Protecting the TRIA Paradigm

What We Need to Know to Renew TRIA Responsibly in 2020

By Ronald R. Robinson

A study of key insurance marketplace data could, for the first time in TRIA history, serve to alter the nature, course, and rhetoric of the renewal debate in 2020. Only such a study could objectively determine whether it is responsible and economically appropriate to recalibrate the marketplace's risk-share allocation.

■ Ronald R. Robinson co-founded Berkes Crane Robinson & Seal LLP, a U.S. News & World Report Top Insurance Law Firm and served as its executive partner. Now Of Counsel to his firm, he has served as chair of the DRI Insurance Law and Excess & Reinsurance Law Committees, and as a member of the DRI Law Institute. Since 2004, Mr. Robinson has chaired the DRI Insurance Law Committee Subcommittee on the Terrorism Risk Insurance Act (TRIA). He has published numerous white papers and articles on terrorism issues generally and terrorism risk insurance issues specifically, as well as on a broad range of coverage law issues. He received the DRI National Community Service Award for his work on TRIA.

Conventional wisdom asserts that it is premature in 2019 to ask Congress, the Treasury Department, and the other relevant stakeholders to begin thinking about reauthorization of the federal Terrorism Risk Insurance Act

(TRIA or the "act"), which is set to expire on December 31, 2020. For all the reasons discussed in this article, this view may be conventional, but it is not necessarily wise.

There are only four approaches to the transfer of terrorism risk: (1) 100 percent government-funded programs, paid for by taxes; (2) 100 percent insurance-funded programs, paid for by premiums, investments, and policy surpluses; (3) a partnership of government and private insurance market resources that allocates shares of the risk to each partner in some rational and objectively supported proportion; and (4) charity-funded programs paid for by donations, which can also operate side-by-side with any of the three preceding approaches. TRIA is based on the third approach.

The first TRIA bill was enacted in 2002 to cover property and casualty losses caused by terrorist attacks in "target cities" and on "Main Street" America. The act created a partnership to share the risk-of-loss (referred to here as the "TRIA paradigm"), comprised of the federal government and the private insurance marketplace. The TRIA paradigm required insurers to make TRIA coverage available to purchasers on the same terms and conditions as their other property and casualty policies. This provision is often referred to as the "make available" requirement.

TRIA 2002 has been amended three times: (1) the Terrorism Risk Insurance Extension Act of 2005 (TRIEA 2005); (2) the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA 2007); and (3) the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA 2015), which is set to expire on December 31, 2020. Each new iteration of the TRIA paradigm has exponentially increased the private insurance marketplace's partnership share of risk of loss, while equivalently decreasing the government's partnership share of the risk of loss. There is little doubt that in 2020 there will be a demand for yet another steep increase in the marketplace's partnership share, with a corollary decrease in the government's partnership share of the risk

However, to date, TRIA's ever-increasing risk-share allocation to the private insurance marketplace has been based on gross assessments of total marketplace policy surpluses and loss capacities. This approach ignores the fact that, in the event of a catastrophic terrorist attack, the marketplace's partnership share of the loss will not be borne equally by all insurers, but will be paid solely by carriers whose policies are triggered by that attack. More importantly, the private insurance marketplace is not a unitary monolith; rather, it is comprised of layers and layers of millions and millions of primary, umbrella, and excess policies, issued each year by private small and medium regional, and some national, insurance companies, as well as large, international insurance companies. From these disparate marketplace segments, those policies randomly triggered by a terrorist attack alone, and no others, will be called on to cover the loss under the TRIA paradigm.

To date, data about the policy surpluses or loss capacities of the private insurance marketplace, segment by segment, has not been available to the drafters of any of TRIA's iterations. Yet the marketplace's partnership share of the risk has been exponentially increased three times. Insurers whose policies are triggered will have access only to their own and their reinsurers' policy surpluses or loss capacities to pay the claims. No one can say—in the absence of objective, private insurance marketplace segment, policy surplus or loss capacity data—that the TRIA paradigm will not put the solvency of small and medium regional and some national insurers at risk.

