

TRIA UPDATE 2008

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Terrorism Risk Insurance Act (TRIA)

On 19 December Congress passed a long-term extension of the Terrorism Risk Insurance Act (TRIA). The bill, which now requires the President's signature for enactment into law, will extend the federal terrorism backstop for seven years and end the distinction between foreign and domestic acts of terrorism.

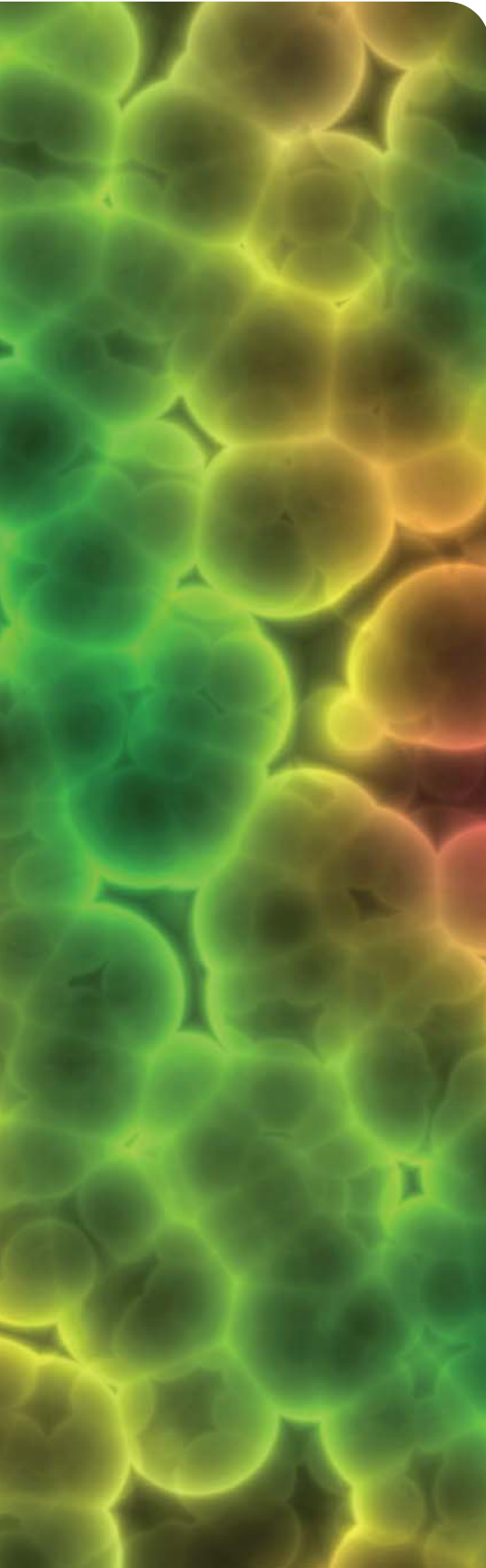
The passage of the bill has been a drawn out process and comes only days before TRIA was due to expire on 31 December 2007. The debate surrounding renewal was reminiscent of the 2005 renewal when the decision also went down to the wire.

Both houses of Congress have been holding hearings debating the merits or otherwise of a TRIA renewal and the regulatory bodies, insurers, agents and other interested parties have been giving their views on the issue. The House was initially in favour of extending TRIA for 15 years and expanding coverage to include group life cover and Nuclear, Biological and Chemical attacks, ending the distinction between certified and non-certified acts. In contrast, the Senate advocated reducing the terms of cover and is opposed to extending the bill for more than seven years. The White House stated early on in the debate that its views were more closely aligned with that of the Senate and the Presidential veto will be invoked if the House version of the bill passes Congress.

Since TRIA's inception, the US government has reiterated its position that it was a temporary measure to encourage the insurance industry to develop terrorism cover. The National Economic Council stated in March 2007 that "t[he] President believes that, in the long run, TRIA is not needed." While TRIA should not be eliminated immediately cover should not be expanded with the intention that it will be phased out over time. The President's Working Group on Financial Markets concluded that the existence of TRIA has negatively affected the development of a more robust market for terrorism insurance. In contrast, the insurance industry claims that TRIA provides the bedrock for insurance coverage and that without it there would not be a private market for terrorism insurance.



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Outcome of the Debate

Term of the Bill

The bill will be extended for a seven year term. On a practical level this is desirable because repeated debates on the provisions of TRIA are an inefficient use of legislative time. From a business perspective the extension for a longer term provides the insurance market with the continuity and certainty required for determining premium rates and capacity, the issuance of multi-year policies and the provision of cover for long-term commercial development projects. The biggest problem surrounding TRIA has been the frequency of renewals, which create uncertainty in the insurance market. As the 2007 renewal loomed contracts for insurance that extend into 2008 were being written with "sunset" provisions making terrorism coverage contingent on the extension of the programme.

