ASSOCIATION OF GOVERNMENTAL RISK POOLS

Terrorism Risk Insurance Protection (TRIP): Points to Ponder

Since 2002, the United States federal government has maintained a Terrorism Risk Insurance Program (TRIP) to require coverage for terrorism the same as for any other insured peril, and to provide compensation for insured losses resulting from a certified act of terrorism. TRIP is the name of the overarching program, and has several related legislative acts for funding, including TRIA, TREA, TRIPRA, etc. This document will refer to TRIP as all-inclusive.

There are several planned adjustments to TRIP taking effect, as well as proposed rules for additional changes being considered. This document presents TRIP provisions as they exist as of May 1, 2016 and provides a summary of both planned and proposed changes.

<u>Q: How does TRIP work?</u>
TRIP is an intricate reimbursement program. No event has triggered TRIP to date, so every interpretation is untested at this point.

TRIP will only come into play for a very large and devastating event. As an example, an event like the Boston Marathon bombings would not even be close to triggering TRIP. Basic TRIP provisions include:

- An insurer subject to TRIP must offer terrorism coverage to insureds on the same basis as coverage for any other peril. The insurer may charge additional premium for the terrorism coverage.

- Certain criteria must be met for TRIP to come into play. First, there must be a certified act of terrorism. The Department of Treasury is responsible for determining whether an event is certified as terrorism, and in no case can it certify an event with less than $5 million of total insured losses.

- Once a terrorism event has been certified, there must be at least $120 million insured losses for TRIP to be triggered. After this, the federal government will share in losses for a certified event. If there is a loss of less than $120 million, or an event has not been certified, TRIP will not be triggered.

- Insurers subject to TRIP will pay deductibles and copays toward certified terrorism losses. Remember, deductibles and copays will only come into play if there has been

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a certified terrorism event that has reached $120 million or more in total insured losses.

- The deductible for each insurer with losses is equal to 20 percent of their covered premiums for the prior year. Covered premiums for purposes of this calculation include workers' compensation, property, and most liability premiums; auto premiums are not included.

- Once an insurer's deductible is reached, the insurer's copay of additional insured losses is 16 percent. TRIP is responsible for 84 percent of insured losses above each insurer's deductible.

- TRIP creates a mechanism for the federal government to recoup its contributions to losses via an assessment against the premiums of all licensed insurers, up to the point at which total insurer payments for any certified event reach $29.5 billion.

- In other words, the insurance industry as a whole will bear $29.5 billion of loss for a certified terrorism event, either through paying deductibles and copays and/or by paying assessments.

- For a certified terrorism event in which total losses exceed $29.5 billion, the Department of Treasury has discretion as to whether to continue assessing insurers to recoup some or all of the federal government's contributions, which continue at the same coinsurance rate of 84 percent after deductibles have been met.

- All funding for terrorism events under TRIP is capped at $100 billion. No insurer is required to make any payment for insured losses in excess of $100 billion. Losses in excess of $100 billion industry-wide could legally go unpaid by insurers and the federal government.

Q: What are known, upcoming changes to TRIP provisions?
There are several recently approved changes to TRIP.

- The Secretary of the Treasury must consult with the Attorney General and the Secretary of Homeland Security before certifying an event. The Secretary of Homeland Security has replaced the Secretary of State for this required consult.

- The baseline threshold of $120 million for an event to be certified will increase $20 million each of the next four years to $200 million in 2020.

- The insurer's copay (16 percent) of incurred losses above its deductible will increase 1 percent each of the next four years to 20 percent in 2020, with a corresponding decrease of 1 percent per year shared through TRIP (down from 84 to 80 percent).

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- The $29.5 billion of loss that is retained by the insurance industry through deductibles, copays, and assessments will increased $2 billion each of the next four years to $37.5 billion in 2020. It is further proposed that the calculation behind this figure be changed in 2020, such that the total loss retained will be closer to $50 billion.

Q: Is your pool subject to TRIP?

Pools have to consider two aspects of how TRIP applies. First, as a buyer of insurance through reinsurance or excess policies. Second, as a provider of coverage for members.

As a buyer, your pool might participate in TRIP in some way through reinsurance or excess relationships, although the mandates and benefits of TRIP to your pool may be indirect. Or, you may opt out of coverage made available by your excess carrier as mandated by TRIP. These considerations are the same regardless of whether your pool is structured as a licensed insurance carrier.

Only pools that are licensed insurance carriers are required to offer terrorism coverage to members as outlined by TRIP. If your pool is structured as a licensed insurance carrier, and does not fall under any exceptions outlined by TRIP or associated legislative acts, you are covered by TRIP and must provide coverage to your members for terrorism the same as for other insured perils.

