

**PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS:
TERRORISM RISK INSURANCE ANALYSIS**

COMMENTS OF

THE COALITION TO INSURE AGAINST TERRORISM

AUGUST 2, 2010

The Coalition to Insure Against Terrorism ("CIAT") files these comments in response to a request by the President's Working Group on Financial Markets ("PWG") published in the June 17, 2010 Federal Register. 75 Fed. Reg. 34530. CIAT is a broad coalition of commercial insurance consumers formed immediately after 9/11 to ensure that American businesses could obtain comprehensive and affordable terrorism insurance. CIAT joined Congress and the Administration in recognizing that only the Federal government could provide the framework to make this coverage available to all those who required it. The diverse CIAT membership represents virtually every sector of the U.S. economy: hotels, insurance, banking, energy, construction, entertainment, real estate and real estate finance, stadium owners, manufacturing, transportation, as well as public sector buyers of insurance. CIAT previously filed comments on terrorism insurance with the PWG on April 21, 2006, and is pleased to have the opportunity to do so again.

CIAT has carefully reviewed the 32 specific questions posed by the PWG and has identified 19 of these questions that call for policyholder comment. In preparing the following comments, we circulated the identified questions among its members and collected responses based upon the member's individual experiences. We then reviewed the various responses received and drafted answers to the identified questions, which were re-circulated for further input from our members.

I. RESPONSES TO SPECIFIC QUESTIONS

3. How, in general, has the state of the financial markets and economy, and the financial condition of commercial property and casualty insurers, affected the availability and affordability of terrorism risk insurance; and how does that compare with effects on the availability and affordability of other lines or types of commercial property and casualty insurance? Please comment on potential entry of new capital into, as well as any exits from, the terrorism insurance and reinsurance markets.

CIAT Comment: CIAT members have generally not seen any impact on the terrorism risk insurance market that would be attributable to the state of the financial markets. While our members believe that insurers have had to exercise greater discipline in underwriting as their investment income decreases, the availability and affordability of terrorism risk insurance has been stable throughout the turmoil in the financial markets.

We attribute this stability solely to the existence of the TRIA backstop and believe that the expiration of the TRIA program would lead to a substantial amount of volatility. The current state of the economy has been difficult on many CIAT members, particularly in the commercial real estate ("CRE") finance sector. While the CRE finance market is starting to show signs of life, any disruption in the availability of terrorism insurance in that sector would have serious consequences on its fragile road to recovery.

5. What role do mitigation and loss prevention play in underwriting and pricing terrorism risk insurance? How has mitigation developed since 2002, what

improvements have been made since 2006, to what effect has the availability of terrorism risk insurance had on mitigation and vice versa; and, how will mitigation evolve in the long-term?

CIAT Comment: CIAT members have implemented many mitigation and loss prevention measures related to terrorism, such as physical protection/security of the premises and personnel (including access controls), employee/vendor background checks, threat escalation and response plans, safety and evacuation plans, contingency plans/back-up systems, and product tampering protections. In some cases insurers have inquired about the details of such measures. We generally believe that such measures may have had some impact on the price and availability of terrorism insurance; however, we do not believe that the converse is true – *i.e.*, the availability of terrorism insurance has not impacted decisions by policyholders to implement mitigation and loss prevention measures. We do not know the extent to which such measures factor in to the cost of insurance, and it is less likely that they are a significant factor in high-risk areas. As we understand it, the modeling of terrorism risk, while improving to some extent with respect to smaller events, is still in the infancy stage regarding catastrophic events.

Furthermore, terrorism risk, by its very nature, is not an area that provides much clarity as to the sorts of mitigation/loss prevention measures that will be most effective. The objective of terrorism, after all, is to circumvent such measures. Thus, over the long term, while CIAT members continue to seek ways of "hardening" their properties against terrorism, they cannot eliminate the risk that terrorists may pursue extreme methods to cause catastrophic losses.

7. What changes and improvements have taken place with regard to the types of terrorism risk insurance coverage available in the market? What changes and improvements have taken place since 2006? Have there been improvements and changes in forms, are there special terms or conditions? What is the state of standalone, "TRIA-only" coverage? Is available coverage limited to, or broader than that required to be made available under TRIA?

CIAT Comment: CIAT members have seen very little change since 2006 in the types of terrorism risk insurance available, with the exception of coverage for domestic terrorist acts, as such coverage is now included under TRIA. Our members have reported that standalone terrorism coverage for both "TRIA-only" and non-TRIA certified acts of terrorism is available, although there are underwriting restrictions on such coverage and it may not be available (or available in adequate amounts and at acceptable cost) for certain geographic areas. What is clear is that the coverage that is available in the insurance marketplace closely tracks what is covered by TRIA. Indeed, even where coverage can be found for uncertified terrorism events, we do not believe that such coverage could be offered but for the critical TRIA protection for certified acts. The TRIA backstop, therefore, is a significant factor in the health of the standalone terrorism market.

