details on these will be provided as they develop.

For questions, please contact Eric Nordman, NAIC's Director of Research at [enordman@naic](mailto:enordman@naic) or 816-783-8005.

The NAIC appreciates its longstanding positive relationship with the Treasury. Insurance regulators stand ready to meet with you on our response to your inquiries and on possible long-term solutions. Please consider this to be a standing offer for any assistance that you desire.

Sincerely,

Alessandro Iuppa  
President of the NAIC  
Superintendent of Insurance  
State of Maine

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## Response to President's Working Group on Financial Markets Terrorism Risk Insurance Analysis

### ***I. Long-term Availability and Affordability of Terrorism Risk Insurance***

#### **1.1. In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage? How can these factors be measured and projected?**

*To reduce the cost and increase availability of coverage for acts of terrorism, insurers need to be able to accurately estimate their ultimate expected loss costs associated with the risk transfer and related costs of capital. To do so requires knowledge of both the expected frequency and severity of future losses. In the case of coverage for acts of terrorism, severity and to a greater degree frequency, are extremely difficult to predict. When insurers are unable to determine what price to charge, they understandably tend to restrict coverage. This problem is partially resolved through the Terrorism Risk Insurance Act (TRIA) by providing insurers with a cap on the severity of events. With limitations in place, insurers can more reasonably assign a price to coverage that will not threaten their solvency and will place them in a better position to make such coverage available.*

*Unfortunately, there is no empirical measure of availability and affordability since they are both subjective measures and intertwined concepts in most cases. It can be argued that coverage for every peril is available to anyone if they are willing to pay any price. However, as a practical matter, if businesses perceive that coverage for acts of terrorism is too expensive for the risk of loss presented, they will choose not to buy the coverage. Further, if insurers perceive that not enough is known about the frequency or severity of losses caused by acts of terrorism, they will choose not to make the coverage available, unless either the state or federal government forces them to do so.*

#### **1.2. What improvements have taken place in the ability of insurers to measure and manage their accumulation of terrorism risk exposures? How will this evolve in the long-term?**

*The working group has heard from industry representatives and has seen anecdotal evidence that insurers have been attempting to diversify their terrorism risk, which is a fundamental element in the theory of risk management. We believe this trend will continue into the future, but it may also cause some availability and affordability issues in some geographic areas, such as metropolitan areas seen as susceptible to terrorism attacks.*

*Insurers now consider proximity to a known or perceived target risk in deciding whether to write a particular business. They also consider whether a business has a large number of employees at a single location. This is particularly true for lines of business that have a risk of concentration such as workers' compensation and group life. With a few exceptions, state laws do not allow an insurer to exclude or limit worker's compensation coverage. As a result, an insurer underwriting this risk without adequate reinsurance is subject to a large potential loss if there are a significant number of employees at a single location. The American Academy of Actuaries estimates that "a modest-sized insured with 200 employees could easily generate a terrorism related event of \$50 million. This presumes death of all employees and typical death*

*benefit of \$250,000 per employee.<sup>1</sup>” A maximum possible loss of \$50 million on a single business presents a risk profile that many insurers would be unwilling to cover. Unless an insurer is assured that it can secure a facultative reinsurance contract on that risk, it would most likely have to decline to write the workers’ compensation coverage. Another way to diversify this risk would be to syndicate the risk among a number of different insurers each assuming a percentage share of the coverage.*

*It is interesting to note that these severity problems affect types of insureds that are generally considered among the least risky from a traditional workers compensation perspective. For example, financial services firms, which traditionally have very low frequency of workers compensation injuries, are considered to have a higher than average terrorism exposure due to their location in urban centers as well as the concentration of employees.*

*Group life is purchased by business to provide protection for their workers. For many families, group life insurance offered by employers is the only life insurance they have to protect themselves from financial ruin. Like workers’ compensation insurance, group life insurers suffer from risk concentration problems. This occurs when group life carriers write businesses with many employees at a single location or many employers within an urban area.*

