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Proposed Terrorism Risk Insurance Act (TRIA) reauthorization may force insurance market to shoulder more risk

On 31 December 31 2014, the Terrorism Risk Insurance Act (TRIA)[1] will expire if it is not renewed by Congress. Although renewal is not guaranteed, it is likely 2015 will usher in a revised TRIA, one with more restrictive measures.

TRIA background

TRIA was enacted after the tragedies of 11 September 2001. The law introduced what was supposed to be a temporary federal program that created a system of shared public and private compensation for certain insured losses resulting from a certified act of terrorism.[2] TRIA rendered almost all policy terrorism exclusions that existed at the time of the enactment null and void, requiring property and casualty insurers to offer terrorism insurance. Under TRIA, participating insurers must offer terrorism coverage that does not differ materially from the terms, amounts, and other coverage limitations available to losses arising from non-terrorism events. In essence, TRIA provides a federal backstop for terrorism insurance policies in an effort to ensure their availability.

Under the current statutory scheme, individual acts of terrorism must exceed US$5 million in losses in the United States or to U.S. air carriers, sea vessels, or missions abroad and the act must be certified by the Secretary of the Treasury, Secretary of State, and Attorney General as an act of terrorism. TRIA is triggered when claims in the aggregate exceed US$100 million dollars. In other words, the federal government shares in an insurer's losses only after the insurance industry in the aggregate suffers losses over US$100 million. An insurer's deductible is 20% of an insurer's annual direct earned premiums on the commercial property/casualty lines of insurance specified. Once the US$100 million aggregate loss threshold is exceeded and the 20% deductible is met, the federal government will cover 85% of each insurer's losses above its deductible until the amount of aggregate losses totals US$100 billion. After US$100 billion there is no federal TRIA coverage but also no requirement that insurers provide coverage.

TRIA extension plans

There are currently two proposals to extend TRIA: a bipartisan bill originating in the Senate (S.2244) proposed by Sen. Chuck Schumer (D-NY) and a draft outline from the House Republicans drafted by Rep. Randy Neugebauer (R-TX). Both extend TRIA but in their own ways force the insurance industry to accept more risk.[3]

<u>Senate bill</u>

The Senate bill passed the Committee on Senate Banking, Housing, and Urban Affairs unanimously on a 22-0 vote and is now on the Senate floor. Experts say the Senate panel's bipartisan vote could lead to swift action in the Senate and put pressure on the House to keep a good legislative pace.

Industry groups such as the American Insurance Association, Property Casualty Insurers Association of America, and National Association of Mutual Insurance Companies support continuing the program but expressed concern over increasing the share of insurer's losses to 20% as the Senate bill now

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1 15 U.S.C. § 6701

2 For an act of terrorism to be covered under TRIA, it must be a violent act committed in an effort to coerce the U.S. civilian population or influence the U.S. government policy. It must have resulted in damage within the United States or to U.S. air carriers, sea vessels, or missions abroad. To qualify as a covered "terrorist act," it must be certified by the Secretary of the Treasury in concurrence with the Attorney General and Secretary of State.

3 See Table 1 for a side-by-side comparison of the current law and the Senate and House proposals as of 3 June 2014.

proposes. They claim that decreasing the federal reinsurance quota share[4] will further undermine economic resiliency. The groups emphasize the difficulty of covering NBCR attacks, noting that what little protection is currently available for NBCR will become increasingly unstable.

House draft

Recently, a working group consisting of the heads of the Treasury Department, the Federal Reserve, the Securities and Exchange Commission, and the Commodity Futures Trading Commission in a report to Congress stated private insurers could afford to take on more risk if the federal backstop is extended. With this in mind the House Republicans drafted an outline for a proposed extension that would require the insurance industry to take on far more risk than the Senate version.

The House draft would limit TRIA substantially by increasing the share of insurer's losses to 25% by 2017 for non-NBCR events, increasing the program trigger to US$500 million by 2017 for non-NBCR events, and decreasing the cap on aggregate liability to US$75 billion. Financial Services Committee Ranking Member Rep. Maxine Waters (D-CA) and Rep. Carolyn Maloney (D-NY) have sharply criticized the House draft as being the equivalent of doing nothing at all, asserting that metropolitan areas will suffer if the draft is adopted. While only in its infancy, if the House draft becomes a bill and is passed, the terrorism insurance market will be substantially limited. Industry groups predict that the increase in the share of insurer's losses will affect the availability and affordability of terrorism insurance for businesses and possibly push some of the providers out of the market. There are also additional concerns about the ability to opt-out for some providers and the proposed definition of a terrorist attack. Requiring insurers to offer terrorism coverage was instrumental for the revitalization of the market in 2002.

Proponents of the House draft note that the outline includes a timeline for the certification process, something industry groups have been requesting. The draft also treats NBCR and non-NBCR events differently, which addresses previous concerns expressed by the American Insurance Alliance about the high costs specifically of NBCR coverage.

If you have any questions about the TRIA reauthorization process, please contact Dean Hansell at dean.hansell@hoganlovells.com or your Hogan Lovells relationship partner.

Table 1. Side-by-side comparison of the current law, the Senate Bill, and the House draft as of 3 June 2014

	Current Law (15 U.S. C. § 6701)	Senate Version: The Terrorism Risk Insurance Program Reauthorization Act of 2014 (S. 2244)	House Draft Outline: The Terrorism Risk Insurance Modernization (TRIM) Act of 2014
Make-available provisions	Must make coverage available for certified acts of terrorism on same terms and conditions as for other covered risks.	No change	In 2016 small insurers can opt-out of the mandatory "make available" requirement.
Covered Acts	Foreign and domestic terrorism in the United States and on U.S. interests abroad. Includes an act of war for workers' compensation	No change	Act must be committed on behalf of any foreign person or foreign interest.

4 The federal reinsurance quota share is the percentage of the insurer's loses above its deductible that the government will cover.

	policies only.		
Certification	Must be certified by the Secretary of the Treasury in concurrence with the Attorney General and Secretary of State. Claim must be over US$5 million.	Final rule from the Treasury Department must be no later than 180 days from the enactment that would establish a timeline for certifying an event as covered or not covered.	Secretary of Treasury must consult with Attorney General and the Secretary of Homeland Security. The US$5 million threshold is removed. Secretary of Treasury must make determination within 90 days.
Program trigger	US$100 million in insured loss in a program year	No change	NBCR events: US$100 million Non-NBCR events: US$250 million (2015), US$500 million (2017)
Insurer deductible (percent of direct earned premium)	20%	No change	Insurance marketplace retention amount to be equal to the sum of the insurer deductibles for the preceding program year for all participating insurers. Mandatory recoupment of federal payments for insured losses after the trigger and an insurer's deductibles have been met that are equal to or below the aggregate industry deductible.
Federal reinsurance quota share	85%	80% (decrease in 1% per year over five years)	NBCR: 85% Non-NBCR: 80% (2016), 75% (2015)
Insurance industry retention for mandatory recoupment[5]	US$27.5 billion (133%)	Increase by US$2 billion per year until it reaches US$37.5 billion (135.5%)	Increase to 150% Requires all participating insurers to establish a capital reserve fund to hold funds in a fiduciary capacity on behalf of the Secretary of Treasury.
Cap on liability	US$100 billion	No change	US$75 billion
Expiration	2014	2021	2017

[5] The aggregate retention amount is equal to the theoretical insured losses. The mandatory recoupment requires the Secretary of the Treasury to recoup a certain percentage of government outlays up to a specified amount. After that specified amount the recoupment is discretionary.