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To renew TRIA responsibly, all stakeholders need to know the policy surpluses and loss capacities of the insurers in each marketplace segment. In turn, the private insurance marketplace's partnership share of risk of the loss cannot continue to be based on the current monolithic approach, which does not allocate risk share for each marketplace segment responsibly. This marketplace segment-driven allocation ought to be based on objective data, gathered by a sound terrorism risk assessment study that accurately evaluates the loss capacity of each marketplace segment.

This article considers (1) how to create a segmented, terrorism risk, private insurance marketplace capacity study that Congress, the Treasury Department, and all other relevant stakeholders will accept as reliable; (2) who could create such a study; and (3) how the study could positively affect the nature, course, and rhetoric of the coming TRIA renewal debate, which will take place in a politically super-charged, partisan climate, due to the presidential election that will unfold in 2020.

Each Time TRIA Has Been Renewed, the Marketplace's Risk-Share Allocation Has Increased Exponentially

TRIA policies cover foreign, and since 2008, domestic acts of terrorism in the United States and abroad at specified U.S. venues and for certain U.S. interests. The TRIA paradigm defines a covered loss as "any act of terrorism, or a violent act dangerous to life, property or infrastructure, committed by individual(s) 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." From 2002 to 2015, TRIA required the Secretary of the Treasury, the Secretary of State, and the Attorney General to certify jointly that a loss event was, in fact, caused by a terrorist act as defined by TRIA. TRIPRA 2015 replaced the Secretary of State with the Secretary of Homeland Security as a certifier of terrorist acts.

Since TRIA 2002, to qualify as a certified event, a given loss must exceed $5 million in the aggregate. That threshold remains unchanged today. However, the rise in the marketplace's risk-share allocation since 2002 is dramatic. The following components of the TRIA paradigm demonstrate the exponential increase in the marketplace's partnership share of the risk.

Individual Insurer Deductible: Under TRIA 2002, before an individual certified event was eligible for any claim payments by the government, each insurer whose policy was triggered by that loss was required to pay a "deductible" to cover that loss initially in an amount equivalent to 7 percent of its direct, earned premium in the previous year. By the close of 2020, the individual insurer deductible will have nearly tripled to 20 percent of the direct, earned premium from the previous year.

Government Participation Trigger Amount: Under TRIA 2002, the government's obligation to make any claim payment was not triggered until the total certified event loss paid by all insurers was $5 million or more. This industrywide, aggregated-loss payment is in addition to the individual insurer deductible. By 2020, the government's TRIA loss participation trigger amount will be a $200 million certified terrorist event, a 3,900 percent increase from 2002.

Insurer Co-Payment: Under TRIA 2002, a triggered insurer was required to pay a maximum of 10 percent of a certified event loss *above* the government participation trigger amount. By 2020, this insurer co-payment will be 20 percent, double the original payment required in TRIA 2002.

Marketplace Aggregate Loss Retention: The aggregate loss per year for all certified events, under all iterations of TRIA, is $100 billion. Under TRIA 2002, the private insurance marketplace as an aggregate was required to cover up to $10 billion of an aggregated loss. By 2020, the marketplace aggregate loss retention will be $37.5 billion, a 275 percent increase from 2002.

Marketplace Risk-Share Allocations Must Be Data Driven

The one-size-fits-all, monolithic, private insurance marketplace partnership share of the loss approach has been the norm since TRIA 2002. However, the allocation has never been supported by objective, empirically neutral, data-based underwriting principles, or founded on the actual policy surpluses or loss capacities that are available in the various marketplace segments to pay certified event losses. Until the marketplace's partnership share of the risk is based on objective marketplace segment data, compiled in a study as is proposed here, the risk of insolvencies after a catastrophic terrorist event cannot be ruled out.

A study would responsibly demonstrate the economically appropriate levels to be mandated by the act for (1) the individual insurer deductible, (2) the government participation trigger amount, and (3) an insurer co-payment for each marketplace segment. This determination would also inform whether it is responsible to raise the current $37.5 billion 2020 marketplace aggregate loss retention in 2020, or if that amount should be lowered to reflect a more responsible and economically appropriate burden in 2020, *i.e.*, one based on the sum of the actual policy surpluses or loss capacities of all the marketplace segments combined.