*Unlike workers’ compensation insurance, a group life policy could be written with an exclusion for deaths caused by acts of terrorism. However, the employer, the insurer, the insurance industry in general and the American economy would suffer if an insurer is only able to pay a fraction of the policy face amount in a mass casualty situation. This outcome is not one that is desirable to either business owners or employees and their families.*

*Insurers can and do manage their accumulation risk more closely than they did before Sept. 11, 2001. They do this by implementing the risk management concept of separation and by monitoring the number of policies that are written in each geographic area. This is good for insurers; however, it can lead to availability problems for businesses as insurers curtail their exposure in particular areas through rejections, cancellations and nonrenewals.*

### **1.3. What improvements have taken place in the ability of insurers to price terrorism risk insurance, including the development and use of modeling? How will this evolve in the long-term?**

*Computer modeling of terrorism risk has been developed and refined by risk modelers since Sept. 11, 2001 in an attempt to measure an insurer’s risk of loss from acts of terrorism. Many insurers have begun to use the computer simulation models to assist them in pricing. While these models provide insurers with additional information about their risks and may provide more validity to premium rates in the future, the accuracy of models particularly with respect to frequency remains uncertain.*

*While some computer simulation modeling has been introduced, the modeling efforts and their results are untested. The models are based on the opinions of counterintelligence experts along with assumptions regarding the type of damage that would occur if certain weapons were deployed. Insurers have relied upon them because they have no other choice. Insurers continue*

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<sup>1</sup> American Academy of Actuaries, P/C Extreme Events Committee May 4, 2004 Report, P/C Terrorism Coverage: Where Do We Go Post-Terrorism Risk Insurance Act?, Page 14.

*to express reservations about their ability to measure the risk of loss from acts of terrorism largely because even though modeling might be able to estimate the severity of loss resulting from specific terrorist events, there is no way to determine the frequency of such events. Unlike weather events or seismic events, which are outside human control and which occur with some statistical regularity, terrorist events are solely dependent on the will of those who seek to carry them out and the effectiveness of those who seek to prevent them. Thus, the insurance industry is left with very little on which to base frequency, and even the most sophisticated terrorism models amount to little more than educated guesses.*

**1.4. How, if at all, were primary insurers' pricing decisions affected by the anticipated expiration of TRIA at the end of 2005, particularly for insurance policies extending into 2006 that cover terrorism risk? What role did the pricing and availability of reinsurance play in those decisions?**

*TRIA was successful in stabilizing the insurance market. However, the commercial insurance business cycle operates in such a way that insurers and their policyholders were required to make decisions as early as September 2004, for coverage going well into 2006. Annual policy renewals with effective dates of January 2, 2005, or later had to contemplate no federal backstop for any losses in 2006. As a result, insurance regulators in most states approved conditional coverage limitations for terrorism coverage for renewal policies on a widespread basis.*

*If triggered by the expiration of TRIA, these limitations would have greatly reduced terrorism coverage in the states that have approved the endorsement. In those states that have rejected these coverage limitations, insurers would have to make the difficult choice of writing the coverage and accepting the potentially catastrophic terrorism exposure or not writing the policy at all. This could lead to availability and affordability problems in the future.*

*Without a mechanism in place to address concerns over providing coverage for acts of terrorism, the nation's businesses will encounter the same coverage situation that existed following the aftermath of Sept. 11<sup>th</sup>. Coverage currently exists for non-certified acts of terrorism that are below \$25 million in aggregate insured losses in states that approved coverage limitations. However, if an insured loss exceeds \$25 million in these states, then there is no insurance coverage provided. Coverage for certified acts of terrorism is provided as required by TRIA. As a result, insurance coverage for acts of terrorism will be diminished for most American businesses when TRIA sunsets, unless another mechanism is developed to replace TRIA.*

