



Independent Insurance Agents



Brokers of America, Inc.



MEMORANDUM

December 27, 2005

TO: Executive Committee
Government Affairs Committee
Agents & Brokers Roundtable
State National Directors
State Presidents
State Executives

FR: Brendan Reilly, Director of Federal Government Affairs

CC: Charles Symington, Senior Vice President of Government Affairs & Federal Relations

RE: **Terrorism Risk Insurance Extension Act of 2005 Signed Into Law**

On December 22, 2005 President Bush signed into law the Terrorism Risk Insurance Extension Act of 2005 after a long year of debate concerning the proper approach to maintain a viable terrorism insurance marketplace. Enactment of this legislation marks a tremendous victory for IIABA, which made the extension of the Federal backstop a top legislative priority in the 109th Congress. The legislation – which extends the Terrorism Risk Insurance Act (TRIA) for two years with some changes to the current program – will ensure that terrorism insurance is available and more affordable for the consumers that our members serve. The Big “T” Federal Government Affairs team was at the forefront of these deliberations and asked by policymakers to lead and coordinate industry efforts at many stages throughout the process.

Background and the Need for Legislation

After September 11th, the increased threat of another terrorist attack – coupled with tremendous uncertainty in the insurance market and the inability to price for future terrorist risks – caused prices for many types of commercial property-casualty insurance and reinsurance to rise dramatically, while coverage disappeared altogether in some areas. This crisis threatened our country’s economic security, impacting construction and development. Congress recognized the importance of terrorism risk insurance for the health of the U.S. economy and enacted TRIA in the 107th Congress. The legislation was signed into law by President Bush in November 2002, and is set to expire December 31, 2005.

TRIA established a three-year Terrorism Risk Insurance Program in the Department of the Treasury to pay the Federal share of compensation for insured losses resulting from acts of international terrorism. The Act only covers the U.S. commercial property-casualty market, and it requires the Federal government to share only in an insurer’s losses if an attack is certified by the Secretary of the Treasury and the industry’s aggregate insured losses exceed \$5 million. In addition, an insurer has to pay out a

certain amount of claims (a “deductible”) that is directly proportional to an insurer’s size (7 percent of direct earned premium in 2003, 10 percent in 2004, and 15 percent in 2005) before receiving Federal assistance. After this threshold is reached, the Federal government pays 90 percent of insured losses over the deductible and as much as a total of \$100 billion in industry losses. However, the amount paid to insurers must be recouped through a surcharge in all commercial insurance premiums in subsequent years for those aggregate industry losses below a certain retention amount (\$10 billion in 2003, \$12.5 billion in 2004, and \$15 billion in 2005).

Since passage of TRIA, the reaction of the marketplace and oversight of the program both indicate that the public-private partnership established by the act has worked well to stabilize the commercial insurance marketplace. However, as TRIA neared expiration, it became clear that the private marketplace for terrorism insurance had not fully developed and that significant amounts of such coverage would not be available without a Federal backstop. This was largely due to the continued threat of a terrorist attack coupled with the insurance marketplace’s inability to price the risk associated with a potential attack.

These concerns were supported by a number of observers of the market. In 2005 the Government Accountability Office (GAO) released a study mandated under TRIA; the study concluded that there was not a sustainable marketplace for terrorism coverage after the program’s expiration. Also, 51 bipartisan commissioners of the NAIC agreed that an availability and affordability crisis potentially loomed in the absence of a Federal backstop. Federal Reserve Chairman Alan Greenspan also opined on the matter, and Big “I” staff worked with members of the House Financial Services Committee to develop a line of questioning for Chairman Greenspan at a Congressional hearing held on the issue. Chairman Greenspan ultimately concluded that catastrophic terrorist attacks remained virtually uninsurable in the private sector. Most troubling, agents and brokers across the country began to see evidence that market disruptions were developing as policyholders faced renewals.

With the insurance market lacking the ability to insure against terrorism without a Federal backstop, the Big “I” took a strong position that an extension of a Federal backstop – either the current TRIA or a modified program – was necessary for the stability of the commercial insurance marketplace.

Although the current law was not scheduled to expire until December 31, 2005, starting in 2004 the Big “I” urged Congress to act as soon as possible to provide the certainty that insurers and consumers needed as they began to make decisions that impacted operations beyond the scheduled expiration of TRIA. The Big “I” asserted that extending TRIA or a modified program would guarantee access to coverage and ensure a continued boost to construction and job creation, while strengthening our economic growth and security and reducing the impact of any future terrorist attack with little cost to the Federal government.

Legislative Process and IIABA Involvement

At the onset of the debate to extend some form of terrorism insurance program, it was clear that there were two major obstacles to passing any extension legislation.

