Lessons Learned from TRIA Unplugged

Written by Bruce Shutan

The foot soldiers of self-insured captives and workers' comp programs waited patiently along the outskirts of a political battlefield riddled with fear and anxiety, breathing a collective sigh of relief upon learning that the Terrorism Risk Insurance Act of 2002 (TRIA) finally had been reauthorized.

An unanticipated legislative roadblock that caused the landmark legislation to lapse for about a month after Congress adjourned for the 2014 holiday season became a distant memory as industry insiders rejoiced. TRIA, which was created in response to the Sept. 11, 2001, terrorist attacks, allows the U.S. government to repay business costs exceeding $100 million that are traced to acts of terrorism.

The biggest lesson learned was that the self-insured industry will need to do a better job planning ahead for the possibility of TRIA not being reauthorized in the future, observes Patrick Theriault, managing director of Strategic Risk Solutions.

"I would expect to see the majority of contracts having provisions that would take consideration possible non-renewal and with automatic adjustments under that scenario," he says. "We may also see even more folks adjusting the effective dates of their agreements to have their policies coincide with the next TRIA expiration date. Bottom line: I think we'll be better prepared for the non-renewal situation."

Marketplace angst over TRIA's uncertain fate, albeit short-lived, demonstrates just how fragile the situation had become, and as such, the importance of building captive policies that are mindful of it happening again, adds David Provost, deputy commissioner of captive insurance for the Vermont Department of Financial Regulation.

Many state regulators huddled late in the fall of 2014 to devise an alternative to TRIA in case it wasn't reauthorized, but Provost reports that there wasn't enough funding. "You need something the size of the federal government to come up with that kind of money on short notice," he says.

A company that files a claim if TRIA should lapse in the future would "have whatever assets and reinsurance outside the federal backstop, and the policies will respond appropriately and to the extent that they can," he observes. His assumption is that "the captive would close up or be recapitalized after that claim. In some respects, that's how we operate with a lot of captives. They are capitalized at a level that's appropriate for the expected losses at some level of adversity, but they're not capitalized for the absolute worst-case scenario in every case."

Most Vermont captives took a wait-and-see approach to TRIA renewals and didn't want to risk losing whatever coverage they had, though Provost recalls how one particular arrangement was made for other terrorism coverage during a mid-summer renewal. "They weren't waiting until December or January to see if Congress was going to act," he says. "They didn't have the option of waiting."

Some of Theriault's clients were savvy enough to add provisions within their captive programs that would automatically take effect even if TRIA wasn't reauthorized, though they immediately faced a reduction in coverage and increase in price.

One company ended up paying nearly four times its anticipated captive/reinsurance program premium for a direct program last year. "They ended up running out of time putting the captive program in place because the lenders basically forced them to place coverage in the commercial market in order to finalize the real estate transactions," he says. Others clients instructed their brokers to investigate whether they needed to switch to commercial coverage.

Harsh Reminders

The irony of TRIA's temporary lapse is that it coincided with two major terrorism events, both strangely enough involving satire, that reminded the nation about the importance of reauthorizing TRIA without hesitation.

The first was a so-called hack attack at Sony, whose internal data was compromised and traced to cyber-terrorists in North Korea. Their apparent objection: the movie studio's release of "The Interview," a comedy about an attempt to assassinate the isolated country's dictator, Kim Jong-un. The second, which happened when the Senate overwhelmingly approved TRIA's reauthorization just as the House did the previous day, involved a terrorist attack in Paris that left 12 people dead at a satirical magazine that had poked fun at Islam and was deemed France's deadliest such incident in more than 50 years.

If the Sony attack, which included leaked e-mails that embarrassed some of Hollywood's leading actors, ultimately is confirmed to be a terrorist act and not the work of a disgruntled former employee as was also reported, then the entertainment conglomerate would have recourse against TRIA for significant damages. So says Les Boughner, deputy CEO of Willis Global Captive Practice and SIIA's most recent past chairman.

The incident highlights "the inherent uninsured business risks that corporations face," according to Duke Niedringhaus, an insurance broker with J.W. Terrill Inc. who chairs SIIA's Workers' Comp Committee. "The data breach, reputational risk, litigation expense and loss of revenue could all be funded through an enterprise risk captive. Sony will certainly incur significant expenses that are not covered by traditional property or casualty insurance policies. These are the typical coverage gaps that should be funded through a captive."

Pricing Risk

There was some indication leading up to TRIA's reauthorization lapse that insurance carriers were considering increasing the supply of captive programs, though Theriault didn't think "the supply would follow the demand in a situation of TRIA non-renewal."

Another component was the nuclear, biological, chemical and radiological part of the coverage for extreme types of terrorism events such as a dirty bomb. "While there is some availability for terrorism in the commercial market, there's virtually none that I'm aware of for NBCR other than a small amount of coverage available through London," he explains. "TRIA fills a void there, as well as helping with supply or availability and pricing – especially in major centers like New York City.

