The Work That Remains

TRIA Is Reauthorized—But Insurers' Insolvency Risks Not Addressed

By Ronald R. Robinson

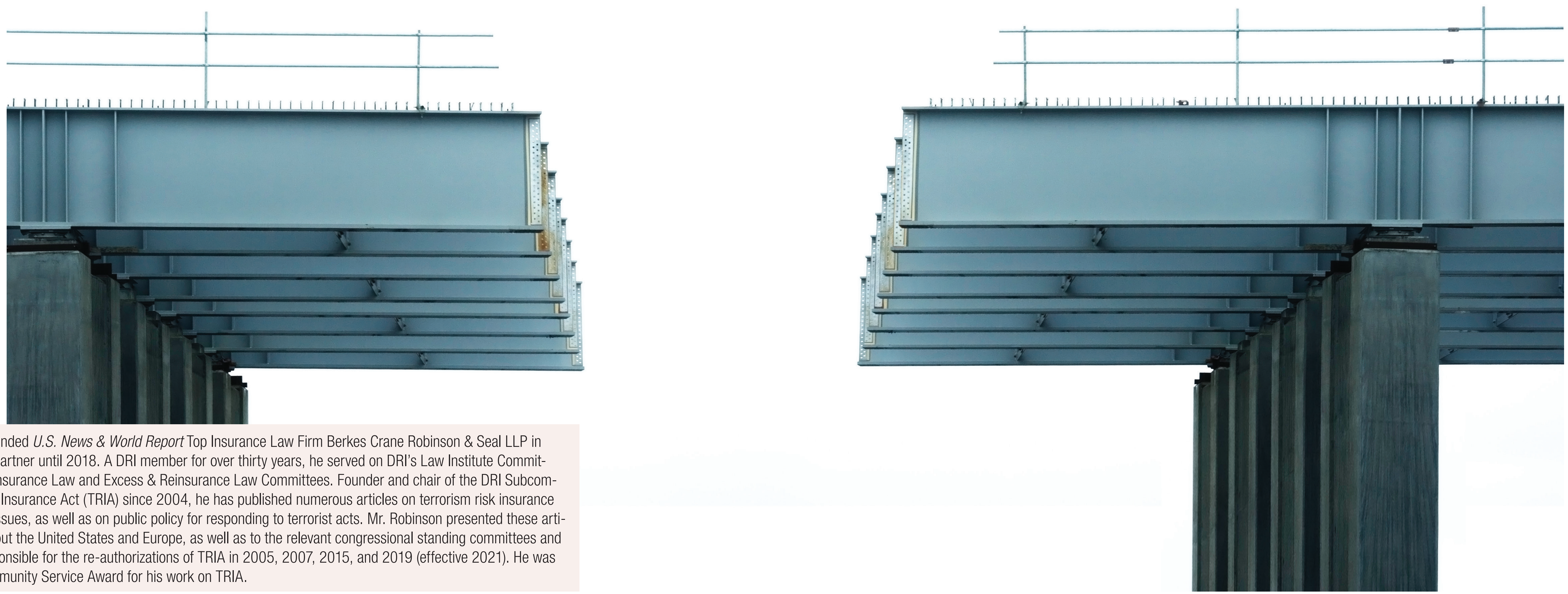
TRIA mandates a risk allocation formula that, in the event of a catastrophic terrorist attack, puts regional, medium, and small participating insurers at risk of insolvency.

The Terrorism Risk Insurance Act (TRIA or "act") requires the private insurance marketplace and the federal government to share, as partners, up to $100 billon in terrorist attack losses per year. The allocation of payment for any qualifying loss, as between them, is governed by a complex four-part formula, referred to here as the "TRIA risk allocation formula."

TRIA was enacted in 2002 and reauthorized for the fourth time in December 2019; to be effective from January 1, 2021, to December 31, 2027. In the debate that led to the creation of the act in 2002, the very existence of any form of TRIA was in doubt. Some members of Congress and some TRIA stakeholders argued that the private insurance market should bear all of the risk of this loss, without underwriting support from the federal government. They insisted that it was contrary to the role of the federal government in a capitalist democracy to participate as an insurer of this risk.