First, there was a sentiment among certain fiscal conservatives in Congress that Federal intervention in the terrorism insurance market would hinder private sector development in this area. In early 2005, the Congressional Budget Office (CBO) released a report requested by the Senate Banking Committee which concluded that an extension of TRIA could discourage businesses from taking steps to reduce

terrorism exposures, such as retrofitting existing facilities and designing new ones to mitigate the risk. The report, which was highlighted in an April 2005 Senate Banking Committee hearing, also concluded that continuation of TRIA discouraged private sector development of capacity and long-term solutions to the problem, even though models still had not been developed to price coverage and address future risks. These same concerns would be the focus of a June 2005 Treasury Department report required by TRIA (discussed later), which officially marked the Administration's opposition to a continuation of the current TRIA program and support for a scaled-back program.

Second, there was dissension in the insurance market as to what form a terrorism insurance program should take – a straight extension of TRIA, a modified program, or a completely new pooling mechanism. This rift was complicated by the fact that most insurers have varying levels of exposure and viewed the details of any proposal as a competitive advantage or disadvantage based on their exposure.

As such, IIABA staff worked with key Members of Congress and staff, as well as industry participants, to push for an extension of some form of the program and to bring interested parties together to form a consensus on key issues related to terrorism insurance. This led to a document drafted by the Big "I" entitled, "Unifying Principles for Renewal of a Federal Terrorism Insurance Backstop," which outlined key issues and also was endorsed by the Council of Insurance Agents & Brokers (CIAB), the Risk & Insurance Management Society (RIMS), and a coalition of policyholders known as the Coalition to Insure Against Terrorism (CIAT). The Big "I" worked with Senate policymakers to incorporate these concepts in legislation – S. 467, the Terrorism Risk Insurance Extension Act of 2005 – introduced on February 18, 2005 by Senators Christopher Dodd (D-CT) and Robert Bennett (R-UT).

IIABA staff also formed other informal working groups with the Property Casualty Insurers Association of America (PCI), the American Insurance Association (AIA), and the National Association of Mutual Insurance Companies (NAMIC), among others. These groups provided a forum to explore and create policy, as well as a center to coordinate education and advocacy efforts for policymakers in the House and Senate.

On June 30, 2005, the Treasury Department released its report on TRIA, as required by Congress. As mentioned earlier, the report and its conclusions expressed the Administration's opposition to an extension of TRIA in its current form. However, recognizing that there was support among a number of Congressional policymakers on both sides of the aisle for some Federal role to ensure a viable terrorism insurance market, the Administration did lay out parameters and listed several principles that they believed should be recognized in any potential extension of the program. These reforms included: reducing taxpayer exposure; increasing the trigger level for government participation, as well as the deductibles and co-pays paid by primary insurance companies; eliminating from the program certain lines of insurance (such as General Liability and Commercial Auto and other smaller lines); and addressing issues related to legal reform.

As a result of this report, Senate Banking Chairman Richard Shelby (R-AL) and House Financial Services Chairman Mike Oxley (R-OH), among others, publicly renewed their preference for a more market-oriented program beyond TRIA's expiration. At two July hearings in the House and Senate, Treasury Secretary John Snow reinforced the Administration's opposition to extending the current program based on their belief that the program hinders market expansion, innovation, and creativity. Following these hearings, IIABA staff was invited to a series of very exclusive coalition meetings in the

House and Senate and asked for our assistance in crafting a modified program, which would focus on improving TRIA and incorporating the private sector to a greater degree.

On July 27, the Big “I” was asked to testify at the House Financial Services Committee hearing on future solutions to terrorism insurance. Then President-elect Bill Stiglitz was the first private sector witness to address the Committee and did an exemplary job discussing the perspective of agents and brokers on these issues. His appearance disputed the notion that TRIA was just a “big city” issue as he described the conditions and exclusions that impacted agents, brokers and consumers throughout the country. He also highlighted the importance of reasonable trigger levels to smaller insurance markets.

With the program scheduled to expire at year-end, the Big “I” Federal Government Affairs team redoubled its efforts to push for some form of extension legislation and continued its work with key policymakers and industry partners over the next several months. This groundwork helped lead to deals in both the House and Senate, which enabled the respective committees in each chamber to pass separate legislation (S. 467 and H.R. 4314) extending TRIA for two years with some modifications. The Big “I” worked closely with Members and Congressional staff in drafting the legislation and strongly supported both measures, which attempted to strike a delicate balance between the needs of the market (i.e. a significant Federal backstop) and the principles outlined by the Treasury Department (i.e. greater private sector involvement and taxpayer protections). IIABA staff helped coordinate coalition efforts to pass the legislation, and the Senate passed a bill out of committee unanimously, while the House moved their bill out of committee by a vote of 64 to 3.

