TRIA RENEWAL: Why Are We Waiting?

By Eric Nordman, Director of Regulatory Affairs and CIPR

It is hard to believe it has been almost 13 years since our view of terrorism was forever changed by the tragic events of Sept. 11, 2001. For many Americans, the name Osama bin Laden still evokes a chill when spoken ... but no more so than in the days and months following those deadly attacks. And, even though overwhelmed with shock and grief, Americans went back to work and to their daily lives with a renewed sense of purpose: to prove no terrorist could change our way of life. However, the 9/11 terrorist attacks have undeniably changed things. One of the major changes was how the insurance industry views the risk of loss from acts of terrorism. This article explores the risk of loss from acts of terrorism and the collective response known as the Terrorism Risk Insurance Program (TRIP). We will explore the debate surrounding the sunset and possible renewal of this program.

Renewal of TRIA is Essential

When the World Trade Center buildings collapsed, the insurance industry’s perspective about the risk of loss from acts of terrorism changed dramatically. The industry realized a determined terrorist could cause substantial damage under the right circumstances. The definition of “substantial damage” shifted from millions of dollars to billions of dollars. The natural initial reaction of the industry is always predictable. They move to limit their exposure to the latest threatening event. They do so by raising prices, limiting coverage and cancelling those with the greatest exposure. This phenomenon is not limited to acts of terrorism; natural disasters invoke the same response. Generally insurers return to the market after the initial shock has passed. What is different for acts of terrorism is that insurers’ willingness to write the coverage has never returned.

The federal Terrorism Risk Insurance Act (TRIA) was initially established as a temporary (three-year) program where the U.S. government agreed to share the risk of loss from acts of terrorism with the insurance industry. TRIA was renewed for two years in 2005 and again for seven years in 2007—with the continuing understanding the program was a temporary solution. In the interim, it has become clear there is nothing temporary about the insurance industry’s unwillingness to write substantial amounts of coverage for acts of terrorism. State insurance regulators have not seen evidence to suggest the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing terrorism risk coverage.

Improvements have been made to computer simulation modeling; however, estimating the risk of loss from acts of terrorism remains uncertain. Yet, neither frequency nor severity can be predicted with any level of certainty. As a result, insurers would likely choose to avoid providing coverage for acts of terrorism if given the opportunity. If TRIA expires, regulators expect some insurers to place limitations on commercial insurance policies to exclude terrorism coverage or choose to withdraw from the market completely.

Currently, TRIA is the enticement to encourage the insurers to venture where they otherwise would not be inclined to go. TRIA provides insurers with a cap on the severity of exposures. 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 to American businesses. In the macroeconomic sense, it is the availability of affordable insurance coverage that allows American businesses to succeed. Without insurance, economic development stops. While coverage for acts of terrorism is only a subset of all the insurance coverage American businesses need to prosper, it is an important component.

Unfortunately, there is no empirical measure of availability and affordability because they are both subjective measures. One could argue coverage for every peril is available to anyone if they are willing to pay any price. However, as a practical matter, if businesses perceive 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 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 the state or federal government forces them to do so. If TRIA is not reauthorized, the absence of a federal backstop could lead insurers to choose to withdraw from the market completely.

Insurance regulators generally agree termination of TRIA would result in an availability crisis, as insurers would not voluntarily offer coverage for acts of terrorism to most U.S. businesses. Evidence for this comes from the fact the insurance industry has filed conditional exclusions. It is possible a limited market for terrorism coverage would develop; however, regulators expect the cost would be high and the coverage very limited in scope.

Terrorists are motivated to inflict maximum loss in the most visible way possible. As a result, there is no limit to the magnitude of property or casualty loss. Major U.S. cities such as Boston, Chicago, Houston, Los Angeles, Miami, New York, San Francisco and Washington, D.C., are the most

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attractive targets for terrorists. This leads to adverse selection, as the strongest demand for terrorism insurance originates from businesses in these geographic areas. If TRIA is not extended, state insurance regulators believe terrorism insurance will become less available and affordable in the areas where there is the greatest demand for coverage. State insurance regulators also believe the elimination of the program would negatively impact the availability of insurance in mid-size cities and some types of commercial enterprises, as well.