To Date, Debates Over Political Doctrine, Not Objective Data, Have Driven TRIA Marketplace Risk-Share Allocations

Immediately after the September 11, 2001, attacks, some called on the United States Congress to transfer 100 percent of the risk of future terrorism losses to the federal government. Their position relied on the political doctrine that mandates that the government assume the entire risk of a loss capable of crippling the financial stability of some sectors of the U.S. economy. Without objective data to support their position, some argued that the private insurance marketplace's loss capacity was insufficient to cover any part of the terrorism risk, relying on an assumption that terrorism losses cannot be underwritten at any level of risk of loss. Thus, some concluded that protection from terrorist acts ought to be part of America's domestic and foreign political policy.

Others called on the private insurance marketplace to accept 100 percent of the risk of future terrorism losses. Their position relied on the political doctrine that the government must never preempt the marketplace to assume the risk of a terrorist act, even if the risk could cripple the financial stability of some sectors of the U.S. economy. Without objective data to define the accuracy or consequences of their position, they asserted that the marketplace's loss capacity was sufficient to cover the entire risk of loss.

The rhetoric accompanying congressional debates that touch on any core differences in political doctrine has become increasingly acrimonious since 9/11. Not surprisingly, debate over TRIA 2002 was not grounded in objective data that would answer the relevant underwriting question: Did the various private insurance marketplace segments have the financial capacity to accept their economically appropriate share of this catastrophic risk responsibly? The marketplace's partnership share of the risk in TRIA 2002 was determined by compromises rooted in the politics of the "proper roles" of the federal government and of private insurance in a democracy, and not objective marketplace loss capacity data.

Even more heated political rhetoric about "proper roles" drove the 2005 and 2007 renewal decision-making process. The 2015 renewal process, which started in early 2014, an election year, was the most contentious yet. There was a serious attempt by some in the House Financial Services Committee not to renew the act, end the government's participation in the act, and transfer all terrorism risk to the private insurance marketplace. As alternatives, some threatened to again drastically increase the marketplace's partnership share of the risk, or to remove the mandatory "make available" requirement. The latter option would effectively end government participation, because any insurance company, especially the small and medium regional carriers and the national carriers, would simply, and quite probably, drop out of the TRIA paradigm.

The Senate Banking Committee debate was not devoid of "proper roles" rhetoric, either. However, unlike the House Financial Services Committee, it was more concerned with strengthening the TRIA paradigm than eliminating it in whole or in part. Nevertheless, the acrimonious 2014 political debate in the House eventually influenced the Senate, and a final enacting vote was blocked. Consequently, TRIA, in fact ended on December 31, 2014, its final renewal date. This resulted in a lapse of the TRIA paradigm, and it took the new Congress twelve days to get a joint bill passed to renew it on January 12, 2015.

Past is often prologue. Unless there is a sea change during the 2020 renewal debate, the reauthorization process will, for the fourth time, devolve into another "proper roles" debate. More unfortunately, this debate will take place during a presidential election cycle. It is quite likely, therefore, that doctrinal rhetoric will be more exacerbated than ever before because of the need for one's candidate and/or party to gain support in the election.

A study would provide the needed sea change that would make it possible for Congress to set a renewal course based on objective data and then simply circumnavigate the "proper roles" debates. Without such a study, the 2014 attack on TRIA's existence would be back on the table and would probably be a more toxic topic than ever before. Therefore, a study is imperative for a second reason: it would positively temper the nature, course, and rhetoric of the TRIA renewal debate in what can now be reasonably expected to be the politically super-charged, partisan climate of the 2020 presidential election.

General and Publicly Available Marketplace Data Collection Efforts, Mandated by TRIPRA 2015, Have Value, but Are Not a Substitute for the Study Proposed Here

Specific terrorism risk insurance capacity data has been collected by private parties over the past seventeen years. The nature of these data collection initiatives has created company-centric, terrorism risk insurance capacity studies for proprietary use. By definition, these proprietary, terrorism risk insurance capacity studies deal with the segment of the marketplace to which the client or company belongs. Unfortunately, too many small and medium regional insurers, and even some national insurers, do not have the financial ability to create or purchase such a proprietary study. In any case, these data have not been broadly or publicly available to stakeholders in the three TRIA renewal debates to date.

