AMERICAN ACADEMY of ACTUARIES

May 16, 2003

Terrorism Risk Insurance Program Public Comment Record
Room 3160 Annex
U.S. Department of Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Re: April 15, 2003 Federal Register Interim Final Rule TRIA Comments

To Whom It May Concern:

The Workers' Compensation Subcommittee of the American Academy of Actuaries[1] offers the following comments addressing the implementation of Title I of the Terrorism Risk Insurance Act of 2002 (TRIA) and the April 15, 2003 Interim Final Rule. TRIA creates a temporary Terrorism Insurance Program to provide federal funding for specific workers' compensation (WC) claims and other insured losses that may be precipitated by future acts of terrorism against the United States.

The concerns articulated in this letter apply to various lines of insurance covered by TRIA. However, as the unique characteristics of WC insurance require special consideration, our Subcommittee has taken the lead in responding to your requests for guidance in implementing TRIA. As you seek to implement TRIA, you may be interested in learning more about some existing WC loss funding and/or spreading mechanisms that were created to achieve public policy objectives. In our discussion of the following implementation issues, we review some of these mechanisms and address how they might be incorporated into TRIA implementation plans at either the federal or the state level.

Section 102(1): Because not all acts of terrorism are covered under TRIA, Treasury needs to act quickly to certify terrorist acts to reduce litigation and bad faith actions against insurers.

While this is not a concern for workers' compensation insurers, other insurance carriers are required only to provide coverage and pay claims for certified terrorist acts. Rather than act on a claim they may not be obligated to pay, some insurers may wait until a terrorist act is certified before paying on what may otherwise be a valid claim. Therefore, in the best interests of the victims of a terrorist act, Treasury should act quickly to determine whether or not a terrorist act is covered.

[1] The American Academy of Actuaries (Academy) is the public policy organization for actuaries practicing in all specialties within the United States. A major purpose of the Academy is to act as the public information organization for the profession. The Academy is non-partisan and assists the public policy process through the presentation of clear and objective actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, comments on proposed federal regulations, and works closely with state officials on issues related to insurance. The Academy also develops and upholds actuarial standards of conduct, qualification and practice and the Code of Professional Conduct for all actuaries practicing in the United States.

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Section 102(5): For large employers with excess or large deductible policies, insured loss should only include the portion of loss that exceeds the self-insured retention.

Treasury should establish procedures to determine whether claims submitted by insurers come from large deductible or excess policies, and also to ensure that they reimburse only the portion of claims exceeding the deductible or self-insured retention.

Section 102(6): An adjustment is needed to Direct Earned Premiums (DEP) in order to equitably implement TRIA for workers' compensation residual market entities that meet the criteria in section 103(d)(2)(B).

TRIA recognizes that workers' compensation residual market pools require special treatment (section 103 (d)(2)). Residual market pools that share their profits and losses with private-sector insurers are not treated as separate insurers (section 103(d)(2)(B)). These residual market pools contract with private-sector insurers to act as servicing carriers. The servicing carriers issue residual market policies and service them in exchange for a servicing carrier allowance. In order to equitably implement TRIA for these residual market entities, the premiums written by servicing carriers on behalf of these pools should not be included as DEP for purposes of calculating the servicing carriers' deductibles for losses covered by TRIA. Instead, the premiums assumed by these states' residual market participants should be included in their DEP for purposes of calculating each pool participant's deductible. These adjustments do not change the total industry-wide DEP or deductible.

Section 102(7,11): Property and casualty (P&C) insurance includes many "long tail"[2] lines, which, like WC, pay out benefits to claimants for years and even decades after an accident occurs.

Treasury needs to clarify that the insurer deductibles and maximum federal compensation apply to program years on an <u>accident year basis</u>, i.e. all payments arising from terrorist acts that occur during the program year regardless of when they are paid, rather than on a <u>calendar year basis</u>, i.e. all payments made during the program year regardless of when the terrorist act occurred.

Section 103(e)(8): Terrorism Loss Risk-Spreading Premiums (TLRPs) should be based on DEP as defined and modified in TRIA regulations.

TRIA provides for TLRPs that allow the federal government to fund reimbursements paid to insurers. The TLRPs are calculated as a percentage of P&C premiums, with a maximum rate of 3 percent, commencing at the discretion of the Secretary, and are collected by insurers as a surcharge. The Secretary should clarify that these surcharges are not to be reported as premiums to the National Association of Insurance Commissioners, and that the basis for determining these surcharges should be consistent with the definition of DEP.

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[2] A term used to describe certain types of third-party liability exposures (*e.g.,* professional liability, product liability, errors and omissions, etc.) where the incidence of loss and the determination of damages frequently extend beyond the term the insurance or reinsurance.

Section 103(f): Determining DEP on a comparable basis for captive insurers and other self-insurance arrangements may be controversial and problematic.

In considering whether to include captive insurers and self-insurance arrangements under TRIA, Section 103(f) requires that "all of the provisions of this title are applied comparably to such entities." Because self-insured businesses do not have "normal" premiums, and because efforts by regulators to determine a theoretical "normal" premium can be controversial, developing a consistent definition of DEP for captive insurers and other self-insurance arrangements and capturing this information may be problematic. In addition, if captive insurers are covered, adjustments may be needed for those captives that have no DEP because they issue policies through insurers, i.e. fronting companies, who in turn cede most of the premium to the captive as reinsurance. If reinsurance assumed by captives is treated as DEP for TRIA purposes, then to avoid double counting, the premiums ceded by fronting companies to these captives should be deducted from their DEP in much the same manner that residual market premiums are deducted from servicing carrier premiums as we have suggested in Section 102(6).

Considerations regarding a long-term replacement for the federal backstop mechanism to fund losses arising from acts of terrorism

Congress acknowledges that "the absence of information from which financial institutions can make statistically valid estimates of the probability and cost of future terrorist events" has created "widespread financial uncertainties" that contribute to a lack of available terrorism insurance (except for workers' compensation). Our Subcommittee is mindful that these conditions will not change when this temporary program is scheduled to terminate. As stated by Richard Falmouth at a recent conference on TRIA, terrorism is "not a statistically patterned phenomenon." Therefore, we believe that it is not likely that a "voluntary" market for terrorism coverage will emerge by the time this federal program expires.

Even though there has been no change in the lack of valid data to predict the frequency of these attacks and their expected costs, Congress intends this program to be temporary until private markets can "stabilize, resume pricing … and build capacity to absorb any future losses." Because this program is set to expire at the end of 2005, employers, insurers, and the Academy are focused not only on the successful implementation of TRIA program, but also on the development of a permanent extension of, or replacement for, this program.

Thank you for your consideration. If you have any questions or would like more information, please contact Greg Vass, the Academy's senior casualty policy analyst, at (202) 223-8196 or vass@actuary.org

Sincerely,

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