

September 16, 2013

Michael T. McRaith  
Director, Federal Insurance Office  
Room 1319 MT  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

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

Dear Director McRaith:

We write on behalf of the National Association of Insurance Commissioners (NAIC) to offer comments regarding the President's Working Group on Financial Markets' analysis of terrorism risk insurance. Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer reviews, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

State insurance regulators have supported the Terrorism Risk Insurance Act (TRIA) since its inception and its subsequent reauthorizations, and the NAIC recently adopted a resolution reiterating its strong support for continuation of the program. We believe that the presence of a federal partnership with the private insurance markets has provided a measure of security to the insurance industry by minimizing market disruptions and ensuring the widespread availability and affordability of property and casualty insurance for terrorism risks. The availability of this coverage provides stability to commercial policyholders, lenders, builders, and the businesses that operate in urban centers and other areas prone to a terrorist attack. This public-private partnership ensures that insurers bear primary financial responsibility for losses from terrorism and must make the coverage available, while effectively capping the magnitude of losses and recouping federal funds if they are expended.

State insurance regulators have not seen evidence to suggest that the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing terrorism risk coverage. The difficulty in accurately determining the frequency, severity, and loss costs for acts of terrorism makes coverage for acts of terrorism one that insurers would likely choose to avoid if given the opportunity. If TRIA were allowed to expire, some insurers might place limitations on commercial insurance policies to exclude terrorism coverage or choose to withdraw from the market completely. While a permanent solution to terrorism risk insurance would be ideal, we support a prompt, long-term reauthorization of TRIA to help ensure economic stability through the availability of terrorism coverage.

Attached to this letter are the NAIC's responses to the questions posed in the Federal Register. The NAIC and its Terrorism Insurance Implementation Working Group look forward to a continued dialogue with the Department of the Treasury regarding long-term solutions to address the risk of loss from acts of terrorism. Should you have any questions regarding these comments please do not hesitate to contact Eric Nordman, Director of the Regulatory Services Division and Director of the Center for Insurance Policy and Research, at (816) 783-8005 or Brooke Stringer, Financial Policy and Legislative Advisor, at (202) 471-3974.

Sincerely,



James J. Donelon  
NAIC President  
Louisiana Insurance Commissioner



Adam Hamm  
NAIC President-Elect  
North Dakota Insurance Commissioner



Monica J. Lindeen  
NAIC Vice President  
Montana Commissioner of Securities & Insurance



Michael F. Consedine  
NAIC Secretary-Treasurer  
Pennsylvania Insurance Commissioner

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

## *TRIA Termination Considerations*

- (1) Describe and explain in detail any and all possible ramifications from the termination of the Program on December 31, 2014, including any available evidence to support the predicted result, regarding: (a) The availability and affordability of insurance for terrorism risk in the United States generally;**

*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 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.*

*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. If TRIA is not reauthorized, the absence of a federal backstop may 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 that, in the past, the insurance industry has filed conditional exclusions<sup>1</sup> in all states, and has received approval to use them in all but two states. 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.*

- (b) The availability and affordability of insurance for terrorism risk in the United States specifically by line of business; geographic location, including the rating tiers defined by the Insurance Services Office, Inc.; and other relevant characteristics;**

*The availability and affordability of terrorism insurance suffers in areas often referred to as Tier 1 terror targets, i.e., those that due to their size, location and potential impact on the economy as a whole are primary targets for terrorist groups. Terrorists seek to inflict maximum loss,*

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<sup>1</sup> Conditional exclusions for terrorism are policy endorsements that add terrorist events to the standard war and military action exclusions, in the event the TRIA program is either not reauthorized or undergoes major changes. These exclusion endorsements typically apply to commercial property and liability insurance policies, and to personal lines property insurance in states that have not enacted the New York standard fire policy.

