Study of Small Insurer Competitiveness in the Terrorism Risk Insurance Marketplace

FEDERAL INSURANCE OFFICE, U.S. DEPARTMENT OF THE TREASURY

JUNE 2017

Table of Contents

I. Introduction 1

II. The Terrorism Risk Insurance Program 4

III. The Data Collection Process 8

IV. Study of Small Insurer Competitiveness in the Terrorism Risk Insurance Marketplace 10

A. Analysis of Changes to Market Share, Premium Volume, and Policyholder Surplus 10

B. Market Differences between Small Insurers and Large Insurers in the Terrorism Risk Insurance Marketplace and Comparison to Other Perils 14

C. Mandatory Availability Requirement 20

D. Impact of the Increasing Program Trigger Amount 21

E. Availability and Cost of Private Reinsurance for Small Insurers 23

F. Impact of State Workers' Compensation Laws 27

V. Conclusion 30

Glossary

2015 Reauthorization Act	....	Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. 114-1, 129 Stat. 3
2016 Effectiveness Report	....	"Report on the Overall Effectiveness of the Terrorism Risk Insurance Program," U.S. Department of Treasury (June 2016)
CMP	....	Commercial Multi-Peril
DEP	....	Direct Earned Premium
FIO	....	Federal Insurance Office
NBCR	....	Nuclear, Biological, Chemical, or Radiological
P/C	....	Commercial Property and Casualty
Program (or TRIP)	....	Terrorism Risk Insurance Program
Program Cap	....	Annual exposure limit for the federal government and insurers under the Program
Program Trigger	....	Minimum amount of aggregate industry insured losses resulting from an act of terrorism that must occur in a calendar year before any federal payments are made
Study	....	This "Study of Small Insurer Competitiveness in the Terrorism Risk Insurance Marketplace," U.S. Department of Treasury (June 2017)
Secretary	....	Secretary of the Treasury
September 11 Attacks	....	Terrorist attacks occurring on September 11, 2001
Small Insurer	....	An insurer as defined under 31 C.F.R. § 50.4(z)
SNL Financial	....	SNL Financial, LC
Treasury	....	U.S. Department of the Treasury
TRIA	....	Terrorism Risk Insurance Act of 2002, as amended
TRIP (or Program)	....	Terrorism Risk Insurance Program
TRIP-Eligible Lines of Insurance	....	Commercial property and casualty insurance subject to the Terrorism Risk Insurance Program pursuant to 31 C.F.R. § 50.4(w)

I. Introduction

Prior to September 11, 2001, commercial property and casualty (P/C) insurance policies generally did not exclude coverage for losses resulting from terrorism. The events of September 11, 2001 (September 11 Attacks) resulted in approximately $43 billion of P/C insurance losses,[1] more than two-thirds of which were reimbursed by reinsurers to insurers.[2] Thereafter, insurers and reinsurers began to exclude coverage for terrorism risk from P/C policies.

Congress enacted the Terrorism Risk Insurance Act of 2002 (TRIA),[3] in part, because the widespread unavailability of terrorism risk insurance "could seriously hamper ongoing and planned construction, property acquisition, and other business projects, generate a dramatic increase in rents, and otherwise suppress economic activity."[4] TRIA established the Terrorism Risk Insurance Program (TRIP or Program), which requires insurers to make terrorism risk coverage available within certain lines of commercial P/C insurance (TRIP-eligible lines of insurance).[5] To assist insurers with the potential financial exposure resulting from this required offer of terrorism coverage, certain insurance losses resulting from an "act of terrorism" as defined by TRIA are eligible for reimbursement through the Program.[6] The Program is administered in the U.S. Department of the Treasury (Treasury) by the Secretary of the Treasury (Secretary) with the assistance of the Federal Insurance Office.[7]

---

[1] Insured losses shown in 2015 dollars. *See* Jayleen R. Heft, "9/11 attacks 15 years later: A look at losses by the numbers," PropertyCasualty360 (September 7, 2016), *available at* http://www.propertycasualty360.com/2016/09/07/9-11-attacks-15-years-later-a-look-at-losses-by-th.

[2] "9/11 and Insurance: The Eight Year Anniversary," Insurance Journal (September 11, 2009), *available at* http://www.insurancejournal.com/news/national/2009/09/11/103694.htm.

[3] 15 U.S.C. § 6701 note. The provisions of TRIA, as amended (including the Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. 114-1, 129 Stat. 3), appear in a note of the United States Code, and, therefore, references to the provisions of TRIA or the 2015 Reauthorization Act are identified by the sections of the law (*e.g.*, "TRIA § 102(1) (definition of an "act of terrorism")").

[4] TRIA § 101(a)(5).

