TRIA Update

Willis

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TRIA is extended, but debate on the contentious terrorism reinsurance program is not likely to end soon. Over the weekend of December 17 and 18, the Senate and the House passed compromise legislation to extend the Terrorism Risk Insurance Act (TRIA) through December 31, 2007, resolving a question that weighed on the insurance industry throughout 2005. The extension was signed into law by President Bush on December 22. For some, however, the legislative process scuttled an opportunity to craft a better, longer term solution.

Below, we compare key provisions of the TRIA bill passed on November 26, 2002 and those of the new version. But first, here is a list of some aspects of the House version that did not survive compromise with the more skeptical Senate:

- Inclusion of group life insurance
- Inclusion of domestic terrorism
- Mandatory coverage for nuclear, biological, chemical and radioactive events (NBCR), albeit subject to sub-limits
- Siloed deductibles in order to eliminate perceived advantages now enjoyed by mono-line insurers
- A sliding coinsurance scale based on various levels of aggregated industry losses
- Mandatory recoupment of the government's share of all losses, not to exceed an annual premium surcharge of three percent
- Allowance for insurers to set up tax-exempt trust accounts for TRIA premiums to fund future retained and government-paid losses
- Creation of a public/private commission to propose specific long-term pooling arrangements for terrorism

Another provision of the House bill that seems to have been lost as much by last-minute lobbying by the National Association of Insurance Commissioners as distaste on the part of the Senate, was one to ease Excess and Surplus lines regulations, allowing "sophisticated" policyholders to have complete freedom of market access and E&S carriers to be regulated by a single jurisdiction.

In a move that may have seemed to the politically uninitiated particularly heavy-handed, the Senate rejected meeting in conference with the House to iron out differences and basically forced that chamber to capitulate or risk TRIA's falling victim to inaction before its expiration. Some of those in the House who had labored long and hard to arrive at what they considered an enlightened approach to a long-term threat – terrorism – were clearly stung by this rejection of custom. According to House Financial Services Committee Chairman Michael G. Oxley (R-OH), "…[W]e have missed a golden opportunity to frame the TRIA program more effectively and to move to a more market-based solution….When Members, inevitably, are asked again to renew this 'temporary' program, they will correctly conclude that in 2005 the can was simply kicked down the road without any real reform." Representative Oxley's judgment was echoed by others, among them Joe Plumeri, Chairman and CEO of Willis Group Holdings, who said that "…the federal government must partner with the private insurance markets to protect our national financial and economic security."

SEVERE
Severe Risk of Terrorist Attacks

HIGH
High Risk of Terrorist Attacks

ELEVATED
Significant Risk of Terrorist Attacks

GUARDED
General Risk of Terrorist Attacks

LOW
Low Risk of Terrorist Attacks

TRIA 2002 vs. TRIA 2005

Original TRIA	Final 2005 Bill
Covered all commercial lines except: federal or other crop, livestock, private mortgage or title, financial guaranty, medical malpractice, health or life or NFIP insurance; reinsurance.	Deletes the following lines of coverage: Commercial Auto, Burglary and Theft, Surety, Professional Liability (except Directors & Officers) and Farm Owners Multi-Peril insurance.
In 2005, eligible insurer deductible was 15 percent of direct earned premiums.	Increases eligible insurer deductible to: 1. 17.5 percent of direct earned premiums in 2006 2. 20 percent in 2007
Eligible insurers were required to make coverage available for qualified lines of coverage in amounts and on terms not materially different from coverage available for other events.	Makes no changes to the "make available" provision.
In 2005, insurer coinsurance above deductible was 10 percent.	Insurer coinsurance above deductible remains at 10 percent for 2006, rising to 15 percent in 2007.
"Certified terrorism" was applied only to acts committed on behalf of any foreign person or interest with the intent to coerce the population or government of the United States.	Makes no changes in the definition of "certified terrorism."
In 2005, mandatory recoupment of the US government's share of losses was for the difference between $15 billion and the amounts retained by insurers, not to exceed a three percent annual surcharge on premiums on qualifying commercial policies for all policyholders. The Treasury Department had the discretion to seek recoupment for additional government share of losses but not to exceed three percent.	Continues mandatory recoupment payments from all policyholders for the difference between $25 billion and the amounts retained by insurers in 2006 and $27.5 billion and the amounts retained by insurers in 2007, not to exceed a three percent annual policyholder surcharge. The Treasury Department continues to have discretion over any further recoupment subject to the same percentage limitation.
The qualified event minimum threshold was $5 million.	The same threshold applies for purposes of declaring a "certified act of terrorism," but insurers will receive no compensation until the industry losses reach $50 million in 2006 and $100 million in 2007.