*The availability and cost of reinsurance clearly played a role in insurer's decisions. If insurers could effectively share much of the risk of loss for acts of terrorism, they would and things would be fine. Clearly the market reaction tells us that things are not fine and are not likely to be fine when the TRIA Extension sunsets at the end of 2007. There is limited capital available that reinsurers wish to devote to insuring acts of terrorism (See response to I.6). Insurance regulators believe that this trend will continue.*

**1.5. What role does mitigation efforts related to terrorism risk play in an insurer's underwriting and pricing decisions? How will this evolve in the long-term?**

*Mitigation in terrorism risk is difficult to evaluate since it doesn't completely lend itself to traditional mitigation efforts. Insureds can mitigate against potential fire losses by installing sprinklers or against potential windstorm losses by installing shutters and strengthening roof tie-down hardware. However, while insureds have taken steps to enhance individual building security, install metal detectors, erect concrete barriers around building perimeters, etc., the losses that ensue from a terrorist event can include nuclear, biological, chemical or radiological events, which are extremely difficult to mitigate.*

**1.6. What is the current availability of reinsurance to cover terrorism risk? Please distinguish by line or type of insurance being reinsured and on what basis (treaty or facultative). How will this evolve in the long-term?**

*According to testimony given by the Reinsurance Association of America(RAA) to the NAIC at the March 29, 2006, public hearing before the Terrorism Insurance Implementation Working Group, private reinsurance is used to provide coverage for primary insurers' retention and loss-sharing provisions under TRIA. An RAA survey of reinsurance brokers and underwriters suggests terrorism capacity for an individual company reinsurance program ranges from \$200 million to \$600 million on an occurrence basis for property and workers' compensation, covering domestic terrorism and, in some cases, personal lines exposures in addition to TRIA-certified acts. Estimated total reinsurance available in the U.S. is \$6-8 billion for TRIA-certified, stand-alone and treaty reinsurance.*

*Over the long-term RAA testified that projected growth under favorable loss experience would be very modest and will not fill the capacity needs of the primary insurance market, with or without TRIA. Additionally, the RAA testified that reinsurers are only able to provide limited capacity for terrorism because the potential losses would otherwise place these companies at risk of insolvency. Reinsurers' capital is necessary to support all outstanding underwriting commitments including natural disasters, terrorism, workers' compensation and other casualty coverages. RAA also noted that CNBR reinsurance coverage is limited and expensive when available.*

**1.7. At what policyholder retention levels are insurance programs being structured to cover terrorism risk: and, with regard to insurers, how are reinsurance programs likewise being structured? Please comment on the availability and affordability at each level.**

*Insurers are better situated to discuss this issue.*

**1.8. In the long-term, what are the key factors that will determine the amount of private-market insurer and reinsurer capacity available for terrorism risk insurance coverage? How will this evolve in the long-term? Please comment on the potential entry of new capital into insurance markets.**

*While capacity increases were seen following last year's hurricane catastrophes, there was no significant capacity increase following the Sept. 11, 2001 terrorism events. Unknown frequency and severity of losses are the major factors preventing growth in capacity.*

*According to testimony by the RAA, there has been little capacity provided for terrorism losses and capacity would not be projected to grow to significant amounts in the foreseeable future.*

**1.9. To what extent have alternative risk transfer methods (e.g., catastrophe bonds or other capital market instruments) been used for terrorism risk insurance, and what is the potential for the long-term development of these products?**

*The NAIC heard testimony that while capital market instruments for natural catastrophes such as hurricanes and earthquakes have experienced growth in recent years, there have been very few insurers using such instruments for terrorism risk. Inadequate information for pricing of the bonds is an impediment to terrorism securitization and the markets have not been able to compensate for this inadequacy. Capital markets do not currently appear to be a viable alternative into which insurers could transfer significant portions of their risk for acts of terrorism. However, the potential for the capital markets to provide significant additional capacity warrants consideration of changes to tax policy designed to make terrorism securitization vehicles more attractive to investors.*