*resulting in no limit to the scale of property or casualty loss. Principal U.S. cities such as New York, Boston, Washington, D.C., Chicago, Miami, Houston, San Francisco and Los Angeles are the primary focus of terrorism, making these risks highly concentrated. This leads to adverse selection as the strongest demand for terrorism insurance originates in these geographic areas. If TRIA is not extended, state regulators believe terrorism insurance would become less available and affordable in the areas with the most need for coverage. We also believe that the elimination of the program may negatively impact the availability of insurance in mid-size cities and some types of commercial enterprises as well.*

*Workers' compensation coverage is a special case since 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 that 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.*

**(c) Additional specific effects on commerce in the United States.**

*As stated above, state regulators believe the expiration of TRIA would lead to terrorism insurance becoming unavailable and unaffordable as the insurance marketplace is not willing to voluntarily take on the risk of providing coverage for acts of terrorism. Insurers are not willing to jeopardize their financial health by accepting the potential unlimited severity and unpredictable frequency. This would lead to many businesses not having proper terrorism risk coverage, leaving them vulnerable to terrorism acts. In the absence of reauthorization, many businesses could not get proper coverage. During past debate over reauthorization of TRIA, regulators report 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 as mortgage lending and securitization of mortgage loans provides a significant portion of the GDP. One rating agency has said it may decline to rate commercial mortgage backed securities on transactions that lack sufficient terrorism insurance.*

*Insurance regulators in the Northeast have been involved with the rebuilding of infrastructure and communities after the destruction of Superstorm Sandy and they are particularly concerned that the expiration of TRIA would severely harm the rebuilding efforts. Further, building owners in Tier 1 & 2 areas might have difficulty attracting tenants as they might be unable to obtain coverage on the building and the tenants might be unable to obtain coverage on business operations and workers' compensation covering their employees.*

*Rating agencies have publicly stated they are seeking detailed plans from insurers in the event that the Program is not renewed due to rating concerns over the availability and affordability of terrorism coverage in the absence of a federal backstop. Insurers without a sufficient plan of action to handle terrorism risks may face rating downgrades as the expiration date approaches.*

- (2) If the Program were to continue beyond December 31, 2014, describe and explain in detail any revisions or modifications to the Program that would promote the availability and affordability of terrorism insurance, including any accompanying challenges that might arise from any proposed revisions or modifications to the Program. All views regarding the appropriate role of the federal government in supporting the availability and affordability of insurance for terrorism risk are welcome.**

*State insurance regulators encourage the development of a permanent solution to terrorism risk insurance in order to avoid the market disruptions and uncertainty associated with continual short-term reauthorizations. While ideally we would support a permanent solution, we recommend a prompt, ten-year TRIA reauthorization.*

*State insurance regulators believe that reauthorization of the Program is needed to provide a measure of security in the insurance industry and to enable insurers to extend offers of coverage for acts of terrorism. Regulators have particular concern with the timing of any revisions or modifications to the Program. A delay in the reauthorization of the Program creates uncertainty and deprives insurers of adequate time to make necessary changes to systems, potentially leading to issues with policy renewals for policyholders. Regulators have already reported receiving filings that provide conditional exclusions in the event that the Program is revised or does not continue. These conditional filings apply to changes to deductibles, co-pays, limits and other changes in the Program. These exclusions create uncertainty in the marketplace with policyholders.*

*The commercial insurance business cycle operates in such a way that insurers and their policyholders will be required to make decisions as early as September 2013 for coverage going well into 2015. Annual policy renewals with effective dates of January 2, 2014, or later will have to contemplate no federal backstop for any losses in 2015. As a result, insurance regulators in most states are approving and will have to approve conditional coverage limitations for terrorism coverage for renewal policies on a widespread basis, just as they did in the 2006-2007 time period.*

*If triggered by the expiration of TRIA, these limitations would greatly reduce or eliminate 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 near future. With the 2014 renewal cycle already underway, there is greater uncertainty in the marketplace. For these reasons, insurance regulators encourage action by Congress this fall rather than waiting until 2014 to address the matter.*

### ***Insurance Market Considerations***

- (3) Describe and explain the ability of the insurance industry to model, quantify, and underwrite terrorism risk, and the resulting impact of such analysis on the availability and affordability of terrorism insurance, including an examination of the price (by line of business, location of risk, and other relevant characteristics) and coverage options for terrorism insurance.**

*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 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.*

*A recent presentation by a catastrophe modeler before the NAIC Property and Casualty Insurance Committee gave regulators insight into current modeling developments. An interesting comment from the modeler was that the TRIP was needed because insurers are essentially agreeing to provide coverage for government's failure to protect its citizens from terrorist acts. The modelers have learned that the more individuals there are involved in plotting a terrorist act, the more likely they are to be caught through governmental anti-terrorism efforts. They remain uncomfortable with their ability to model the severity of terrorism losses or the frequency. The frequency is dependent on the success of government anti-terrorism activities and the severity is boundless, according to the modeler.*