The 15 year extension initially requested by the House was considered to be untenable. Governments find it habitually challenging to plan far beyond the next election cycle and it is incredibly difficult to design a bill that will have continuing relevance in the face of political and economic change.

Nuclear, biological & chemical explosives

The bill does not include cover for Nuclear, Biological and Chemical attacks. This would have constituted a dramatic extension to the provisions causing property carriers offering TRIA to drastically reduce their lines, prices to rise significantly and some providers to leave the market.

Even in its current form there is limited capacity for high risk targets such as oil refineries, airports and sporting venues and densely populated areas like New York City. The inclusion of NBC would cause the market to contract further. This is evidenced by increased regulator scrutiny, since 2005, of insurers required to potentially retain more risk in the event of an incident covered by TRIA. The increases in deductible and coinsurance have led to heightened insurer sensitivity to aggregate exposures, which has led to a capacity strain in major metropolitan areas.

Fair value is difficult to ascertain in terrorism insurance pricing. In the absence of big losses, which would reveal the true costs of claims, insurers are managing their books to prevent accumulation. The inclusion of NBC would have made pricing more uncertain as there is no historical benchmark against which to quantify the impact and cost of such attacks. A 'chemical' attack is particularly broad and the scale will depend on the type of chemical. In the event of a biological attack it will be difficult to convince the public that a building is free of anthrax for example and some insurers believe that the building would have to be destroyed and rebuilt before the public could be convinced to re-occupy it.

Lobbies are generating support for the federal government to provide "first dollar coverage" for nuclear, biological, chemical and radiological (NBCR) risks since they are acts of war that the insurance industry is not capable of insuring against.

US vs. non-US attacks

The bill removes the current distinction between certified and non-certified attacks. The logic for the distinction has diminished since 9/11 as home grown terrorists have become the more likely perpetrators of terrorist attacks, the 7/7 bombings being a notable example. It would be difficult for the new bill not to end this distinction. Public outrage would ensue were a claim for a large-scale terrorist attack to be declined because the perpetrators were US citizens and the federal government would find itself contributing to the reconstruction.

Trigger level

The bill keeps the trigger level at \$100 million. This was widely anticipated and is not expected to impact on capacity or premiums. Terrorism insurance is viewed as a form of catastrophe cover and in the event of a terrorist attack losses are expected to far exceed \$100 million.

Reinsurance

US insurers reinsure their retention in excess of TRIA in the London market. In the absence of TRIA or if the terms had become less favourable to the insurance market, a major constraint may have been the increasing cost of reinsurance and the amount of business insurers need to write to pay for it.

The Past as a guide

It took more than a year after the terrorist attacks of 9/11 for the US government to pass a bill whereby the federal government offered financial support to business and the insurance

sector in the event of a foreign terrorist attack in the United States producing at least \$5 million in insured losses. The Act, passed by Congress in November 2002, created a three-year programme. The insurance market was responsible for covering 10% of all losses exceeding the deductible, with the federal government bearing the remaining 90%.

As anticipated, in December 2005 the Act was extended for a further two years with a substantial increase to the risk retained by insurers in the deductible layer and in the vertical coinsurance layer. The threshold for losses was raised from \$5 million to \$50 million in 2006 and \$100 million in 2007. Previously each insurer's deductible was set out at 7% of its previous year's direct earned premium for 2003, at 10% for 2004 and at 15% for 2005. Under the extension, the overall industry deductible was increased to 17.5% in 2006 and 20% in 2007. The division of losses exceeding the deductible remained unchanged.

Coverage was also reduced under the extension. Commercial automobile, surety, burglary, theft and professional liability were excluded. Directors and Officers liability was covered.

Conclusions

Had Congress failed to extend the bill, which banned insurers from excluding terrorism coverage from their property/casualty policies, insurers made it clear that they would immediately start excluding terrorism cover. This decision may have created



the circumstances in which the US market was unable or unwilling to meet demand for terrorism cover, forcing companies to approach the international market, namely London and Bermuda. If they do, companies are likely to balk at the price. The US market is now six years away from the last significant terrorist event. Memories fade and tolerance for paying high premiums is limited.

This is a scenario the federal government will want to avoid. In the event of a major terrorist attack, the federal government does not want to

find itself financing the fallout of a country with little or no terrorism cover. The impact on the economy will be tremendous and the federal government will be forced to assist businesses and individuals affected by an attack. This is the strongest incentive for the renewal of TRIA.

The worst case scenario would have been the failure of Congress to agree the terms of the TRIA extension and/or the use of the Presidential veto could create a situation of limbo entering an election year. Presidents only like "slam

dunk" bills in an election year and a significant dispute within Congress or between Congress and the White House would have been viewed as dangerous. This situation has been avoided with the passage of the bill through Congress and it is widely expected that the President will sign the bill into law before the end of the year.

If you would like to discuss the issues raised in this bulletin, please speak with Matthew Strong on +44 (0) 207 558 3778 or email matthew_strong@jltgroup.com

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