**1.10. To what extent have captive insurance companies been used for terrorism risk insurance, and what is the potential for the use of captive insurers to insure against such risk long-term?**

*Pure captive insurers accept risk transfers from their parent corporation and its subsidiaries. The use of a pure captive does nothing to spread the risk of loss from an act of terrorism. It is simply borne by the corporation, but managed through its captive. Since captive insurers generally reinsure their exposures in the same reinsurance market as primary insurers, there is no potential benefit to using captive insurers to insure terrorism risks. However, captives to a great extent protect the parent from the vagaries of the marketplace after disasters in terms of pricing and continuation of coverages.*

**1.11. Have state approaches made coverage more or less available and affordable, such as through permitted exclusions and rate regulation? To what extent will the long-term availability and affordability of terrorism risk insurance be influenced by state insurance regulation? Please comment on state approaches to ensure the continued availability and affordability of terrorism risk insurance in the absence of the TRIA Program being in-place (include state approaches after September 11, 2001 and before TRIA became law on November 24, 2002, as well as state approaches in preparation for the expiration of the TRIA Program).**

*Only a few states prohibited insurers from using any coverage limitations for acts of terrorism. Most states implemented the language contained in the NAIC's model bulletin. It provides that for policies providing property insurance coverage the following limitations apply to non-certified losses:*

- *Exclusion for acts of terrorism only apply if the acts of terrorism result in industry-wide insured losses that exceed \$25,000,000 for related incidents that occur within a 72 hour period;*
- *Exclusions for acts of terrorism are not subject to the limitations above if:*
  - *The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;*
  - *The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or*

- *Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.*

*For policies providing liability insurance coverage the following limitations apply to non-certified losses:*

- *Exclusion for acts of terrorism only apply if the acts of terrorism result in industry-wide insured losses that exceed \$25,000,000 for related incidents that occur within a 72 hour period; or*
- *Fifty or more persons sustain death or serious physical injury for related incidents that occur within a 72-hour period. For purposes of this provision serious physical injury means:*
  - *Physical injury that involves a substantial risk of death;*
  - *Protracted and obvious physical disfigurement; or*
  - *Protracted loss of or impairment of the function of a bodily member or organ.*
- *Exclusions for acts of terrorism are not subject to the limitations above if:*
  - *The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;*
  - *The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or*
  - *Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.*

*The states of New York, Florida, Georgia and California chose not to allow insurers to implement any conditional language related to coverage for acts of terrorism. In those states, insurers are faced with a choice of whether to cancel or non-renew the business or accept the risk of loss from acts of terrorism and try to secure reinsurance coverage.*

*Insurers and insurer trade associations may argue that the problem with providing coverage for acts of terrorism is related to rate regulation. Most states, however, do not have a rigorous rate review regime in place for commercial insurance products, especially with regards to large policies. In many states, there are no rate reviews at all because the prevailing regulatory philosophy is that sophisticated insurance buyers and sellers do not require assistance from regulators to conduct business. Thus commercial property and casualty rates are largely unregulated. Insurers have indicated that coverage for acts of terrorism may be more widely available in the absence of rate regulation. This notion is disabused when one looks at the appetite for providing reinsurance for acts of terrorism. Reinsurers are free to price their products as they see fit, yet they are unwilling to meet the demands of the primary insurers even with regard to coverage in the areas where TRIA does not apply (i.e. the insurer portion of the risk sharing and for insurer deductibles).*

*It is the opinion of the NAIC that changes in rate regulation would have minimal impact on commercial lines insurers' appetite for providing coverage for acts of terrorism.*

**1.12. What are the differences in availability and affordability of terrorism risk insurance between the licensed/admitted market and the non-admitted/surplus lines market, and, if so, to what degree are those changes attributable to the degree and manner in which each market is regulated?**