[5] *See* TRIA § 103(c). The TRIP-eligible lines of insurance are defined as those lines identified for state regulatory purposes as follows: Fire, Allied Lines, Commercial Multiple Peril (non-liability), Commercial Multiple Peril (liability), Ocean Marine, Inland Marine, Workers' Compensation, Other Liability (but not including Professional Liability, which is otherwise within this line for state reporting purposes), Products Liability, Aircraft, and Boiler and Machinery. 31 C.F.R. § 50.4(w). Some of these lines also contain personal property and casualty premium exposures that are not subject to the Program. There are also certain other defined exclusions within these lines, which are outlined at 31 C.F.R. § 50.4(w)(2).

[6] Further details concerning the operation of the Program are provided in Section II of this Study.

[7] 31 U.S.C. § 313(c)(1)(D).

TRIA originally authorized the Program for a three-year period ending December 31, 2005. The Program has since been reauthorized three times,[8] most recently in 2015 when the Terrorism Risk Insurance Program Reauthorization Act of 2015 (2015 Reauthorization Act) extended the Program through December 31, 2020.[9] Changes enacted with each Program renewal have generally reduced potential federal exposure to insured losses.

The 2015 Reauthorization Act provides that the Secretary shall conduct studies of small insurers participating in the Program, and identify any competitive challenges such small insurers face in the terrorism risk insurance marketplace.[10] The first small insurer study is to be conducted in 2017, and a second study in 2019. The 2015 Reauthorization Act also requires the Secretary to define the "small insurers" subject to these studies through regulation.[11]

TRIA requires the studies of small insurers to include analyses of:

(1) Changes to the market share, premium volume, and policyholder surplus of small insurers relative to large insurers;
(2) How the P/C insurance market for terrorism risk differs between small and large insurers and whether such a difference exists within other perils;
(3) The impact of the Program's mandatory availability requirement under section 103(c) on small insurers;
(4) The effect of increasing the trigger amount for the Program under section 103(e)(1)(B) on small insurers;
(5) The availability and cost of private reinsurance for small insurers; and
(6) The impact that State workers' compensation laws have on small insurers and workers' compensation carriers in the terrorism risk insurance marketplace.[12]

The Secretary is required to submit a report to the Congress setting forth the findings and conclusions of each small insurer study.

This Study addresses Treasury's initial findings and conclusions on small insurer competitiveness. Based on data collected to date, and as described in the Study, Treasury has identified several areas for further investigation. As Treasury collects more data over subsequent

[8] Terrorism Risk Insurance Extension Act of 2005, Pub. L. 109-144, 119 Stat. 2660; Terrorism Risk Insurance Program Reauthorization Act of 2007, Pub. L. 110-160, 121 Stat. 1839; Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. 114-1, 129 Stat. 3.

[9] Treasury has issued rules to implement changes to TRIA under the 2015 Reauthorization Act, and for other purposes. *See* 81 Fed. Reg. 88592 (December 7, 2016) (Certification Interim Final Rule); 81 Fed. Reg. 93756 (December 21, 2016) (Program Final Rules except Certification).

[10] TRIA § 108(h).

[11] TRIA § 108(h)(1). The small insurer definition was adopted by Final Rule in December 2016. *See* 81 Fed. Reg. 93756, 93757-59 (December 21, 2016).

[12] TRIA § 108(h).

years, enabling more sophisticated analysis of market changes, it will refine its observations and conclusions regarding competitiveness issues possibly faced by small insurers participating in the terrorism risk insurance marketplace. Treasury will also assess whether changes to the TRIP data call are warranted to provide additional information for its 2019 study.

II. The Terrorism Risk Insurance Program

The Program requires that each entity meeting the definition of an insurer make available coverage for insured losses resulting from acts of terrorism.[13] This offer must "not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism." The "make available" requirement applies only to TRIP-eligible lines of insurance.[14] TRIA does not mandate that insurers offer terrorism risk insurance for any particular price,[15] nor does TRIA require any policyholder to purchase insurance for terrorism risk.[16]

Insurers are eligible for federal payments under the Program only for losses resulting from "acts of terrorism." An "act of terrorism" is defined under TRIA as an act certified by the Secretary, in consultation with the Attorney General of the United States and the Secretary of Homeland Security:

- to be an act of terrorism;
- to be a violent act or an act that is dangerous to human life, property, or infrastructure;
- to have resulted in damage within the United States;[17] and
- to 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 U.S. government by coercion.[18]

Additionally, the Secretary shall not certify an act that was either committed as part of the course of a war declared by Congress,[19] or that does not result in P/C insurance losses exceeding $5 million.[20] If the Secretary certifies an act of terrorism, participating insurers may submit claims

[13] An insurer is defined under TRIA as any entity, including any affiliate thereof, which receives direct earned premiums for TRIP-eligible lines of insurance and is licensed or admitted to engage in the business of insurance in any state; an eligible surplus lines carrier; a federally-approved maritime, energy, or aviation insurer; a state residual market insurance entity or workers' compensation fund; or, to the extent provided in rules issued by the Secretary, a captive insurer or a self-insurance arrangement. TRIA § 102(6).

