

July 2004

TRIA Extension Prospects Brighten

Hard on the heels of the US Treasury's June decision to extend the "make available" provision of the Terrorism Risk Insurance Act of 2002 (TRIA), members of the House of Representatives have introduced H.R. 4634, the Terrorism Insurance Backstop Extension Act of 2004. The bill calls for TRIA to be extended from its current expiration of December 31, 2005 to December 31, 2007. There appears to be widespread bipartisan support for this measure in the House.

Recent reports of increased terrorism activity, albeit outside the United States, have reinforced the sense that the threat of terrorism is no less today than it was when Congress passed TRIA at the end of 2002.

The bill extends the "make available" provision through 2007, eliminating potential mid-term fingernail biting by policyholders and insurers. It also sets retention levels for insurers, continuing their 2005 retention level (15% of direct earned premiums) into 2006, with an increase to 20% in 2007.

The bill was developed in response to concerns voiced by a broad spectrum of constituencies including policyholders, agents and brokers, state insurance commissioners, insurers and reinsurers that failure this year to agree to extend TRIA would lead to widespread disruption in negotiations of policies whose expirations would run past the Act's original sunset date.

Recent reports of increased terrorism activity, albeit outside the United States, have reinforced the sense that the threat of terrorism is no less today than it was when Congress passed TRIA at the end of 2002. Experts continue to speculate that as security tightens at trophy sites, government buildings and key infrastructure, terrorists may turn their attention to softer, more vulnerable targets, generating broader interest in purchasing terrorism coverage. The recent revelation of a plot to attack a shopping center in Columbus, OH seems to validate this speculation.

Lexington Expands Coverage Under Stand-Alone Terrorism Contracts

Early last month, Lexington announced that it was making biological and chemical contamination coverage available under its stand-alone Terrorism offering. The maximum limit available for this extension is \$10 million per occurrence and in the aggregate per policy year and the minimum rate level, at this point, is five percent of the limit of liability. We expect this rate to drop as others make this coverage available and competition emerges. We still see no willingness on the part of underwriters to offer this extension under traditional Property contracts.

Treasury Issues Final Regulations for TRIA Claims Procedures – Mixed News for Captives

Also last month, the US Treasury issued its Final Rule on claims payments for TRIA events. Its position is of particular interest to captives that have written certified terrorism coverage relying on the government backstop provided by the Act (90 percent of the amount in excess of their retentions).



In this Issue:

TRIA Extension Prospects Brighten	1
Lexington Expands Coverage Under Stand-Alone Terrorism Contracts	1
Treasury Issues Final Regulations for TRIA Claims Procedures	1
Maximizing UK Terrorism Protection Provided By Pool Re	2
Stand-Alone Terrorism Insurance Continues Global Growth	3

Treasury also reiterated that it reserves the right to withhold payments [to captives] if it is determined that a “claim is designed to circumvent the purposes of the Act and regulations.”

In response to concerns expressed by captives, among others, about the liquidity crisis that would occur if insurers had to “pay first” and then await reimbursement, Treasury “has revised the proposed rule to allow advance payments under certain conditions.”¹ Insurers will need to submit a request for claims payments that are “about to be made,”² accompanied by a certification that payments to their policyholders will be made within five business days of receipt of funds from Treasury and that any interest accrued in the interim will be remitted to Treasury.

On a somewhat ominous note, Treasury also reiterated that it reserves the right to withhold payments if it is determined that a “claim is designed to circumvent the purposes of the Act and regulations. This is intended to discourage those who may attempt to ‘game the Program.’”³ This is at least the second time Treasury has issued what could be viewed as a warning to parties trying to circumvent TRIA’s intent. Earlier this year, in a published response to an inquiry regarding its position on captives formed for the purpose of providing TRIA-only coverage, Treasury stated the following:

The *post*-enactment formation or utilization of a captive insurer that will only write stand-alone, single-risk *TRIA-only* coverage for losses from acts of terrorism raises questions regarding the integrity of the Program. We believe that an entity considering forming a captive insurer for stand-alone, single-risk terrorism insurance should be strongly cautioned and advised against undertaking such proposed action if it is doing so in order to avoid the Act’s deductible requirements.⁴