TRIA is a public-private partnership where all stakeholders shoulder some of the risk for terrorism events. While the coverage provided by insurers generally tracks what is

backstopped by TRIA, the federal government does not bear the entire burden of the TRIA program. While the federal backstop is an important component, policyholders and insurers also share terrorism risk. Policyholders, of course, pay premiums and have their own retentions in TRIA-backed policies, and are also subject to post-event TRIA surcharges that recoup a defined amount of the federal share of compensation. Insurers retain their own statutory deductibles and co-shares as well.

8. What are the differences in availability and affordability of terrorism risk insurance coverage for foreign and domestic terrorist acts?

CIAT Comment: CIAT members have generally seen no difference in the availability or affordability for foreign versus domestic terrorist acts. Coverage is available for both, and policies generally do not distinguish between them. CIAT believes this is largely because the TRIA backstop is now available for both types of acts pursuant to the Terrorism Risk Insurance Program Reauthorization Act of 2007 ("TRIPRA"). As noted above, the coverage that is available in the insurance marketplace tracks what is backstopped by TRIA, and therefore the impact of TRIPRA's inclusion of domestic terrorism was immediately felt in the marketplace.

9. Did the Terrorism Risk Insurance Program Reauthorization Act of 2007's amendment to the definition of "act of terrorism" lead to more availability due to the requirement that such coverage be made available, or was such coverage available prior to 2007; conversely, did the amendment lead to less coverage due to the broadened scope of "act of terrorism" exclusions, or were exclusions revised to distinguish between coverage of foreign and domestic terrorist acts?

CIAT Comment: While CIAT members noted that some (though not all) insurers offered coverage for domestic terrorist acts prior to the 2007 reauthorization, the elimination of the foreign v. domestic terrorism distinction has removed a great amount of uncertainty in the marketplace. Prior to 2007, policyholders faced the prospect of delays in payment – or outright coverage denials – while the nationality of the perpetrator was determined. Those that did have coverage for so-called "domestic" terrorist acts often paid an additional "non-TRIA" premium. Since the 2007 reauthorization, we have seen no decrease in coverage availability through the use of exclusions.

The spectrum of American citizens with affiliations to, or simply having sympathy for, foreign terrorist groups can often blur the lines in determining what is a foreign act or a domestic act. CIAT believes that the elimination of the foreign v. domestic terrorism distinction has had a positive effect on market certainty, and for this reason we strongly oppose any effort to return to the pre-TRIPRA "act of terrorism" definition.

10. What are the differences in availability and affordability of terrorism risk insurance coverage for losses at U.S. locations, as compared to such coverage for losses at non-U.S. locations? What are the differences as compared between TRIA-covered locations and non-TRIA locations?

CIAT Comment: Those CIAT members with properties in non-U.S. locations have found that comparing the availability and affordability of terrorism risk insurance depends primarily upon the location of the risk. In particular, some members have found that terrorism risk insurance is more readily available in countries where there is a government-backed program or pool, such as Pool Re in the United Kingdom, GAREAT in France, ARPC in Australia, and Consorcio in Spain. A recent study by Marsh identifies 18 such programs worldwide (including TRIA), while noting that "the standalone terrorism and political risk markets can also offer broader political violence insurance to clients with locations in developing countries." *The Marsh Report: Terrorism Risk Insurance 2010*, pp. 31-32, (available at www.themarshreport.com/terrorism2010). Additionally, the Government Accountability Office noted the existence of such programs in several European countries in a 2005 report to the House Financial Services Committee. U.S. Gov. Accountability Office, *Catastrophe Risk: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks*, pp. 38-46 (2005)(available at: www.gao.gov/new.items/d05199.pdf).

In general, we believe the majority of our members' non-U.S. properties are in countries with such programs, but some also have properties/operations in numerous countries without such programs. Absent these government sponsored programs, policyholders are subjected to a stand alone insurance market which, depending on risk characteristics, can result in higher costs and restrictive terms.

12. To what extent have businesses used captive insurance companies to provide terrorism risk insurance, and what is the potential for the use of captive insurers to insure against such risk long-term? How have stand-alone terrorism captives developed, and how will these evolve long-term, including after the expiration of the Program in 2014?