[14] Reinsurance is excluded from the TRIP-eligible lines of insurance. TRIA § 102(11)(B)(vii). Issues concerning small insurers' use of private reinsurance and the Program are discussed further below at Section IV.E.

[15] State insurance rating laws and regulations may affect the price that can be charged by insurers writing terrorism risk insurance subject to TRIA.

[16] In some circumstances, state law may require the purchase of (or limit the ability to exclude) coverage for terrorism risk, such as in the case of workers' compensation insurance, discussed further below in Section IV.F.

[17] TRIA also provides that an act may occur outside the United States in the case of certain air carriers or vessels, or on the premises of a U.S. mission. TRIA § 102(1)(A)(iii).

[18] TRIA § 102(1)(A).

[19] This limiting clause regarding an act of war does not apply to coverage for workers' compensation insurance. TRIA § 102(1)(B)(i).

[20] TRIA § 102(1)(B)(ii).

to Treasury and Treasury will determine whether, and in what amounts, insurers are eligible for payments under the Program.[21]

A participating insurer's recovery under the Program is based on application of its individual insurer deductible, the Program Trigger, the federal share of compensation of an insurer's losses, and the Program Cap. Treasury may obtain reimbursement of any payments of the federal share of compensation that it makes based upon the recoupment process. Finally, Treasury has adopted a definition of "small insurers" to guide its analysis of any competitive challenges that such small insurers may face in the terrorism risk insurance marketplace.

Insurer Deductible

Two pre-requisites must be met before an insurer is eligible for payments from Treasury under the Program: the insurer's losses must exceed its deductible, and the Program Trigger must be satisfied. An individual insurer will not be eligible to receive federal payments unless its losses exceed its deductible, which is 20 percent of the insurer's direct earned premium (DEP) in the TRIP-eligible lines for the prior calendar year.[22]

Program Trigger

The Program Trigger is the minimum amount of aggregate industry insured losses resulting from an act (or acts) of terrorism that must occur in a calendar year before any federal payments are made. The Program Trigger was $120 million in calendar year 2016;[23] it increases by $20 million per year thereafter until it reaches $200 million in 2020.[24]

Federal Share of Compensation

After an insurer meets its insurer deductible and the Program Trigger is satisfied, the federal government will pay a certain percentage of that insurer's losses in excess of the insurer's deductible. For calendar year 2016, the federal share of compensation was set at 84 percent of an insurer's losses above its deductible, with the insurer responsible for the remaining 16 percent. The federal share of compensation will continue to decrease (and the insurer share will

[21] Any determination by Treasury is made pursuant to the Program regulations. *See* 31 C.F.R. Part 50.

[22] TRIA § 102(7).

[23] The 2015 Reauthorization Act provided for certain changes in Program mechanics from the date of the 2015 Reauthorization until the expiration date for the Program in 2020. This Study focuses upon the Program structure in place in 2016 because much of the Study's analysis is based on the 2017 TRIP data call, which uses year-end 2016 data.

[24] TRIA § 103(e)(1)(B). TRIA did not originally have a Program Trigger. This requirement was introduced in the 2005 Program reauthorization. It was initially set at $50 million (for losses occurring in 2006), and increased to $100 million for losses occurring in 2007. When TRIP was reauthorized through 2014, no change was made to the Program Trigger, which remained at $100 million. The 2015 Reauthorization Act, however, provides for an annual increase in the Program Trigger beginning in 2016.

increase) by one percentage point per year through 2020, at which time the federal share will be 80 percent and the insurer co-participation share will be 20 percent.[25]

Program Cap

TRIA limits the aggregate exposure of both insurers and the federal government arising from insured losses for an act or acts of terrorism. Specifically, TRIA prohibits the Secretary from making payments for any portion of aggregate insured losses from acts of terrorism which exceed the "Program Cap" of $100 billion during any calendar year.[26] If the Program Cap is reached, an insurer that has met its insurer deductible by making payments for insured losses subject to the Program is not liable for any portion of losses that exceeds the Program Cap.[27]

Recoupment

TRIA includes a mechanism for the Secretary to collect "terrorism loss risk-spreading premiums" from insurers if federal payments are made to insurers under the Program. Under this mechanism, a process known as recoupment, insurers writing TRIP-eligible lines of insurance may be required to collect funds from policyholders by placing a surcharge on insurance policies written in those lines. These surcharges must then be remitted to the Secretary.[28] The requirement to collect, or recoup, terrorism loss risk-spreading premiums does not apply only to insurers that received federal payments under the Program, but rather applies to all insurers writing policies in TRIP-eligible lines of insurance. Surcharges are placed on insurance policies regardless of whether the policyholder elects to purchase terrorism risk insurance.[29]

Small Insurer Definition

Treasury adopted its small insurer definition as required by the 2015 Reauthorization Act[30] to provide a benchmark for any study of small insurers that would help identify any competitive challenges such small insurers might face in the terrorism risk insurance marketplace.[31] The small insurer definition specifically references the impact of the Program Trigger:

---

[25] TRIA § 103(e)(1)(A).