Workers’ compensation presents special issues because terrorism cannot be excluded from individual workers’ compensation policies. An expiration of TRIA would be especially disruptive to the workers’ compensation market. It is likely the size of residual markets would grow. In particular, businesses with large numbers of employees concentrated in a single location would be vulnerable, as would businesses located near iconic buildings perceived to be attractive targets for terrorists.

**What Might Happen?**

There are some things we know about terrorism and terrorists, but many things we do not. We know the threat of terrorism remains, and is, a concern for the U.S. economy. We do not know when the next terrorist will strike or what target will be selected. We do not know the extent of damage the terrorist will inflict or the number of lives that will be lost. We know terrorists are planning their next attack and communicating with fellow terrorists about their plans. We rely on our government to be vigilant in thwarting these terrorist plots and protecting Americans from harm—both physical and economic. In fact, some have suggested a successful terrorist attack proves the government failed in its duty to protect its citizens.

Insurers are disinclined to provide all of the coverage for acts of terrorism demanded by American businesses without “encouragement” from the government. The current encouragement comes in the form of the TRIP. Arguably, the program might be one of the most efficient and least costly federal programs in place today. Initially, a small staff for the TRIP office was housed in the U.S. Department of the Treasury. The staff worked on publishing regulations and other guidance. They also frequently communicated with state insurance regulators to seek guidance and collaboration on how the program should be structured and what regulations might work best for all parties.

When the federal Dodd-Frank Consumer Protection and Wall Street Reform Act of 2010 was adopted, the TRIP staff were transferred to the Federal Insurance Office. For the price of some office space and a few federal employees, the TRIP provides comfort and certainty to insurers, provides affordable and available insurance to American businesses covering the risk of loss from acts of terrorism, and encourages sound economic development. It is a sound use of public funds, as it has a reimbursement mechanism so if funds are expended, most will be recouped by a policyholder surcharge in the following year(s).

So, what would happen if TRIA is not reauthorized? Some opponents say TRIA is costly and temporary. They say closing it now would save the country money and allow the funds saved to help reduce the federal deficit. They maintain TRIP gets in the way of the private markets, crowding out the insurers and reinsurers clamoring to write the business. That is the alternative view ... if the opponents are right. If, however, the opponents are wrong, this could be their alternative reality: Insurers will lose the incentive to write coverage for terrorism risk when TRIA sunsets.

Simply put, insurers are not willing to jeopardize their financial health by accepting the potential unlimited severity and unpredictable frequency terrorist attacks present. This would lead to many businesses not having proper terrorism risk coverage, leaving them vulnerable to acts of terrorism. In the absence of TRIA reauthorization, many businesses would not be able to get proper coverage.

During past debates over the reauthorization of TRIA, regulators reported receiving numerous inquiries from policyholders about not being able to obtain construction loans from banks. A slowdown in lending would have a chilling impact on the economy, because mortgage lending and the securitization of mortgage loans provide a significant portion of the gross domestic product (GDP). One rating agency has said it may decline to rate commercial mortgage-backed securities on transactions lacking sufficient terrorism insurance.

The result is extreme price increases, loss of coverage for most businesses, difficulty in obtaining workers’ compensation coverage for employers with large numbers of employees is a single location and a general drag on economic development, particularly in high-profile urban centers. Banks will not lend when terrorism insurance coverage is unavailable or unaffordable. If banks will not lend, builders will not build. When building stops, the economy slows down. The result is a recession at a time when the U.S. economy is just beginning to show signs of a solid recovery. When the economy declines, tax revenues go down, adding to the deficit rather than reducing it.

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A worst-case scenario would include a major terrorist event striking an area with little or no insurance coverage. There would be incredible pressure for the U.S. president to declare the event a federal disaster. Then the Treasury would be called upon to provide funds to rebuild the damaged area. Without TRIA, the federal government would be without the claims paying facilities of the insurers they currently enjoy with TRIA in place. Further, the funding would be entirely at taxpayer expense, as there would be no recoupment as there is today.

SUMMARY
Knowing all we know about terrorism risk and the provision of terrorism insurance coverage, how can we risk allowing TRIA to sunset? It seems obvious the economy, businesses and the taxpayers are all better off with TRIP in place. So, what are we waiting for? Let’s renew TRIP and keep the economy running smoothly.

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