*In states where rates for commercial lines are largely unregulated, there should be no significant difference in rates charged by admitted or non-admitted insurers. Immediately following Sept. 11, 2001, the non-admitted or surplus lines market was quick to exclude coverage for acts of terrorism, and there remain many different reasons why insureds migrate between the two markets that are totally independent of terrorism insurance.*

**1.13. What are the differences in availability and affordability of terrorism risk insurance coverage for losses at US locations as compared to such coverage for losses at non-US locations?**

*While the NAIC has not done a formal study of this issue, the Government Accountability Office has researched European solutions to terrorism insurance and found a mix of private/public sector solutions implemented in several countries. See the GAO's Catastrophe Insurance: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risk for further information.*

**II. Long-term Availability and Affordability of Group Life Insurance Coverage**

**2.1 What impact, if any, does terrorism risk have on the availability and affordability of group life insurance coverage to the policyholder (e.g. employer) and certificate holders (e.g. employees)? How will this evolve in the long-term?**

*Group life insurance is mentioned in TRIA in Section 103(h). This section asks the Treasury to perform an expedited study of the issue and include group life if it is warranted. Group life was not included in the original bill because initially life insurers asked not to be included. It was only after the original enactment, that group life insurers discovered that catastrophe reinsurance had become less available to them and much more expensive. They are able to transfer some of their risk to reinsurers; however, they must retain much of the risk of loss themselves. Individual life insurers still do not wish to be included in TRIA.*

*Insurance regulators studied data supplied by group life insurers and evaluated their arguments for inclusion of group life in TRIA. Based on the information available to them, insurance regulators concluded that group life insurers face the same kind of risk concentration issues as workers' compensation insurers. For example, if a business has 1,000 employees at a given location, the pricing employed by life insurers for group products probably assumes that three or four employees might die in a given year. If instead, a location with 1,000 employees is hit by a terror attack and all of them die, the insurer has an enormous financial exposure from a single occurrence.*

*Unlike worker's compensation, there is no statutory requirement for group life that prohibits an insurer from limiting available coverage for acts of terrorism in some fashion. However, the employer, the insurer, the insurance industry in general and the American economy would suffer if an insurer is only able to pay a fraction of the policy face amount in a mass casualty situation. Furthermore, state insurance regulators are not inclined to approve exclusionary or limiting language in those states that have approval authority over the wording within group*

*life insurance contracts. Although there is some level of private reinsurance available for group life coverage, it is not sufficient to cover a catastrophic terrorism loss situation. The NAIC has adopted a resolution supporting the inclusion of group life in TRIA or another form of federal backstop. Insurance regulators continue to believe that the lack of adequate affordable reinsurance coverage for group life insurers will lead them to eventually amend contract language to limit the number of lives that can be covered from a single event. This might manifest itself in the form of an aggregate coverage limit to an employer.*

## **2.2 To what extent is an insurer's decision to issue group life coverage influenced by aggregation or accumulation risk in certain locations? What steps have group life insurance providers taken or do they plan to take to offset any aggregation or accumulation risk?**

*While group life insurers are better positioned to respond to this question, regulators want the Treasury to know that the dynamics of group life insurance make aggregation and accumulation risk an inherent risk in writing the coverage. For example, if a group life insurer is considering whether to write insurance on an employer that has 1,000 employees with an average salary of \$30,000 per year, and an average premium rate of \$2.40 per year per \$1000 of insurance coverage, it would have some reservations about providing the coverage without adequate catastrophe reinsurance in place. An average group life insurance benefit is one to two times salary. Let's assume coverage of 1.5 times salary for this example. The annual premium collected from this employer is \$108,000 ( $1,000 * 45 * 2.40 = \$108,000$ —that is 1,000 lives multiplied by 45 units of \$1,000 each times \$2.40—the rate per thousand). The amount of insurance provided is 1,000 lives times \$45,000 per each life or \$45 million. In other words, the insurer is exposing itself to a loss of \$45 million if all of the employees are killed during a single event.*