There are now, however, a few public sources of useful, but generalized, marketplace terrorism risk capacity data. TRIPRA 2015 required the Treasury Department to collect certain marketplace data in 2016 and 2017. The Treasury Department has

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continued to collect the data to the present. That information will be available to the stakeholders for the 2020 TRIA renewal debate. The National Association of Insurance Commissioners (NAIC) engaged in separate data collection exercises in 2016 and 2017. In 2018, the Treasury Department and the NAIC partnered to develop a consolidated collection approach to the data collection required by TRIPRA 2015. These initiatives are public and provide general data, but they do not provide the data needed for the study proposed here.

> **This study** would provide all stakeholders with a public and objective basis on which to debate and recalibrate all four component parts of the marketplace's partnership share of risk: the individual insurer deductible, government participation trigger amount, insurer co-payment, and marketplace aggregate loss retention.

The data collection mandated by TRIPRA 2015, on which the Treasury Department and the NAIC are collaborating, requires "data calls," which typically collect the following information: (1) policy surplus; (2) the policies actually issued for all TRIPRA 2015 approved insurance lines; (3) direct earned premium, sorted by specified regions of the country; and (4) the amount of stand-alone terrorism insurance being issued nationwide (coverage not imbedded in a general property or casualty policy). There are separate "data calls" for direct earned premium for (1) stand-alone "cyber risk" casualty policies; and (2) for "cyber risk" casualty coverage sections or grants incorporated into a standard commercial general liability policy.

The "data calls" also request that carriers assess the potential for terrorist act claims by region of the country and identify the policies at risk by standardized insurance policy identification codes (*i.e.*, the type of coverage risk, *e.g.*, utilities, construction, agriculture, arts, and entertainment). Carriers also collect similar information concerning the reinsurance market. These data are a part of what the study proposed here must collect and assess.

Interestingly, TRIPRA 2015 requires the Treasury Department identify competitive challenges that small insurers face in the national and international insurance industry. For calendar year 2018, the Treasury Department developed relevant data collection templates, organized by the nature and size of an insurer's operations, to satisfy this requirement. The instructions require separate reporting for small companies, captives, and alien companies, but ignore the medium company market segment. This approach does not reflect the economic realities of the marketplace. The Treasury Department is also conducting a separate, annual study of small insurer competitiveness in the market and is issuing annual reports of its findings. TRIPRA 2015 does not, however, require collection of data for medium-sized regional and national carriers.

The Government Accountability Office (GAO) is required under TRIPRA 2015 to conduct a study of the $200 million government participation trigger amount. The GAO study will assess the possible effects of instituting the following measures: (1) premiums under the next iteration of the TRIA paradigm, to be paid by insurers to participate in the program; and (2) requiring insurers to carry capital reserve funds for terrorism losses, just as they would in a normal reinsurance situation. Again, while clearly relevant to, and part of, the study proposed in this article, the GAO report by itself is neither the focus of, nor the endpoint for, such a study.

While all the different data collection efforts above are clearly relevant to the study proposed in this article, they do not provide a full, segment-by-segment marketplace analysis. They are, however, a good starting point from which to begin designing and constructing the study. Such a study would permit applying differing individual insurer deductibles, government participation trigger amounts, insurer co-payments, and marketplace aggregate loss retentions to each marketplace segment. This study would provide all stakeholders with a public and objective basis on which to debate and recalibrate all four component parts of the marketplace's partnership share of risk: the individual insurer deductible, government participation trigger amount, insurer co-payment, and marketplace aggregate loss retention.

A Proposed Author for a Segmented Terrorism Risk Insurance Marketplace Capacity Study

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) created the Federal Insurance Office (FIO), a new administrative office in the Treasury Department. The FIO's authority extends to all lines of insurance, except health insurance, long-term care insurance (except that which is included with life or annuity insurance components), and crop insurance. Part of the FIO portfolio is the administration of the current and future iterations of the TRIA paradigm, including the following:

- monitoring all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system; and
- assisting the Secretary of the Treasury in administering the various iterations of the Terrorism Risk Insurance Program, including providing guidance to address, on an interim basis, certain aspects relating to the implementation of the program.

The FIO charter also specifically mandates that it do the following:

- monitor an important aspect of the insurance industry's role in the TRIA partnership, *i.e.*, the private insurance

market's terrorism risk transfer capacity; and

- assist the Treasury Department in the administration of the Terrorism Risk Insurance Program, which logically includes providing guidance to address, on an interim basis, certain aspects relating to the implementation of the allocation of risk to the private insurance markets.