"The TRIA renewal would see retention increase from 15% to 20%," Theriault continues, "and the early indications provided by reinsurance brokers on quotes for the additional 5% for some of our clients in high-risk area such as NYC show a much higher pricing than what we saw last year for the coverage – with some carrier even stating that they do not have capacity for the additional percentage, which demonstrates the likely major imbalance we would have faced without TRIA. So, even with TRIA renewed, pricing for coverage is difficult and very sensitive to demand, and captives is one tool to try to manage availability and pricing."

It's also worth noting that many first-party transactions between commercial reinsurance captives and middle-market companies were built around a flat pricing that didn't reflect the organization's location, according to Theriault. "A company in the Midwest should not pay the same amount of money to its captive for the same amount of terrorism coverage as something in New York City," he says.

Larger Economic Impact

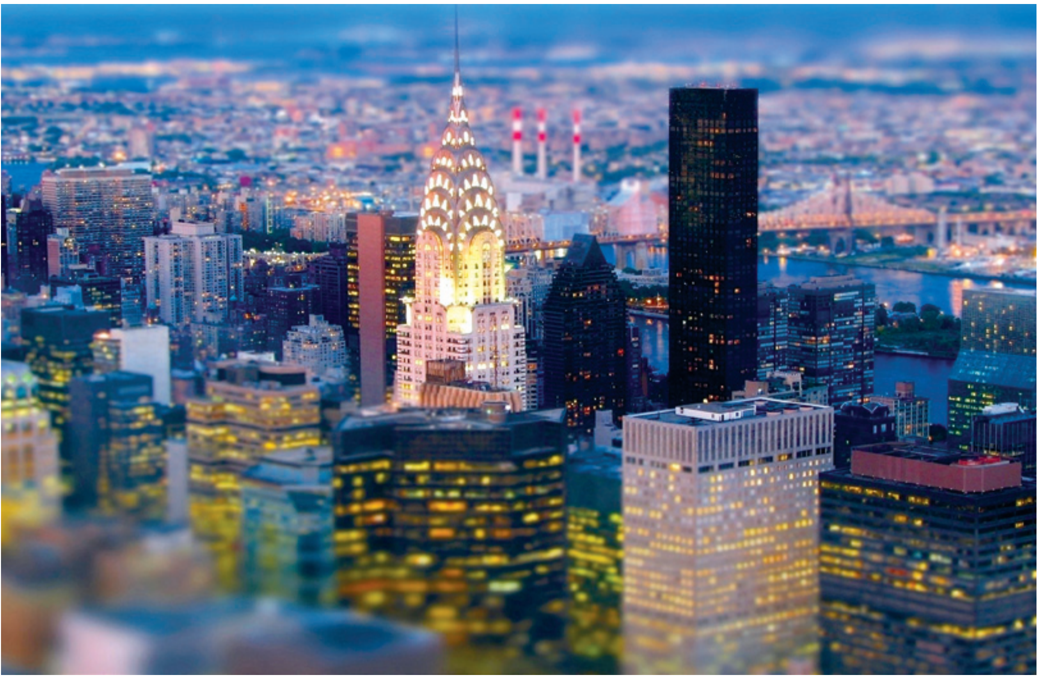
The implications of TRIA's temporary lapse went far beyond insurance, spotlighting the role of banking. Lawmakers failed to realize the connection between how a material drop in limits would cause a technical default of borrowing and lending agreements, Boughner observes. In short, he says any protracted congressional inaction on this issue would have potentially had "a very large impact on the economy."

A hard-line stance to block a Senate vote on TRIA was adopted by Sen. Tom Coburn (R-Okla.), who was concerned about an unrelated separate rider. And while Boughner says the retiring senator had expressed consternation about the issue of insurance agency licensing, he adds that the larger point to consider is that "insurance facilitates a lot of construction and infrastructure development."

Captive programs weren't the only area of concern for self-insurance. When Congress failed to reauthorize TRIA, excess workers' comp carriers continued

to provide full statutory limits assuming the TRIA extension would be the first priority in 2015. "The excess markets did not overreact," Niedringhaus reports.

An extended non-renewal lapse beyond January "may have disrupted the marketplace with fewer carriers offering capacity and most likely higher premiums," surmises Tom Hebson, VP of product development and government relations at Safety National Casualty Corporation, addressing the workers' comp carrier side of the equation.



Asked what it's like to be a regulator in a state that's not a terrorism target, Provost says there are still local businesses that use captives to access TRIA to safeguard "installations of various kinds across the country that they view as potential targets," including Manhattan skyscrapers.

Provost calls TRIA "a reasonable and necessary tool for companies to operate with," noting that "acts of terrorism aren't something we can predict, and in theory, they're not insurable. But this is something that Congress has established, and it's not a free ride. Companies have to pay the money back. It's just a help to get over the shock of a major terrorism event again. It's almost like flood insurance. At some point, if you have a disaster, the federal government is going to step in anyhow. This way, at least we have a way to pay them back, and it's all done in writing about how it's supposed to work if something like 9/11 happens again."

Bruce Shutan is a Los Angeles freelance writer who has closely covered the employee benefits industry for more than 25 years.