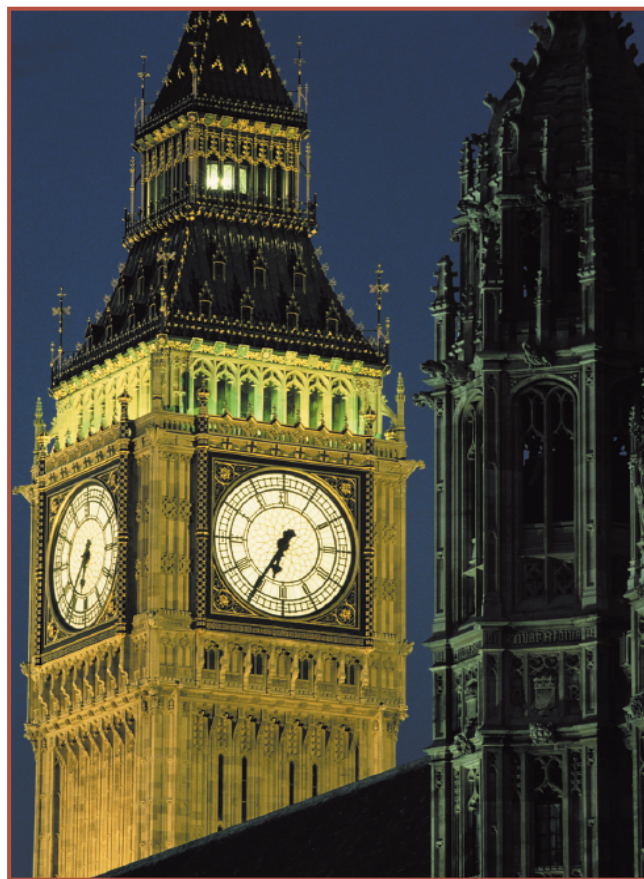
While deductible avoidance is by no means the reason most captives are used for providing TRIA coverage, Treasury also made it clear in the same interpretive letter that it was considering future rules with captives in mind.

Maximizing UK Terrorism Protection Provided By Pool Re

The ceilings on limits insurance carriers are willing to front has reduced the ability of some corporations to access the full amounts of Terrorism protection available through Pool Re in the United Kingdom. Particularly for those in the financial services, hospitality, real estate and retail sectors, values at risk, as well as the actual limits of their global programs, may far exceed those of local policies issued in the UK. For example, a corporation might have \$1 billion in exposures, \$750 million in global Property protection, but only a \$100 million limit on its underlying UK policy. Pool Re is only available through a policy issued in the UK, and then only for the amount of such a policy.

The irony of this situation is that Pool Re rates are applied to the 100 percent values, so premium is paid for limits not being made available because of fronting restrictions alone. There are two ways around this protection inadequacy:

1. Corporations can use their captives or a protected cell company (PCC) to write excess to total insurable values over the fronted limit for their UK assets, sharing the Pool Re premium with the primary carrier on some pre-agreed basis.
2. Corporations can use their captives or a PCC to front the entire policy in the UK, reinsuring the non-Pool Re cover to their property panel and reinsuring terrorism to Pool Re.



1 Final Rule – Claims Procedures, Dept. of the Treasury 31 CFR Part 50, June 2004, page 10

2 Ibid., page 19

3 Ibid., page 16

4 Letter to Ms. L, from Jeffrey S. Bragg, Executive Director, March 2, 2004, page 3

In line with TRIA in the US, a captive's retention under Pool Re is minimal. Unlike TRIA, Pool Re requires no coinsurance above that retention.

Two additional points of interest regarding Pool Re:

1. Post 9/11, coverage was extended to include nuclear, biological and chemical contamination (NBC), although not cyber terrorism. Some fronting carriers have tried to exclude NBC from local policies. Insureds and their brokers should fight these exclusions, given that Pool Re's rates were increased in specific recognition of this extension and there is no rating option available without it.
2. Like TRIA, Pool Re does not cover all acts of terrorism. Covered acts must be committed for the purpose of overthrowing the UK or some other government. In many cases, global policies can be written to pick up the difference between an otherwise absolute terrorism exclusion and Pool Re, similar to non-certified terrorism coverage in the US.

Stand-Alone Terrorism Insurance Continues Global Growth

The downward trend in stand-alone Terrorism insurance rates since the end of 2001 is now leveling out and in many cases renewal terms are static. The total premium income earned for terrorism risks since 9/11 is still overshadowed by the losses estimated for the 9/11 attacks, and, without TRIA, another catastrophic terrorism event in North America could result in financial ruin for the commercial property-casualty industry. For the moment, however, the situation is relatively stable.

While capacity within the market has increased, there are few notable new carriers. Annual global written Terrorism premium outside of various indigenous Terrorism pools, such as Pool Re, is estimated at about \$800 million. Capacity in Lloyd's has increased to \$300 million, while AIG (\$100M), ACE (\$125M) and AXIS (\$175M) still stand out among overseas markets. As ever, the availability and cost of this capacity are dependent on the type and location of the risk.

Willis TRIA Working Group

The Willis TRIA Working Group regularly brings together experts from our insurance, reinsurance, captive, legal and other departments in seven cities and three countries. Their joint recommendations and insights are relayed to Willis Client Advocates across the world as well as to readers of this publication.

Mary Caiazzo

Co-Chair
Nashville, TN

Suzanne Douglass

Co-Chair
New York, NY

Philip Andrea

London, UK

Robert Barr

London, UK

Tom Bartleet

London, UK

Paul Blackmore

Hamilton, Bermuda

James Costner

Nashville, TN

Mark Edwards

London, UK

Oliver Goodinge

London, UK

Michael Mann

Chicago, IL

Wendy Peters

Philadelphia, PA

Guy Ragosta

Burlington, VT

Craig Simon

New York, NY

Rod Thaler

New York, NY

Mike Vaughn

Nashville, TN

Paul Yelavich

New York, NY