CIAT Comment: Several CIAT members have used captive insurance companies as a part of their overall insurance and risk management programs for many years, often to provide enhanced coverage that is not generally available, or to decrease third party premium costs for risks that the captive owner is comfortable in retaining to a larger extent. The use of captives by businesses, including our members, pre-dates TRIA, and such captives may be used to accomplish many different objectives and are often used by our members to insure a much broader range of perils and coverages than terrorism risk alone.

With respect to terrorism coverage, however, they have proven to be useful in enhancing the captive owner's overall insurance program, such as by providing excess coverage when other insurance does not provide high enough limits. Captives have also been used to provide additional coverage that is otherwise unavailable or prohibitively expensive. Such coverage can include cyber-risk, which is typically excluded from property policies. See *The Marsh Report*, p. 28. Several CIAT members have also reported using captives to provide coverage for chemical, nuclear, biological and radiological ("CNBR") terrorism perils, due to the fact that such coverage is not otherwise widely available. Indeed, several of our members see captives as the only way to access affordable CNBR

coverage, and this is only the case because such captives are mandatory participants under TRIA and thus have the TRIA backstop. Were TRIA to expire, our members believe that CNBR coverage would decline substantially, as it is unlikely that a captive insurer would be able to completely replace the protection provided by the TRIA backstop with private reinsurance.

13. Have state approaches (such as those applicable to mandatory coverage, permitted exclusions, and rate regulation) made coverage more or less available and affordable? Have there been any changes in state insurance regulation of terrorism risk insurance since the Terrorism Risk Insurance Program Reauthorization Act of 2007 was enacted? To what extent has the availability and affordability of terrorism risk insurance been influenced by state insurance regulation, and what role is state regulation expected to have long-term? Please comment on state-approved terrorism related rate loads.

CIAT Comment: CIAT members have generally not seen a large impact upon the affordability and availability of terrorism risk insurance due to state-based approaches. One area where our members have seen some impact is in states that mandate use of the Standard Fire Policy ("SFP") and prohibit the exclusion of losses resulting from a fire following an act of terrorism.¹ Here, some of our members have indicated that certain insurers have been hesitant to provide all risk coverage options in SFP states due to concerns regarding the state mandated "fire following" coverage requirement, and that in certain high-risk areas like New York (an SFP state), it may even result in reduced capacity. Another issue identified in this area is that "fire following" coverage is offered on an Actual Cash Value basis, whereas most properties are insured on a Replacement Cost basis. TRIA, therefore, remains the critical element in ensuring that policyholders have access to affordable terrorism coverage.

14. What are the differences in availability and affordability of terrorism risk insurance between the licensed/admitted market and the non-admitted/surplus lines market, and to what degree are those differences attributable to the degree and manner in which each market is regulated?

CIAT Comment: CIAT members have generally not seen wide differences between the admitted and non-admitted (surplus lines) markets, and we attribute this to the fact that most insurers who do business on a surplus lines basis are also eligible for the TRIA backstop. When differences can be found between the admitted and non-admitted markets, it may be attributable to the non-admitted market adding coverage enhancements more readily.

16. What have been the trends in pricing of terrorism risk insurance? Please comment on the extent to which such coverage is not priced and charged-for.

¹ We understand that 14 of the SFP states have passed legislation to permit terrorism exclusions in SFP policies. See *Marsh Report*, p. 9. We also understand that Massachusetts is considering such legislation in its current legislative session.

How has pricing changed since 2006, when the President's Working Group on Financial Markets issued its last report? To what do you attribute any changes?

CIAT Comment: CIAT members have generally seen a decline in pricing for terrorism insurance. We do not attribute the decline in pricing to the normal ebb and flow of the insurance market, but rather we believe the decline in price is largely due to the continued availability of the TRIA backstop and the fact that there have been no certified acts of terrorism since the enactment of TRIA.

17. How has the recent "soft market" impacted the availability of and affordability of terrorism risk insurance? What would be the impact on the availability and affordability of terrorism risk insurance should the market "harden" in near future?

CIAT Comment: As noted above, CIAT members do not believe that the general insurance market condition is the primary driver of the affordability and availability of terrorism risk insurance – rather, it is the continued availability of the TRIA backstop and the absence of catastrophic terrorism losses in the United States in recent years. This is particularly true in the area of availability – since TRIA requires insurers to offer terrorism coverage, the hardening or softening of the insurance market does not have a significant impact upon insurers' willingness to write it. CIAT members believe that a hardening of the insurance market may contribute to some increase in the cost of terrorism risk insurance, but a major terrorist event or the expiration of the TRIA backstop is more likely to have a significant impact.