Notwithstanding the fact that proponents of this doctrinaire-driven position unsuccessfully tried to kill the act in 2002, and then failed to end it in each of the three of the four subsequent reauthorization cycles (2005, 2007, and 2015), they did succeed in requiring private insurers to carry an ever-increasing share of the risk, while the federal government's share correspondingly declined.

Changes in the TRIA risk allocation formula over the past three reauthorization cycles demonstrate the critical imbalance of loss allocation in favor of the federal government. By the 2015 reauthorization, there had been: (1) a doubling of insurers' co-payments; (2) a tripling of insurers' deductibles; and (3) a 275 percent increase in insurers' loss retention. Moreover, by 2015, the amount to be paid initially by private insurers, before the federal government pays its first dollar, has increased 3900 percent. These exponential increases were imposed on the private insurance marketplace, not on the basis of any of



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In June 2019, the Treasury Department issued a study, based on objective economic data, which found the solvency of small insurers is at risk under the current allocation formula ("2019 Treasury study"). However, the parallel question—whether medium and regional insurers, as opposed to large and international carriers, are also at risk of insolvency in the event of a catastrophic terrorist attack—was not addressed.

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Despite the data available to Congress in the June 2019 Treasury study, it simply renewed the 2015 version of TRIA in December 2019, without any meaningful debate over its findings. Consequently, the grossly imbalanced allocation of loss favoring the federal government, as mandated by the 2015 TRIA risk allocation formula, was not changed. In fact, in none of its four iterations has the TRIA risk allocation formula been debated or altered, based on objective economic data that would disclose whether small, medium, and regional insurers (as opposed to large and international carriers) are at risk of insolvency in the event of a catastrophic terrorist attack.

TRIA 2021 can fairly be read to mandate a new and expanded Treasury study of the insolvency risks of participating insurance companies. Treasury is required to conduct a new study in June of 2021. Nothing in the act prohibits Treasury from conducting a broader examination of economic data for the medium and regional carrier segments of the private insurance marketplace, while it updates the 2019 Treasury study's findings pertaining to small insurers. When completed, the expanded "2021 Treasury study" proposed in this article (discussed fully below) should be given to Congress. Congress should then consider this information and ask whether the TRIA risk allocation formula should be rewritten to apply different allocation approaches to each of the individual segments of the private insurance marketplace. This article proposes a way for Congress to do just that and amend the TRIA risk allocation formula to reflect the economic realities of each private insurance marketplace segment by the Fall of 2021.

TRIA's Past Is Its Prologue

The act, first implemented in 2002 ("TRIA 2002"), was one of several government programs created in response to the September 11, 2001, terrorist attacks that murdered about 3,000 people and resulted in thousands more casualties. That attack also resulted in property and liability losses of over $35 billion. The creation of the act was dominated by a doctrinaire policy debate, engaged in by Congress and all interested stakeholders, over the proper roles of government and private enterprise in a democracy faced with demands for coverage of losses stemming from a terrorist attack. The policy question, simply put, was one of government over-reaching: Should the federal government assume all or any part of an insurance program covering terrorist risks?

A minority of Congress members and stakeholders argued that terrorist attack coverage is the sole responsibility of the private insurance marketplace, because the federal government should never preempt private enterprise's assumption of the risk of this particular loss. A minority of other members of Congress and stakeholders argued that both protection from terrorist acts, and payment for attendant losses, is the sole responsibility of the federal government, reasoning that any response ought to be part of America's domestic and foreign policies. The debate was heated and intense on both sides, but neither view could command a majority to support its views (herein, the "doctrinal debate").

Congress attempted to move forward in 2002 by adopting a strategy that neither side in the doctrinal debate much liked. The compromise was to create a federally legislated partnership between the government of the United States and all property and casualty insurance companies doing business in America ("the private insurance marketplace") that would assume this risk together. The act mandated that all property and casualty insurers must issue terrorism risk coverage that matches the scope of its general coverages (the "mandatory availability requirement").