For many policyholders whose contracts ran past December 31, 2005, there is little change in coverage or premium for the remainder of their policy terms. Several exceptions apply, however:

- For those with ISO-based Conditional Exclusions ("pop up" endorsements) attached to their contracts, 1) for covered lines of business, additional premiums may be due or 2) absolute exclusions of or sub-limits on terrorism became effective on or about midnight December 31, 2005 for those lines of coverage newly excluded from TRIA, i.e., Commercial Auto, Burglary and Theft, Surety, Professional Liability (except Directors & Officers) and Farm Owners Multi-Peril insurance, unless otherwise notified by the insurer(s);
- Certain insurers (Lloyd's being one) attached endorsements that excluded "certified acts of terrorism" at midnight December 31, 2005 without regard to TRIA's extension for the lines of coverage involved (NMA2969A is an example). Because of guidance issued by Treasury on December 29, it is interpreted that these insurers have until January 31, 2006 (and perhaps longer) to make a new offer of insurance that must be accepted or rejected by the insured before this exclusion is invalidated. Willis believes this suspension of coverage is outside the spirit, if not the letter, of the extension legislation and we are appealing this to Treasury. We are also pressing such insurers for timely offers of mandated cover should Treasury not respond in the positive on a timely basis.

Be aware that rating structures are not addressed in the original Act or its extension. Therefore, additional premiums may not necessarily be pro-rata of those previously charged.

For those whose policies for covered lines renewed on January 1, but who did not receive offers of TRIA coverage due to the delay in the extension legislation, the same interpretation is being made: insurers have until January 31 (or later) to extend the offer of coverage for acceptance or rejection and until then, the TRIA exclusion applies.

Insurer reactions to the changes in TRIA are not yet clear. In private conversations prior to the act's extension many of them pointed to the sizeable retentions they were already bearing in 2005 as an indication of how little protection they felt TRIA really provided. In this regard, a report issued by Bank of America Securities[1] outlined the following for certain of the insurers they cover:

Company	Estimated 2006 Deductible	Percentage of Equity at 9/30/05
Ace Group	$1.3 billion	12.5
Arch Capital	$0.3 billion	13.5
Chubb Corporation	$1.4 billion	12.0
Hartford	$1.1 billion	6.9
St. Paul Travelers	$2.0 billion	9.0
XL Capital	$1.4 billion	19.8

In the same conversations, these insurers spoke of their underwriting terrorism to an "acceptable accumulation" taking into account their aggregations across covered lines of business. Some sought the elimination of Auto Liability, and all feared the requirement to make NBCR available. To the extent the final legislation accomplished the first and did not encompass the second, there were probably few surprises for insurers.

The failure to extend TRIA to cover domestic terrorism means clients and prospects may still be subject to sub-limits from certain insurers on this risk. Unfortunately, few insurers have taken the steps necessary in their policy languages to clearly differentiate this from vandalism, which should otherwise be a covered cause of loss. And the need to cover exposures outside the United States, its territories and possessions still remains for global corporations. In both these regards, and with TRIA's fate resolved for the moment, the stand-alone Terrorism market is robust and active. The Willis Terrorism Practice can assist in securing alternative proposals.

At this juncture, US-domiciled captives continue to be the only source of NBCR coverage in the United States in any material amounts. Please consult a representative of Willis CAPS for captive solutions.

Will 2007 be déjà vu all over again? It seems clear that without a major change in thinking in the Senate, the prospects for a further extension of TRIA at the end of 2007 are dim. Senate Banking Committee Chairman Richard Shelby (R-AL) and others on his side of the aisle have been averse to TRIA since its introduction and have been vocal about ensuring that this program does not become a permanent government "handout" to the insurance industry.

For those of us who do not relish another round of nail biting at the end of 2007, now is the time to begin lobbying for a permanent solution to what seems to be a permanent threat to the US economy – terrorism.

[1] Equity Research, Bank of America Securities, December 12, 2005

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