

Terrorism Risk Insurance Act (TRIA) of 2002

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What losses are covered by TRIA

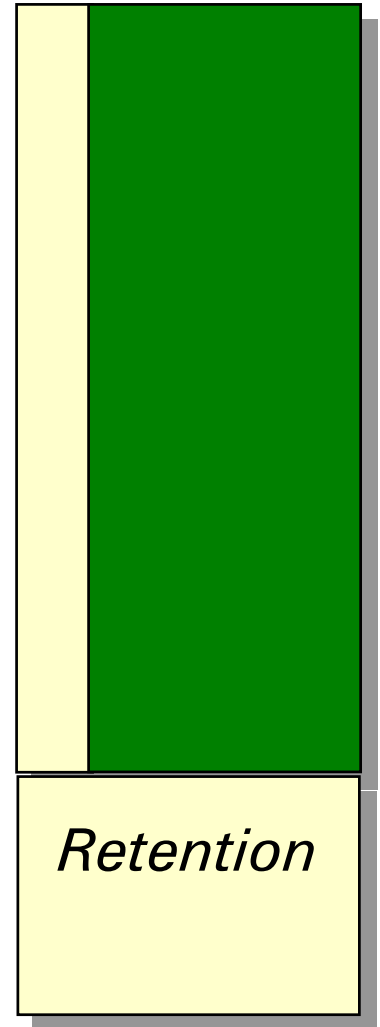
- Acts of terrorism certified by Secretary of Treasury
 - Violent act
 - Damage inside the US and its territories, or to a US aircraft or vessel or mission outside of US
 - Perpetrated by foreign interests, to influence policy
 - Not part of a declared war, except for Workers Comp
 - Insured p/c losses greater than \$5 million
- Commercial lines of p/c insurance, excluding
 - federal crop and flood insurance
 - private mortgage and mono-line financial guaranty insurance
 - medical malpractice
 - health or life

What insurers are eligible?

- Insurers licensed or admitted to engage in (primary or excess) insurance in the US
- Surplus lines insurers on the NAIC Alien Insurers Listing
- Insurers approved by a Federal agency in connection with maritime, energy or aviation
- State residual market entities (not pools) and Workers Compensation funds
- Secretary may extend to captive insurers, municipal self-insurance programs, other entities by regulation
 - before-the-fact
 - consistent treatment
- After study, Secretary may extend to Group Life insurers

How does the federal reinsurance coverage work?

- Coverage is on an annual aggregate basis
- Each insurer has a deductible -- based on covered commercial lines direct earned premium for the preceding calendar year; adjusted for residual market pool premium
 - 7% for 2003
 - 10% for 2004
 - 15% for 2005
- Government will reimburse insurers for 90% of annual losses above deductible, with an annual cap of \$100 billion



The larger commercial insurers will have substantial deductibles under the program

Commercial Market Share Rank	Company	Estimated 2002 Commercial Lines Premium	Estimated Terrorism Deductible		
			2003	2004	2005
1	AIG	12,751	893	1,403	2,209
3	Travelers	7,965	558	876	1,380
5	Liberty Mutual	5,948	416	654	1,030
7	Hartford Financial	4,936	345	543	855
12	California State WC Fund	4,071	285	448	705
21	Cincinnati Insurance	2,148	150	236	372
33	Allstate	1,018	71	112	176
50	Utica National	642	45	71	111

Note: Earned Premiums are assumed to grow by 10% in 2003 and 5% in 2004

How will the federal program be funded?

- No pre-funding; partial recovery of federal payouts via policyholder surcharges
 - Surcharges in any year capped at 3% of premium; continue until all recoveries are made
 - Surcharges may vary based on economic and risk considerations
- TRIA specifies the following annual formula amounts:
 - \$10.0 billion for 2002-2003
 - \$12.5 billion for 2004
 - \$15.0 billion for 2005
- The government will recoup the difference between
 - the lesser of actual losses and the formula amount in each year; and
 - the industry retained losses

To illustrate ...

<i>Insured Terrorism Losses for 2003</i>	<i>Losses Retained By Industry</i>	<i>Losses Reimbursed by Federal Gov't</i>	<i>Formula Amount</i>	<i>Recovered via Surcharges</i>
<u>(1)</u>	<u>(2)</u>	<u>(3)</u>	<u>(4)</u>	<u>(5)</u>
5.0	3.9	1.1	10.0	1.1
7.5	5.1	2.4	10.0	2.4
10.0	6.0	4.0	10.0	4.0
15.0	7.2	7.8	10.0	2.8
20.0	7.9	12.1	10.0	2.1
30.0	9.0	21.0	10.0	1.0
40.0	11.1	28.9	10.0	0.0