The core of the compromise was the TRIA risk allocation formula. In 2002, it allocated all future terrorist attack losses between the federal government (the major share) and the private insurance marketplace (the minor share). The partnership would cover losses from a terrorist attack, or attacks, in any given year, up to a total of $100 billion in the aggregate. The TRIA risk allocation formula and the mandatory availability requirement are the foundation of the act (collectively, they constitute the "TRIA paradigm").

The TRIA paradigm insures certified losses caused by foreign and, since 2007, domestic acts of terrorism in the United States, as well as abroad at specified U.S. venues and for certain U.S. interests. Losses must be certified for coverage by three members of the Executive Branch: the Treasury Secretary; the Attorney General; and the Homeland Security Secretary (the last member replaced the Secretary of State as of 2015). TRIA defines a certifiable loss as:

> [A]ny act of terrorism, or a violent act dangerous to life, property or infrastructure, committed by individual(s) as part of an effort to coerce the civilian population of the United States, or to influence the policy or affect the conduct of the United States Government by coercion.

Neither side in the doctrinal debate prevailed in what became TRIA 2002, but neither retreated from their doctrinaire positions. Instead, the act was a temporary, ideological compromise that was mandated to last only until December 31, 2004; the doctrinal debate over who should bear this risk and in what proportion would renew after this date. Many stakeholders thought the 2004 debate could lead to the termination of the act. The strategy to preserve the act was to recalibrate the TRIA risk allocation formula to reduce the government's share of risk, while concomitantly raising the private insurance marketplace share.

The act was reauthorized to be effective from 2005 to 2007. However, the price of its survival was, in fact, a steep cut in the federal government's share of the risk. The 2005 negotiated truce in this ideologic dispute was fragile, to say the least, and the reauthorization debate in 2006 was again centered on threats of termination of the act versus a recalibration of the TRIA risk allocation formula. The 2006 reauthorization, effective in 2007 through 2014, required a second, steep cut in the government's share of risk—the continuing price of renewal.

The doctrinal debate over the very existence of the TRIA paradigm reached its apex in 2014. The forces opposed to the act finally achieved a symbolic victory when Congress failed to reauthorize the act by the December 31, 2014, deadline. The act lapsed until mid-January 2015, when a newly elected Congress reauthorized it as the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("TRIPRA 2015"). This time, the price of renewal was a further and precipitous, some argued draconian, decrease in the government's risk share allocation. This escalation of cuts in the government share was accomplished in annual stages until the act's expiration on December 31, 2020.

The cumulative result of these bitter debates has been an exponential increase in the share of risk borne by the private insurance marketplace. The concomitant and steep decrease in the government's share has been successfully driven by the never-ending doctrinal debate. Consequently, allocation recalibration arguments based on private insurance marketplace economic data, which could objectively demonstrate how much loss participating insurers could actually bear, have historically been sidelined or ignored.

TRIA Was Reauthorized in 2019 Without Debate—and Nothing Changed

Most stakeholders expected yet another doctrinal debate in the summer of 2020, hopefully to be followed by renewal of the act by January 1, 2021. Instead, in mid-2019, a year and one half before TRIPRA 2015 was set to expire, the 116th Congress, without much debate, reauthorized the act for a fourth time. The House proposed H.R. 4634 and the Senate proposed S. 2877, both of which simply reauthorized the TRIPRA 2015 version of the act with no substantive changes. As reported out of their respective committees in late Fall of 2019, the two bills had broad bi-partisan support and easily became P.L. 116-94, the Terrorism Risk Insurance Program Reauthorization Act of 2021 ("TRIPRA 2021"), effective January 1, 2021 to December 31, 2027.

Amazingly, TRIPRA 2021 was enacted without a renewed debate on government overreaching versus the proper role of the private insurance marketplace in the TRIA paradigm. More importantly, the risk-share allocation debate was not revisited. How did this happen? Most of the participating international and large carriers united in mid-2019 to argue that TRIPRA 2015 was functioning well and should be readopted it in its entirety. They had two goals: (1) prevent another risk-share allocation debate, which they feared would lead to a further steep decrease in the government's risk share; and (2) assure that the general private insurance marketplace renewal cycles in 2020 and 2021 could both proceed without the risk of a another broadly disruptive lapse of TRIA coverage as happened in 2015.