20. At what policyholder retention levels are insurance programs being structured by policyholders to cover terrorism risk (e.g., deductibles, self-insurance, captives); and, with regard to insurers, how are reinsurance programs being structured and at what attachment points? Please comment on the availability and affordability of reinsurance for terrorism risk.

CIAT Comment: Policyholder retention levels vary significantly based on a variety of factors, including pricing, exposure, and the policyholder's appetite for risk. Several CIAT members have reported seeing retention levels that mirror those for other risks, even when the terrorism coverage is written as a separate, standalone policy. It is unclear, however, the precise impact that retention levels have had upon price. *The Marsh Report* noted that terrorism insurance rates "are less subject to credits for higher retentions and loss-control efforts." *The Marsh Report*, p. 13.

The structure of terrorism insurance programs varies widely among policyholders, although it is common for larger companies, with higher total insured value, to use multiple insurers, with layered programs. See *The Marsh Report*, p. 10. Additionally, as noted above, some policyholders are using captive insurance companies to enhance their coverage – often in the area of CNBR risk and also cyber-risk.

It should also be noted, with respect to policyholder retention levels, that they will invariably include whatever post-event surcharges that would be imposed under TRIA. Indeed, policyholder deductibles in TRIA-backed policies are not a simple arms-length agreement between insurer and policyholder – they are also impacted by the fact that policyholder surcharges will apply in the event of any federal government outlay under TRIA.

24. What is the current availability and affordability of coverage for CNBR events? For what perils is coverage available, subject to what limits, and under what policy terms and conditions? Is there a difference in the availability and affordability of coverage for CNBR events caused by acts of terrorism? To what extent have various States allowed insurers to exclude coverage for CNBR events (Please comment on requirements for workers' compensation and fire-following coverage.)? How have exclusions developed?

CIAT Comment: CIAT members report that CNBR coverage is extremely limited in terms of availability and affordability. Where insurers do offer such coverage, it may be limited in terms of geographic area (*i.e.*, coverage is harder to procure in "target" cities such as New York or Washington), and it may also be limited to certain perils (*i.e.*, biological and chemical events may be covered, but not nuclear or radiological). Coverage limits for insurance that is available tend to be relatively small and expensive. For this reason, as noted above in response to question 12, several CIAT members have used captive insurance companies achieve a greater level of CNBR protection than can be found on the open market.

25. Is it the case that some insurers appear unwilling to provide coverage for CNBR events caused by acts of terrorism, despite TRIA limits on an insurer's maximum loss exposure? If so, why?

CIAT Comment: CIAT members have found that most insurers are unwilling to cover CNBR terrorism despite the availability of the TRIA backstop. We understand that the principal factor in these insurers' decisions not to cover CNBR is their lack of sufficient data to properly model their exposure to such losses with any degree of certainty.

26. In the long-term, what are the key factors that will determine the availability and affordability of terrorism risk insurance coverage for CNBR events? The President's Working Group on Financial Markets previously reported that there appeared to be little potential for market development. Has anything changed since 2006?

CIAT Comment: CIAT members have not seen any indication that a market will develop for CNBR terrorism coverage, and in that vein there has been no significant change since 2006. Key factors that our members believe would lead to broader availability and affordability for CNBR coverage include (1) a better ability for insurers to model their exposure to such losses, and (2) enhanced backstop protection under TRIA for CNBR perils.

On this last point, we would point out that the House Financial Services Committee, in considering legislation to extend TRIA's authorization in 2005, adopted a measure that would have encouraged greater availability and affordability of CNBR coverage, by requiring smaller insurer deductibles for such events. H.R. 4314, 109th Cong. (1st Sess. 2005). While this provision was not ultimately included in the legislation that became the Terrorism Risk Insurance Extension Act of 2005, we believe that policymakers may need to revisit this issue given that the market for CNBR terrorism coverage has generally not improved.

29. Describe efforts undertaken by the insurance industry and/or policyholders since 2006, when the President's Working Group on Financial Markets issued its last report, to ensure the availability and affordability of terrorism risk insurance after 2014 when the Program expires, and long-term?

CIAT Comment: CIAT members report that, from a policyholder perspective, much has been done to limit exposure to terrorism risk if TRIA were to expire in 2014. Policyholders have undertaken significant mitigation and loss prevention measures in order to "harden" themselves against terrorism risk, and policyholders have also provided data on such measures and other risk factors to insurers in order to give such insurers the most information possible to assist them in underwriting terrorism risk. In this sense, we believe that policyholders have met their obligations.

That said, there is little else that policyholders can do to impact the availability and affordability of terrorism risk insurance in a post-TRIA environment. As noted above, terrorism risk, by its very nature, is not an area that provides much clarity as to the sorts of mitigation/loss prevention measures that will be most effective. We believe that continued availability of terrorism risk insurance depends upon the existence of the TRIA backstop, as we are not convinced that insurers will be able to effectively model for catastrophic terrorism exposure.