*In the past, the insurer would have purchased catastrophe reinsurance protection against the possibility of a large number of covered lives being lost in a single event. The cost of this protection was negligible before Sept. 11, 2001. A typical reinsurance policy would have protected the company against the loss of more than three lives in a single event. Thus the maximum loss from a single event would have been capped at \$135,000 for the primary insurer.*

*The post-Sept. 11, 2001, world is different. If reinsurers exclude coverage for terrorism or limit the aggregate amount of catastrophe reinsurance that they are willing to provide, the primary insurer must now decide whether they should continue to insure this group. The expected profit on these 1,000 lives is about \$10,000. If the best-case scenario develops and no lives are lost during the policy period, the result for the group life insurer is a profit of about \$85,000 (premiums less typical underwriting expenses). A worst-case scenario develops if all 1,000 lives are lost in a terrorist attack. The resulting loss is almost \$45 million.*

*With all the uncertainties surrounding terrorist activities, a rational response to this set of facts is for the insurer to choose not to write the policy described in the example. While it appears that life insurers are continuing to offer coverage for group life exposures, the constriction in the catastrophe reinsurance market leaves the primary insurer exposed to losses that would have been covered in the pre-Sept. 11, 2001, world. Life reinsurers have taken steps to manage their exposures. One could reasonably expect that primary insurers will make similar choices in the future to prudently manage their probable maximum loss exposure.*

**2.3 Has terrorism risk made group life coverage less affordable to the policy or certificate holder? Have group life insurance rates increased or decreased as compared to rates before and since Sept. 11, 2001?**

*Since there is no formal rate regulation for life insurance coverages, life insurers are better positioned to respond to this question.*

**2.4 Please explain how group life insurance coverage may be bundled with other coverages and benefits provided through an employee-benefits program, and how group life coverage is priced, either separately or collectively, through such programs. Please describe any effects competition has on such pricing.**

*Please refer to 2.2 for a pricing example. Regulators believe that the packaging of group life insurance coverage with other employee benefits leads insurers to take a chance that the worst-case scenario will not develop. The insurers' option is to leave the employee benefits market entirely. From a competitive position, if they want to sell the other employee benefits, they have to be able to offer group life insurance. From a regulatory point of view, this scenario adds an element of uncertainty that was not apparent before Sept. 11, 2001.*

**2.5 Are group life providers voluntarily providing coverage for loss of life arising out of or resulting from acts of terrorism, or is coverage mandated by any state or federal laws? Are group life providers prohibited by law from excluding terrorism risk from group life insurance policies?**

*Group life insurers provide coverage for acts of terrorism because the businesses that purchase group life insurance demand that they do. No employer wants to tell employees that their benefit package is reduced this year because if they are killed by an act of terrorism, their life insurance coverage no longer applies. Imagine the good will that would be lost if the business suffered casualties from an act of terrorism and they had to inform surviving spouses that no compensation was forthcoming. That alone could ruin the business enterprise.*

*To the best of our knowledge, no state or federal laws exist that require coverage for acts of terrorism.*

**2.6 Has terrorism risk affected segments of the group life market differently, such as in the case of small/medium sized employers, and if so, why?**

*Life insurers are better positioned to respond to this question.*

**2.7 In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage for group life insurance?**

*Group life insurers need to be able to accurately estimate their ultimate expected losses from acts of terrorism if they are to be able to continue to make group life insurance available at affordable prices. They will also need to find a way to manage their probable maximum loss and purchase affordable catastrophe reinsurance to assure that they remain solvent. To do so requires knowledge of both the expected frequency and severity of future losses. In the case of coverage for acts of terrorism, insurers either need to develop a historical record of frequency and severity of losses or find another alternative way to accurately measure expected losses.*

*When insurers are unable to determine what price to charge, they understandably tend not to want to provide coverage.*