Since inception, the provisions of TRIP have included permissive language that indicates the Secretary of Treasury *may* apply TRIP provisions to captive insurers and self-insured arrangements including those formed by municipalities. To be applicable in any certified terrorism event, such provisions must have been promulgated and applied prior to the act of terrorism. To date, applying TRIP to public entity self-insured groups has not been openly considered.

Q: What is "terrorism" under TRIP?

There is no definition of terrorism under TRIP or any of its related acts. The determination of what is an eligible terrorism event under TRIP resides with the Secretary of the Treasury, who is called upon to "certify" a bona fide terrorism event for TRIP. This means a qualifying act of terrorism will only be known after it has occurred and the Secretary of the Treasury has certified it.[1]

[1] This paragraph addresses only the lacking definition of terrorism under TRIP but in truth the complexity of defining a terrorism event is one all pools should carefully consider. Terrorism might be any act that is politically motivated and could include something as simple as a pipe bomb aimed at a city council meeting where there will be debate on a local land use issue. While this sort of event would not come close to qualifying as terrorism under TRIP, it certainly could meet the definition of terrorism (or not) under a pool's reinsurance or excess policies, or under the pool's own coverage document for members.

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TRIP provides some guidance about what might constitute a covered terrorism loss, although meeting these criteria does not guarantee a terrorism event will be certified.

Eligible losses for certification must:

- Be an act of terrorism;
- Be a violent act or an act that is dangerous to human life, property, or infrastructure;
- Have resulted in damage within the United States, to an air carrier, United States flagged vessel, or the premises of a United States mission; and
- Have been committed by an individual or individuals, 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 Unites States Government by coercion.

An event is <u>not</u> eligible to be certified as an act of terrorism if:

- It is committed as part of the course of a war declared by Congress (except with respect to any coverage for workers' compensation); or
- The aggregate property and casualty insurance losses resulting from the act do not exceed $5 million.

<u>Q: What events are *unlikely* to be covered by TRIP</u>?

Some hypothetical examples of events unlikely to be covered by TRIP:

Example 1: An international terrorist group organizes several bombs to detonate at state capitols around the country. The plot is largely thwarted by law enforcement and only two of the ten bombs planted are successfully detonated. Loss of life and property damage include insured losses totaling an estimated $85 million. This act, although likely appropriately considered terrorism, would not meet the $120 million threshold for TRIP certification.

Example 2: A disastrous, intentional explosion topples major buildings and infrastructure in Los Angeles, resulting in mass casualties, property damage, and infrastructure damage of $600 million total insured losses. The perpetrators are never identified and therefore no terroristic motive can be determined. This act might not be certified as terrorism and therefore not eligible for TRIP.

Example 3: A computer virus is spread via commonly used software to all computers, smartphones, and web-enabled devices, with significant hardware damage and associated damage to computer network infrastructures. Insured losses exceed $20 billion. The virus' creator did not intend to coerce or influence any policies; in fact, he did not even intend the virus to be released into public domain. This act might not be certified as terrorism under TRIP.

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Q: How might TRIP impact your pool's reinsurance or excess insurance coverage, cost, or decisions?

Most pools do not see significant cost implications in reinsurance or excess insurance pricing as the result of TRIP. However, any provisions that change the benefits or aggregate loss levels under TRIP, or create additional fees or assessments that must be paid by carriers subject to TRIP, could have modest pricing implications for reinsurance or excess coverage.

Excess insurance carriers must contribute to and participate in TRIP, and must offer you the same coverage for terrorism losses as for any other perils, and they may charge a premium in exchange for the terrorism coverage. This coverage is optional. If you opt to take the terrorism coverage offered, you are participating indirectly in TRIP and there may be benefits under TRIP applicable to your members' losses if all the TRIP event requirements are met.

Reinsurance carriers are not required to contribute to or participate in TRIP. If your pool is structured as a licensed insurance carrier and participates directly in TRIP, your reinsurance coverage should follow form inclusive of your obligations under TRIP. It can be difficult in some cases to discern reinsurance from excess insurance, so pools will want to carefully review their relationships and partnerships.

When you are evaluating reinsurance and excess relationships, it's important to know how you will be impacted by TRIP and how losses will be allocated or paid should your pool members have losses as part of a certified terrorism event. In the case of excess insurance relationships, you should also understand the alignment between the definition of terrorism in your excess policy and that in your policy language for members.

Another, perhaps more important point of clarification, is whether there are coverage limitations as a result of your reinsurance or excess policies should your pool experience a terrorism loss that does not meet the TRIP threshold or is not certified as a terrorism loss by TRIP.