The proposed study would support the FIO mandate to identify issues relevant to future risk-share allocation decisions and to regulating insurers under the statutory TRIA paradigm.

The Federal Advisory Committee on Insurance (FACI) provides advice and recommendations directly to the FIO to assist the FIO in carrying out its statutory responsibilities. The FACI could recommend and facilitate the creation of a terrorism risk capacity study by the FIO.

FACI members consist of representatives of the insurance and reinsurance community, academics, and state regulators who agree to serve three-year terms. FACI members are well qualified to manage the creation of a non-partisan, objective, terrorism risk capacity study.

The FACI annual budget is less than $200,000, plus whatever costs are incurred by members to attend the quarterly meetings envisioned by the Federal Advisory Committee Act. However, the FACI can recommend to the FIO that (1) the FIO undertake the financial burden for the study; and (2) the FACI itself be empowered by the FIO to create a reliable, neutral study independently, to be completed by spring 2020, when the debate will begin.

Stakeholders in the TRIA Renewal Debate Will All Benefit from the Existence of the Study Proposed Here

Congress, and in particular the House Financial Services and Senate Banking Committees, are directly responsible for TRIA's renewal. The Executive Branch's stakeholders include the Treasury Department, the Department of Homeland Security, and the Office of the Attorney General; these are the government entities charged with certifying or declining to certify a given event as a terrorist act that qualifies for TRIA coverage. The non-governmental stakeholders include all sectors of the national and international financial markets; real estate markets; leisure time, vacation, and travel markets; insurance and reinsurance markets; insurance brokers; insurance regulators; policyholder and insurer trade associations; coverage counsel trade associations and related associations; and major educational public policy associations.

The American Insurance Association (AIA) and the Property and Casualty Insurance Association of America (PCIAA) insurance trade organizations have historically been the property and casualty insurance community stakeholders in the debate. Some of their members have argued that one cannot insure terrorism in the private sector; others hold the opposite view, if the marketplace's partnership share of the risk is economically appropriate and responsible. These two leading industry trade associations merged (effective January 1, 2019) to become the American Property Casualty Insurance Association (APCI). The APCI will speak for nearly 60 percent of the U.S. property-casualty market. It remains to be seen whether the APCI will be at the forefront of fine-tuning the current bill or will seek, instead, to effect broad changes that lessen or expand the role of private insurers in the TRIA paradigm. However, their members hold differing views of the TRIA paradigm. The study proposed here would be a critical asset to the decisions to be made on its position on the renewal of TRIA in 2020.

The Reinsurance Association of America (RAA), the other key insurance trade organization, will likely continue to play a unique role in the debate. In the past, the RAA sought to build a consensus among all stakeholders to continue the TRIA program on an economically sound footing.

Conclusion

The TRIA paradigm always has raised and always will raise legitimate and complex questions about (1) the proper application of historic underwriting principles that should govern the transfer of terrorism risk; (2) the proper roles of the government and private insurance marketplace in effecting a transfer of terrorism risks in a democracy; and (3) the calculation of marketplace's partnership share of the risk. Without doubt, these questions must be debated rigorously and fully. However, assuring responsible debate over the renewal of the TRIA paradigm in 2020 mandates the creation of the study proposed here and its publication to all stakeholders.

A study of key marketplace data could, for the first time in TRIA history, serve to alter the nature, course, and rhetoric of the renewal debate in 2020. Only such a study could objectively determine whether it is responsible and economically appropriate to recalibrate the marketplace's risk-share allocation. The study proposed here would provide all stakeholders with an opportunity to debate and recalibrate all four component parts of the marketplace's partnership share of risk: the individual insurer deductible, government participation trigger amount, insurer co-payment, and marketplace aggregate loss retention. In the absence of such a study, the debate will again devolve into bitter, partisan attacks, based on political doctrine. In the absence of a study, further increases in the marketplace's partnership share of the risk could unnecessarily endanger the solvency of the small and medium regional and national marketplace segments should there be a catastrophic terrorist attack. The results of this study could be: (1) what we need to know to renew TRIA responsibly in 2020; and (2) what will assure protection of the TRIA paradigm.