Regional, medium, and small participating carriers mounted no significant opposition to this approach. Congress, which at this same time was embroiled in the President Trump impeachment debate, was told by the insurers that there was no significant opposition to the current act. Congress accepted that representation, fast-tracked the reauthorization process, and simply re-adopted the provisions of TRIPRA 2015, which thereby left the TRIA risk allocation formula unchanged.

TRIA's Risk Allocation Formula Is Unsupported by Objective Economic Data and Remains Grossly Imbalanced

The magnitude of the doctrinaire-driven decrease in the government's risk of loss share can be easily calculated by analyzing the changes in each of the four components of the TRIA risk allocation formula over the past two decades as follows:

> The TRIA paradigm insures certified losses caused by foreign and, since 2007, domestic acts of terrorism in the United States, as well as abroad at specified U.S. venues and for certain U.S. interests.

1. **Private Insurer's Deductible:** Under TRIA 2002, before a certified event was eligible for any claim payments by the federal government, each insurer whose policy was triggered was required to pay a "deductible" in an amount equivalent to 7 percent of its direct earned premium in the previous year. Under TRIPRA 2015, individual insurers' deductible tripled to 20 percent of the direct earned premium from the previous year. It remains at 20 percent in TRIPRA 2021.
2. **Federal Government Participation Trigger Amount:** Under TRIA 2002, the federal government's obligation to make a claim payment was not triggered until two conditions were met. Private insurers had to pay the deductible amount described above, and the total certified event loss paid by all insurers had to exceed $5 million. Under TRIPRA 2015, the loss trigger amount grew from $5 million to $200 million per certified event. This 3,900 percent increase remains in effect in TRIPRA 2021.
3. **Private Insurers' Co-Payments:** In addition to the deductible amount discussed above, TRIA 2002 mandated that a triggered insurer was required to pay a maximum of 10 percent of a certified event loss above the federal government's participation trigger amount. Under TRIPRA 2015, the insurer co-payment doubled

to 20 percent. It remains at this level in TRIPRA 2021.

4. **Private Insurance Marketplace Aggregate Loss Retention:** The aggregate loss limit for all certified events, under all iterations of the act, is $100 billion per year. TRIA 2002 required the private insurance marketplace to cover up to $10 billion in aggregated loss. TRIPRA 2015 prescribed that the private insurance marketplace cover up to $37.5 billion, a 275 percent increase. It remains at this level in TRIPRA 2021.

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The TRIA Risk Allocation Formula Should Be Determined by Economic Realities

The private insurance marketplace is comprised of layers and layers of primary, umbrella, and excess policies issued by hundreds and hundreds of companies. The act's mandatory availability requirement would be rendered much more economically responsible and fair, if different risk shares were to be allocated to participating insurers based on their place in the four generally recognized marketplace segments: small carriers, medium carriers, regional carriers, and large national or international insurance companies (herein collectively referred to as "insurance marketplace segments").

A catastrophic terrorist attack will randomly require numerous insurers, probably drawn from all marketplace segments, to cover the loss under the TRIA risk allocation formula. Each of the four segments of the marketplace should have their four TRIA risk allocation formula components recalibrated, based upon each segment's economic realities. While large national or international insurance companies probably have the financial assets to pay their currently mandated shares, the absence of an objective, and comprehensive private insurance marketplace economic study leaves the solvency of small, medium, and regional insurance carriers seriously in doubt.

The Department of Treasury started to address the question raised here, in part, just before the 2019 reauthorization process got underway. The June 2019 Department of Treasury "Study of Small Insurer Competitiveness in the Terrorism Risk Insurance Marketplace" or "2019 Treasury study" reported an uncomfortable truth about the validity of the now reauthorized TRIA risk allocation formula. Its key small insurance companies marketplace segment's risk-share findings are found on pages 2–3, sections C–E, as follows:

C. The mandatory availability requirement appears to affect small insurer participation in the terrorism risk insurance market by causing them to assume more terrorism risk exposure than they might otherwise provide absent the requirement.

D. Small insurers could sustain significant terrorism losses without federal backstop support if their losses fail to satisfy the Program Trigger. This could have a negative effect on small insurers, potentially causing financial distress and ratings downgrades.