The Big “I” immediately urged Senate leaders to bring S. 467 to the Senate floor, and on November 18, 2005, the Senate considered and passed S. 467 unanimously. In the House of Representatives, a number of conservative Members of Congress, backed by the Administration and outside groups (Club for Growth, National Taxpayers Union, etc.), temporarily blocked consideration of H.R. 4314 in an attempt to scuttle the House legislation. The House Financial Services Committee specifically reached out to the Big “I” to lead industry efforts to encourage Members to support the legislation, and the House passed their version of the terrorism insurance bill on December 7, 2005 by a vote of 371-49, amending S. 467 and substituting the full text of H.R. 4314.

Overall, both the House and the Senate bills included provisions to ensure that terrorism insurance is available and more affordable for the consumers our members serve, while limiting and phasing out the Federal government’s involvement (eliminating lines and increasing deductible, co-share, and retention levels). The House included additional language authorizing insurers to create risk-sharing mechanisms and allowing them to establish capital reserve accounts (two provisions intended to enable the market to build up capacity prior to the extension’s expiration), and a commission to propose a long term private sector solution for terrorism insurance. Most importantly, the legislation passed by each chamber extended TRIA for two years and included several provisions important to our members:

- Limited Federal intervention in the insurance market and preservation of State insurance regulation.
- Requirement that insurers “make available” coverage so that we can serve our consumers.
- Reasonable trigger levels important to agents and brokers in an array of communities – large and small – across the country.

While the House appointed Members to serve on a conference committee, the Senate elected to negotiate outside of a formal conference meeting due to the time constraints. Since Big “T” priorities were included in both the House and Senate legislation, IIABA staff made one major request in the conference deliberations regarding an amendment to the definition of an “act of terrorism.” This change, as drafted, would ensure that coverage is available and affordable for smaller terrorist attacks and that the trigger level for the Federal backstop is set at a reasonable amount of industry-wide losses.

On December 15, 2005 negotiators reached an agreement on an amendment to S. 467, and the conference report passed both chambers within the next two days and was sent to the President for signature. The compromise largely reflects the Senate-passed bill with two changes: 1) the Big “T” request to amend the program trigger to ensure continued availability of terrorism insurance to policyholders while keeping the trigger numbers at \$50 million in 2006 and \$100 million in 2007 per the Senate and House passed bills; and 2) the industry retention and resulting payback increased marginally to \$25 billion in 2006 and \$27.5 billion in 2007.

An executive summary of the final legislation is listed below:

Duration	The Act extends the TRIA program for two years, through December 31, 2007.
Triggering event	The size of an event needed to trigger TRIA is raised from \$5 million in the current program to \$50 million occurring after March 31, 2006 and before January 1, 2007. For losses occurring in 2007 the program trigger would increase to \$100 million.
Lines of coverage	The extension includes all of the lines covered by the current program with the exception of commercial auto, professional liability, surety, burglary & theft, and farmowners multi-peril.
Make Available	The requirement that insurers make coverage available to policyholders in all lines covered by the program is retained.
Individual retention	The individual insurer retention level – the amount of terrorism losses that an individual insurance company must pay before federal assistance becomes available – rises from the 2005 level of 15% of premiums collected in TRIA-covered lines (current law) to 17.5% of such premiums in 2006 and 20% of such premiums in 2007.
Co-pays	Insurers must pay a share of losses above their individual retentions, known as co-pays. In 2006, co-pays would stay the same as current law (90% Federal/10% insurer) and in 2007 co-pays would rise to 85% Federal/15% insurer.
Industry retention	The insurance industry as a whole must cover a certain amount of losses before Federal assistance is available. This cost may be spread among policyholders by a policy surcharge not to exceed 3% of premiums annually. This industry-wide retention amount rises from \$15 billion in 2005 (current law) to \$25 billion in 2006 and \$27.5 billion in 2007.

Study	The President's Working Group on Financial Markets is required to do a study and report to Congress by September 30, 2006, on the long-term availability and affordability of terrorism insurance, including the availability and affordability of group life insurance.
Litigation	The Act continues current litigation provisions and codifies the Treasury Department's existing regulation regarding advance approval of certain settlements which an insurer intends to submit for reimbursement under the TRIA program.

A comprehensive FAQ on the application of TRIA and the Extension Act to insurance transactions prepared by IIABA's Office of the General Counsel is available to IIABA members in the Legal Advocacy section of www.independentagent.com under Memoranda and FAQs.

The Future of Terrorism Insurance

Terrorism insurance was a top legislative priority for the Big "I" Federal Government Affairs team in 2005 and the extension of the Federal backstop is a huge victory for our membership and the insurance marketplace. However, the Big "I" remains committed to continuing to work with interested parties in the public and private sectors to develop long term solutions to terrorism insurance. IIABA staff also will continue to work on behalf of our members to ensure that terrorism insurance is available and affordable beyond the 2007 expiration of the Terrorism Risk Insurance Extension Act of 2005. Please don't hesitate to contact us with any questions.