*For now, group life insurers have to bide their time and hope for the best. Since group life insurance is often sold as part of a broader employee benefits package, the group life insurers are left with a Hobson's choice of accepting a risk transfer that they know could ruin the company if a worst-case scenario were to develop or exiting the employee benefits business. For now most of them have chosen the former and supplemented their choice with the purchase of less robust and more expensive catastrophe reinsurance along with prayer that nothing really bad happens. Insurance regulators are understandably uneasy with that choice.*

*The only hope for adding pricing stability for acts of terrorism is the use of computer simulation modeling. Refer to question I.3 for further information on modeling. It works the same way for life insurers*

*The NAIC has supported the position that group life insurance coverage should be included in the recent extension to TRIA and also believes that any subsequent program, regardless of whether or not the long-term solution includes federal governmental involvement, should include group life insurance.*

### **III. Long-term Availability and Affordability of Insurance Coverage for Chemical, Nuclear, Biological and Radiological (CNBR) Events caused by Terrorism**

*Preliminarily, the NAIC would like to provide a general overview of CNBR coverages with the caveat that, as is the case with all causes of loss, coverage for any specific claim will ultimately be governed by the policy provisions, conditions and exclusions of the policy under which the claim is made.*

*Generally speaking, there is no coverage for nuclear or radiological incidents, terrorist-related or otherwise, because policies contain nuclear and radiological exclusions. This is true even in situations where the insured has purchased TRIEA terrorism coverage. A terrorist event involving a nuclear/radiological device would not result in coverage because TRIEA terrorism coverage only applies to covered perils under the policy and a nuclear event is not a covered peril. However, in states that mandate use of the New York Standard Fire Policy, and regardless of whether the insured has purchased TRIEA terrorism coverage, fire losses following any nuclear event will be covered subject to other policy conditions and requirements. Also, it should be noted that the Price-Anderson Act establishes an insurance mechanism to provide insurance to operators of nuclear reactors in the U.S. in the event of a nuclear accident.*

*Standard policies generally do not contain a specific chemical or biological exclusion. However, many policy forms include pollution or contaminant exclusions. Depending on the specifics of the incident in question, these exclusions might eliminate coverage from the policy for chemical or biological events. TRIEA terrorism coverage for chemical or biological events would apply, if such events were considered covered perils under the primary policy. As noted above, in states that mandate use of the New York Standard Fire Policy, and regardless of whether the insured has purchased TRIEA terrorism coverage, fire following a chemical or biological event will be covered subject to other policy conditions and requirements.*

*Finally, it is important to note that workers' compensation policies do not permit exclusions for CNBR events.*

**3.1 What is the current availability and affordability of coverage for CNBR events, and for what perils is coverage available, subject to what limits, and under what conditions? Is there a difference in the availability and affordability of coverage for CNBR events caused by acts of terrorism?**

*To the extent that coverage for CNBR events exists in primary policies, as explained above, insurers are required to make it available pursuant to TRIEA for certified acts of terrorism. Specific information regarding the affordability of this coverage is not available to the NAIC at this time. Since the policy forms either include or exclude coverage for CNBR events without distinction as to the cause of the event, there should be no difference in the availability of coverage for such events caused by acts of terrorism. Affordability may be impacted to the extent that insurers will consider their exposure to terrorist acts and will ultimately reflect this exposure in the additional premium charged for TRIEA coverage.*

*For the states that have adopted the NAIC Atomic Energy Exclusion Model Law, insurers are permitted to notify a policyholder that the insurer does not “cover loss or damage caused by nuclear reaction or nuclear radiation or radioactive contamination, all whether directly or indirectly resulting from an insured peril under said policy; provided, however, that nothing herein contained shall be construed to prohibit the attachment to any such policy of an endorsement or endorsements specifically assuming coverage for loss or damage caused by nuclear reaction or nuclear radiation or radioactive contamination.”*