E. Small insurers cede a higher percentage of their DEP to purchase reinsurance than do non-small insurers. Reinsurance purchases covering terrorism risk have increased, but some small insurers do not purchase enough private reinsurance to cover the potential gap between a small insurer's individual deductible and the Program Trigger.

Despite the fact that the 2019 Treasury study presented a compelling case that the risk for small insurance companies should be drastically decreased, the TRIA risk allocation formula was neither altered nor meaningfully debated in the 2019 reauthorization cycle. Based on the results of the 2019 Treasury study, it is unwise to continue to assume that small, as well as medium and regional carriers, are immune to insolvency risks today in the case of catastrophic terrorist attack losses.

Treasury Could Conduct an Expanded TRIA Insolvency Risk Study by June 2021

TRIPRA 2015, reauthorized intact in TRIPRA 2021, requires the Secretary of the Treasury to submit a report every two years to the House of Representatives' Committee on Financial Services and to the Senate's Committee on Banking, Housing, and Urban Affairs. The report is to include

> …(A) an analysis of the overall effectiveness of the Program; …(C) an evaluation of any changes or trends in the data collected…; and (D) an evaluation of whether any aspects of the Program have the effect of discouraging or impeding insurers from providing commercial property casualty insurance coverage or coverage for acts of terrorism….

The 2019 Treasury study was issued pursuant to this mandate.

Based on this broad mandate, an expansion of the 2019 Treasury study is warranted and should be prepared and issued by Treasury in June 2021. This proposed 2021 Treasury study should provide the objective economic facts upon which Congress could consider whether recalibration of the four-components of the TRIA risk allocation formula is warranted to protect the solvency of medium and regional carriers, as well as to update the findings for small insurers. In 2019, DRI's monthly magazine, *For The Defense*, published an article by this author, "Protecting TRIA, What We Need to Know to Renew TRIA Responsibly in 2020." *See* **http://www.bcrslaw.com/articles/TRIA_Responsibility.pdf**. The article, written before the release of the 2019 Treasury study, outlines the structure for a comprehensive review of the relevant economic data for each of the four segments of the private insurance marketplace. That same approach could be the starting point for the creation of the proposed 2021 Treasury study advocated in this article.

The TRIA Insolvency Risk Debate that Ought to Happen in Fall 2021

If Treasury agrees to research the necessary and relevant economic data and to issue the proposed 2021 Treasury study, Congress could act as early as Fall 2021 to debate whether changes in the TRIA risk allocation formula are warranted. Such a debate will, for the first time, either objectively affirm that the current allocation structure is sound or mandate an amendment to the TRIA risk allocation formula in the near term. Either way, the TRIA risk allocation formula would, for the first time, be supported by objective, private marketplace economic data. The proposed 2021 Treasury study is, therefore, a "win/win" exercise.

However, given the 2019 Treasury study, the overwhelming odds are that recalibration of the TRIA risk allocation formula is warranted. The private insurer deductible, federal government participation trigger amount, private insurer co-payment amount, and private insurer's aggregate loss retention components of this formula should be individually tailored for each insurance marketplace segment.

Treasury's succeeding bi-annual studies in 2023 and 2025 could update the objective economic facts necessary for periodic re-evaluation of the current or revised TRIA risk allocation formula, market segment by market segment. Thus, both sides of the debate can have factually based confidence in the allocation decisions that are made. That confidence is critical because, due to the make available provision, there is no choice about accepting the risk, unless an insurer exits the marketplace.

There is no sound reason to refuse either to prepare and issue the proposed 2021 Treasury study, or to meaningfully consider this "win/win" question. Yet, the relentless doctrinal debate will result in many in Congress and TRIA stakeholders arguing that there is no pressing reason to pause to consider doing anything on this issue until 2027, if even then. In actuality, they will be asking the small, medium, and regional insurers to "bet the company" that there is no risk of insolvencies under TRIPRA 2021. The most apt and succinct response to those who will demand we do nothing is to quote a very street-smart Casino owner, "Not so fast, Louis." Richard Blaine, owner of Rick's Café, *Casablanca*, Columbia Pictures, 1942.