30. Please comment on any anticipated state approaches to ensure the continued availability and affordability of terrorism risk insurance after the Program expires in 2014 (such as those approaches taken by the States after September 11, 2001 and before TRIA was enacted on November 26, 2002).

CIAT Comment: CIAT members are generally unaware of any anticipated state approaches to ensure the availability and affordability of terrorism risk insurance following the planned expiration of TRIA in 2014. Unlike certain state-level programs focused on natural catastrophes, there are no "cat fund" programs for terrorism insurance at the state level. Indeed, in the period following 9/11 and before the enactment of TRIA, many states approved the use of terrorism exclusions that made terrorism coverage very difficult to procure.

31. Please comment on any other developments in markets that might affect the continued availability and affordability of terrorism risk insurance.

CIAT Comment: While we do note that terrorism risk insurance may be available to some small extent in the commercial insurance market, we do not think such coverage would be widely available post-TRIA. One development that would undoubtedly impact the availability and affordability of terrorism risk insurance would be a catastrophic terrorist event, which we believe would lead to substantial volatility in the market and perhaps even a return to the post-9/11, pre-TRIA environment where terrorism coverage was virtually unavailable.

A development that would impact the availability and affordability of terrorism risk insurance on the positive side would be the ability of insurers to more effectively model for catastrophic terrorism exposure. As we have noted previously, however, we do not believe that insurers have that ability at present.

32. In the absence of the Program, in what forms, at what levels, under what terms and conditions, and at what price might terrorism risk insurance be available; and, at what duration (i.e., long-term)? Please distinguish from state-mandated coverage, such as workers' compensation and fire insurance.

CIAT Comment: CIAT members cannot comment specifically as to what they expect terrorism risk insurance would cost in a post-TRIA environment. We expect that coverage would be severely limited compared to what is available today, as insurers would not be willing to write coverage on similar terms without the availability of the backstop. We do not believe that private reinsurance capacity is available to fill that void. As the Marsh Report pointed out, reinsurers use only a limited portion of their risk capital to cover terrorism exposure, and typically prefer to provide such cover only in standalone contracts. *The Marsh Report*, p. 25.

We expect that state-mandated coverage, such as workers' compensation, would experience a degree of volatility in the aftermath of a TRIA expiration, as some insurers may attempt to exit certain markets. We cannot predict whether this would be a long-term problem.

II. CONCLUSIONS

Overall, TRIA has been a success in that it has ensured the availability of terrorism risk insurance and provided a mechanism for public-private sector cooperation following a future act of terrorism. The program has been improved since its enactment – particularly through the elimination of the foreign v. domestic terrorism distinction – and it has not cost the federal government anything other than modest administrative costs. Indeed, with the program's current insurer deductible levels and the program trigger, the only way in which the federal government would be required to provide compensation would be in the event of a major terrorist attack. Therefore, the TRIA program ensures that, in the aftermath of such an attack, a significant portion of the costs of recovery will be borne by the private sector. Contrast this to the ad hoc nature of prior federal disaster

responses, where recovery could be hampered by the lack of an efficient payment distribution network.

From the policyholder perspective, we have seen the cost of terrorism insurance become more affordable over the years, although we fear that another catastrophic terrorist event could lead to drastic increases in terrorism insurance premiums. A current shortcoming of the terrorism risk insurance market is the lack of adequate CNBR coverage, and some policyholders have attempted to mitigate this exposure through the use of TRIA-eligible captive insurance companies. Without the TRIA backstop, however, even the limited CNBR coverage that policyholders are able to obtain would likely disappear.

The continuation of TRIA, and the hope for a permanent solution, is important and necessary to provide firms with the reassurance that such catastrophic risks can be insured through viable, cost-effective and efficient means. The availability of TRIA enables the insurance industry to provide broader terrorism coverage at more competitive pricing, and as such, drives competition and capital to the line. Failure of TRIA to be extended would have serious consequences on the insurance market's ability and willingness to continue providing such insurance. This would have serious and adverse implications on the economic viability of business, and especially in certain "high profile" locations.

We believe the TRIA program has been a success because it provides for the sharing of risk between government, private insurers, and policyholders. Ultimately, it is critical for the U.S. economy that commercial policyholders be able to obtain coverage for terrorism risk. For the reasons stated above, we do not believe that such coverage would remain available with the necessary limits without the support of the TRIA backstop. Therefore, TRIA must be extended beyond its current 2014 authorization.

Respectfully Submitted,



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