- (4) Describe and explain, with supporting information where available, any additional insurance market considerations that could impact the long-term availability and affordability of terrorism insurance (e.g. implications for coverage of insurance for nuclear, biological, chemical, and radiological acts of terrorism; cyber acts of terrorism; and terrorism in workers' compensation policies).**

*The magnitude of potential terrorism risks, for example, those from nuclear, biological, chemical, and radiological (NBCR) losses, is so great that it does not conform to the traditional methods available to insurers to spread and share the risk. Industry representatives consider the limited amount of capital available to insure all commercial losses to be inadequate to cover a large-scale NBCR event. An NBCR event has the potential to affect a large geographic area. This creates a large potential concentration of risk 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.*

*Preliminarily, the NAIC would like to provide a general overview of NBCR 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 TRIA terrorism coverage. A terrorist event involving a nuclear/radiological device would not result in coverage because TRIA 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 TRIA 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 exclusion for losses from chemical or biological weapons. 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. TRIA 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 TRIA 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 NBCR events.*

*To the extent that coverage for NBCR events exists in primary policies, as explained above, insurers are required to make it available pursuant to TRIA 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 NBCR 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 TRIP coverage.*

*There is a report by the Government Accountability Office (GAO) on the topic of NBCR coverage (GAO-09-39). The findings in the report are as accurate today as they were when the report was written. The GAO found insurers generally seek to exclude coverage for NBCR events in commercial policies, relying on long-standing standard policy exclusions for nuclear and pollution risks. Further, the GAO found insurers "generally remain unwilling to offer NBCR coverage because of uncertainties about the risk and the potential for catastrophic losses..." Regulators believe these findings accurately describe today's marketplace.*

*Most standard commercial lines policies do not cover cyber risk. To cover these unique cyber risks through insurance requires the purchase of a special cyber liability policy. The markets for these policies are relatively new with a growing number of insurers offering coverage. Like all new markets, coverage contained in the policy forms is evolving as risks evolve and competitive forces come into play. There are some risks that are commonly covered by cyber liability policies. Generally cyber liability policies cover a business' obligation to protect the personal data of its customers. The data might include personal identifying information, financial or*

*health information or other critical data that if compromised could create a liability exposure for the business. The policy will cover liability for unauthorized access, theft or use of the data or software contained in a business' network or systems. Many policies also cover unintentional acts, errors, omission or mistakes by employees, unintentional spreading of a virus or malware, computer thefts or extortion attempts by hackers. At this time, insurance regulators do not believe it has been demonstrated that there is a need for acts of cyber terrorism to be included in TRIA.*

- (5) Explain and describe in general the demand (or “take-up”) of terrorism insurance and provide specific data and information, where available, regarding the take-up rate by line of business, location of the risk, and other relevant characteristics.**

*The insurance industry is best suited to address this issue.*

### ***Reinsurance Considerations***

- (6) Describe and explain in detail the long-term availability and affordability of private reinsurance for terrorism risk. Analyze, with supporting information, the impact of the Program, and any changes to the Program, on the private reinsurance market for terrorism risk, including any accompanying challenges that might arise from revisions or modifications to the Program.**

*The reinsurance industry is best suited to address this issue.*

### ***Additional Consideration***

- (8) Describe and explain any other developments, considerations, or market issues that might affect the long-term availability and affordability of terrorism risk insurance.**

*TRIA provides insurers with the security they need to allow them to offer coverage for acts of terrorism. It gives insurers a boundary on their ultimate costs of insuring the risk, and provides the maximum probable loss statistic for ratemaking and solvency purposes. It is important to note that TRIA requires the private insurance industry to cover losses up to \$100 million, and only after that point would the federal government provide assistance. To date, this threshold has never been met and the federal government has never paid claims under TRIA. If the federal government were to pay claims under TRIA, there is a recoupment mechanism so, in most cases, losses paid for by the program would be reimbursed by a surcharge on property and casualty policies in future years. In our view, a permanent solution to insuring for terrorism risks would be ideal, but we urge a prompt, ten-year reauthorization of TRIA to avoid disruptions to the commercial insurance marketplace.*