(1) Assumption

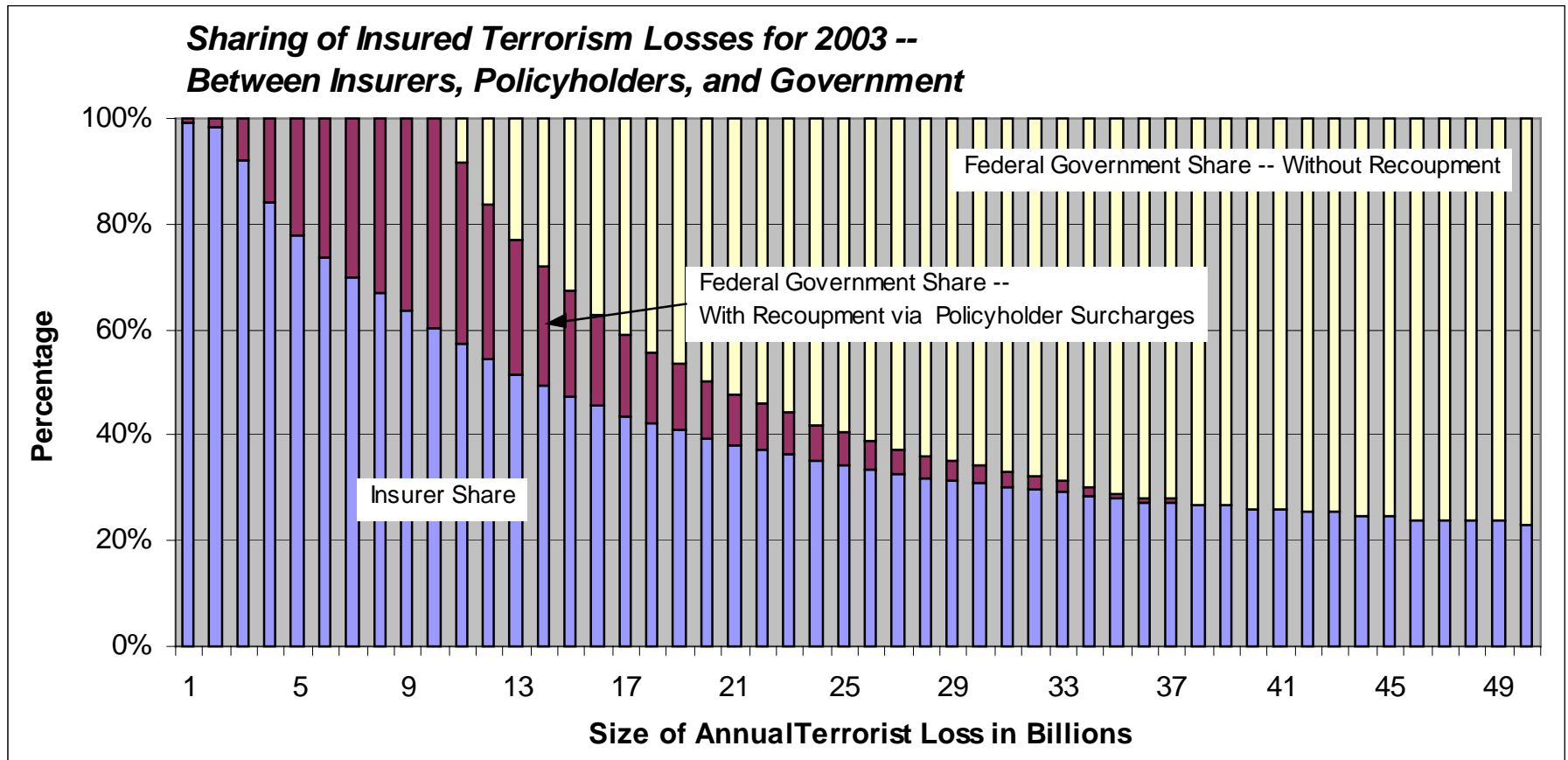
(2) Result from Tillinghast Industry Terrorism Pricing Model

(3) = (1) - (2)

(4) From Terrorism Legislation

(5) = [Minimum of (1) or ((4)] - (2), but not less than zero

Insurers will retain the majority of smaller losses; the government will respond mostly to mega-events



Source: Tillinghast Industry Terrorism Pricing Model

The majority of expected terrorism losses will still be borne by the insurance industry

	<u>2003</u>	<u>2004</u>	<u>2005</u>
<i><u>Expected Annual Insured Terrorism Losses</u></i>	4.500	4.500	4.500
<i>Expected Losses Retained By Insurers</i>	2.655 59%	2.977 66%	3.323 74%
<i>Expected Losses Reimbursed By Federal Government</i>	1.845 41%	1.523 34%	1.177 26%
<i>Expected Recoupment via Policyholder Surcharges</i>	623	521	357

Source: Tillinghast Industry Terrorism Pricing Model

What is the quid pro quo?

- Mandatory participation
- Any terrorism exclusions in primary policies subject to the Act are voided
- Insurers must “provide clear and conspicuous disclosure to the policyholder” of the premium charged for terrorism within 90 days
- Rates for terrorism coverage are not subject to state prior approval; “use and file” until end of 2003
- Insureds may reject terrorism coverage

Issues for insurers

- Estimation of deductibles; direct premium minimization strategies
- Rates for terrorism for all lines in all jurisdictions
- Coordination with reinsurance programs
 - No explicit coordination in Act, except that total terrorism recoveries may not exceed total payout
- Rating agencies are negative
- Domestic terrorism; natural catastrophes; long term solution
- Position of Group Life and self-insurers: in or out?