Q: How might TRIP impact the coverage you provide to your members?

If you are directly subject to TRIP as an insurer, you are required to provide members with terrorism coverage just as any other peril, although your members may elect to reject such coverage. Although you may be required to offer the same coverage as for other perils under TRIP, there is no guarantee a terrorism event for which your coverage is triggered will have a corresponding TRIP reimbursement.

If you are not directly required to participate in TRIP, you might be participating indirectly through an excess insurance relationship. This *could* have the impact of extending some protections under TRIP to your members, but it will take careful review of your own coverage documents and your excess insurance policies to compare coverage provisions. It

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is very likely that gaps in coverage exist between the pool's excess policies and member coverage language, which could have an impact on the coverage you intend to provide your members.

Q: Can your pool opt-in to TRIP?
Licensed insurers are required to participate in TRIP. Currently there is no mechanism for others to opt-in.

Q: Are there viable alternatives for terrorism coverage?
Following the 9/11 terrorist attacks, many insurers quickly excluded terrorism from coverage, giving rise to the need for TRIP. Since that time, a global marketplace for terrorism coverage has emerged. Terrorism coverage is available at fairly low cost, covering domestic and foreign terrorism acts, and available for a wider range of possible terrorism events than those contemplated under TRIP.

In fact, one of the currently proposed rules related to TRIP is data collection requested by Congress to compile a report of whether the federal backstop continues to be necessary.

Q: What are the basic provisions of recently proposed rules under TRIP and how might changes apply to public entity pools?
On April 1, the Department of Treasury released proposed rules to implement changes under TRIP. The proposed rules are meaningful to overall TRIP administration, but most do not appear to notably change the TRIP landscape for pools.

Although there are not proposed rules regarding application of TRIP specifically to public entity pools, the *proposed rules do invite specific comment by May 31 "in anticipation of the development of rules" for captive insurers and self-insured arrangements, including those by municipalities and other [presumably private or public] entities*.

Most notably, comments are invited to address:
- What is the current role of self-insurance arrangements in providing workers' compensation reimbursement for losses that could be subject to TRIP?
- What is the current extent of self-insurance arrangements in other TRIA-eligible lines?
- Should self-insurance arrangements qualify for participation in TRIP and do self-insurers wish to participate?
- If self-insurers were to participate, how would that participation be structured?

Other proposed rules that individual pools subject to TRIP may wish to review include:
- Several possible new data collection requirements for insurers participating in TRIP, including data for administration of TRIP generally and claim information should a qualifying TRIP event occur.
- Changes to the claims process and to final netting of TRIP-eligible claims, and to settlement agreement processes.

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- Suggested greater clarity or at least more structured communication as part of the process to certify events under TRIP, with provisions to at least provide periodic updates about the criterion being considered and timeline for determining whether an event will be certified as terrorism.
- Increases to civil penalties that may be assessed against insurers in conjunction with TRIP administration, and slight modifications to the penalty process including penalty notice and response provisions.

In some cases, your pool's own unique circumstance or structure might warrant further evaluation of additionally proposed rules such as revised definitions for attorney-in-fact, reciprocal insurer, small insurer, and captive insurer.

Q: Are these proposed rules good or bad for pools?

For pools that are not licensed insurers, the currently proposed rules probably don't have much impact. General awareness around application of TRIP, the certification and dollar thresholds, and other nuances of how TRIP impacts the terrorism insurance market is always a good idea and pools should monitor the current proposed changes along those lines.

Q: Should pools comment about possible application of rules related to TRIP to a wider array of self-insured groups?

The Department of Treasury's specific invitation as part of proposed rules to comment on application of TRIP to self-insured entities is notable, in particular the framing of it "in anticipation of" further rules. AGRiP anticipates writing comments to represent public entity pooling interests and would welcome input from members on topic.

Specifically, it would be helpful to know:

- Is your pool a licensed insurer?
- Is your pool purchasing excess insurance covered by TRIP for your members?
- Does your pool provide some (possibly limited) coverage for terrorism without relying on TRIP?

Our goal will be to highlight the wide variety of covered risks, membership, financial resources, organizational structures, and possible implications for pools should TRIP be applied to self-insured entities. We are communicating and coordinating with other organizations to prepare comments, including the Self-Insurance Institute of America (SIIA), the Public Risk Management Association (PRIMA), the National League of Cities-Risk Information Sharing Consortium (NLC-RISC), and the California Association of Joint Powers Authorities (CAJPA). Contact Ann Gergen or Joel Kress as soon as possible with your questions or suggestions.

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