**3.2 What was the general availability of coverage for CNBR events prior to the terrorist attack of Sept. 11, 2001? To what extent, subject to what limits, and for what perils was coverage available? Did it cover acts of terrorism?**

*As noted above, insurers have always excluded nuclear events. In recent years pollution losses have been subject to sublimits in commercial property policies. For example, the Insurance Services Office, Inc. (ISO) Building and Personal Property Coverage Form provides coverage for pollutant cleanup and removal, but the limit for that supplemental coverage is \$10,000. Further, pollutants are broadly defined as “any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.”*

*The ISO Causes of Loss-Basic Form also contains an exclusion for the nuclear hazard that is broad enough to encompass all radiological events. It says that the insurer will not pay for loss or damage caused directly or indirectly caused by “nuclear reaction or radiation, or radioactive contamination, however caused. But if the nuclear reaction or radiation, or radioactive contamination, results in fire, the insurer will pay for the loss or damage caused by that fire.” Other ISO coverage forms contain identical or similar language.*

**3.3 If coverage for CNBR events caused by acts of terrorism is available, please describe generally to what extent (i.e., limits, locations, exclusions, etc.) for what kinds of insurance and from what types of insurers (i.e., large/small, admitted/surplus lines, etc.). How will this evolve in the long-term?**

*Specific information is not available to the NAIC.*

**3.4 To what extent is terrorism risk coverage available and affordable for nuclear facilities and for chemical plants, manufacturers, and industrial chemical users?**

*The Price-Anderson Act establishes an insurance mechanism to provide insurance to operators of nuclear reactors in the U.S. in the event of a nuclear accident. This act may provide a basis on which CNBR losses from terrorism events are covered.*

**3.5 To what extent, both prior and since Sept. 11, 2001, have various states allowed insurers to exclude coverage for CNBR events? Please comment on requirements for workers' compensation and fire-following coverage.**

*As noted in the preamble to this section, nuclear and radiological losses have been excluded from policies even prior to 2001. Since 2001, most states have allowed insurers to exclude coverage for chemical and biological events.*

*There are 23 states (including DC) that have not enacted the New York Standard Fire Policy. Sixteen states have enacted the New York Standard Fire Policy with no provision for terrorism exclusions. There are twelve states where the New York Standard Fire Policy has been modified to allow insurers to either exclude or limit coverage for acts of terrorism.*

*As previously noted, workers' compensation policies cannot be modified to exclude acts of terrorism, including CNBR events.*

**3.6 It appears that some insurers are unwilling to provide coverage for CNBR events caused by acts of terrorism even with the federal loss sharing provided by the TRIA program. Why would this be the case given that TRIA limits an insurer's maximum loss exposure?**

*The magnitude of potential CNBR losses is so great that it does not conform to the traditional methods available to insurers to spread and share the risk. The limited amount of capital available in the industry to insure all commercial losses is considered to be inadequate to cover a large-scale CNBR event. A CNBR event has the potential to affect a large geographic area implicating concentration of risk considerations that may have substantial implications for individual insurers. Even with TRIA's loss limitations, the potential of a severe event may dissuade insurers from providing the coverage given their exposure to TRIA's deductible and co-insurance requirements.*

*In his remarks to the working group at its recent public hearing Edmund F. Kelly, Chairman, President and CEO of the Liberty Mutual Group had this to say, "Whatever the structure, we believe that Nuclear Biological Chemical Risk, or CNBR, has to be dealt with explicitly. For one thing, a dirty bomb for example could cause more loss to individual homeowners than to business, while TRIA has been viewed as a commercial insurance need. And of course the sheer magnitude of a potential CNBR loss implies separate treatment in a stand-alone program or as part of a combined one."*

**3.7 In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage for the CNBR events?**

*Unless a way is found to dedicate substantial capital to these events, the industry will remain reluctant to make coverage available and affordable. As stated above, these losses present a catastrophic exposure to an industry with limited capital and are difficult to mitigate using traditional methods of risk management and loss control.*

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