[26] TRIA §103(e)(2)(A).

[27] TRIA requires the Secretary to notify Congress if insured losses are projected to exceed the Program Cap and in that case to determine the pro rata share of insured losses to be paid by each affected insurer. TRIA §§ 103(e)(2)-(3).

[28] TRIA §§ 103(e)(7)-(8).

[29] Depending on how any federal payments under TRIP that have been expended compare with the total insured losses paid by participating insurers, recoupment under the Program may be mandatory, or may be subject to a discretionary determination by the Secretary. *See id*.

[30] TRIA § 108(h)(1).

[31] Treasury's small insurer definition should not be viewed as having relevance to any other definition of "small insurer" that may be used in other statutory and regulatory determinations, either at the federal or state levels.

> *Small insurer* means an insurer (or an affiliated group of insurers . . .) whose policyholder surplus for the immediately preceding year . . . is less than five times the Program Trigger amount for the current year and whose direct earned premium for the preceding year is also less than five times the Program Trigger amount for the current year. An insurer that has not had a full year of operations during the immediately preceding calendar year is a small insurer if its policyholder surplus in the current year is less than five times the Program Trigger amount for the current year. A captive insurer is not a small insurer, regardless of the size of its policyholder surplus or direct earned premium.[32]

Significance of the Program Trigger for Small Insurers

For an insurer above the small insurer size threshold, the Program Trigger has no practical impact. This is because once an insurer of this size has satisfied its insurer deductible, those losses will be sufficient to satisfy the Program Trigger as well. Such an insurer will be entitled to submit claims for the federal share of compensation for any amount in excess of its insurer deductible.

For a small insurer, however, the Program Trigger might pose a very significant consideration. This is because a small insurer may pay insured losses that are in excess of its insurer deductible that do not, in and of themselves, satisfy the Program Trigger. For example, if in 2016 an insurer had a deductible of $20 million (because its DEP in 2015 was $100 million), and paid total insured losses of $60 million, the insurer would not be entitled to payments under the Program for losses above its deductible (in this example, $40 million) unless total insured losses across all Program participants from an act or acts of terrorism were above the Program Trigger of $120 million. If this hypothetical insurer were the only insurer that sustained insured losses, it would not be able to collect any portion of the $40 million above its deductible because the Program Trigger had not been satisfied.

[32] 31 C.F.R. § 50.4(z).

III. The Data Collection Process

TRIA requires Treasury to collect data related to the Program.[33] Treasury uses this data, among other things, to prepare required studies and reports concerning the effectiveness of the Program and small insurer competitiveness in the terrorism risk insurance marketplace. This Study is based primarily on the results of Treasury's 2017 TRIP data call. In addition, Treasury performed qualitative research and sought input from stakeholders, including small insurers, other Program participants, state regulators, the National Association of Insurance Commissioners, and the general public.[34] When analyzing certain market changes over time for this Study, Treasury also considered information reported by insurers to state regulators.

The 2017 TRIP data call was mandatory for participating insurers,[35] subject to an exception for small insurers that wrote less than $10 million in TRIP-eligible lines premium in calendar year 2016.[36] For the purposes of the 2017 TRIP data call and this Study, small insurers were considered to be (pursuant to the small insurer definition) insurers with a 2015 policyholder surplus of under $600 million and 2015 TRIP-eligible direct earned premium of under $600 million, which is five times the 2016 Program Trigger of $120 million.

Treasury collected information on a group basis from multiple affiliated companies because TRIP is generally administered on a group basis. The information collected included data concerning premium, policy exposures, and reinsurance. Treasury also collected data to evaluate policyholder take-up rates for terrorism risk insurance offered by small insurers. Treasury collected similar information from other industry segments, such as larger licensed insurers above the small insurer threshold (or "non-small insurers"), captive insurers, and alien surplus lines insurers.

Treasury collected data through a third-party insurance statistical aggregator, as provided for under the 2015 Reauthorization Act.[37] The statistical aggregator provided results to Treasury in an aggregated, anonymous format that did not identify any particular reporting insurer. Treasury obtained most of the workers' compensation insurance elements from the National Council on Compensation Insurance (providing data from the states in which it operates as well as on behalf of other independent state workers' compensation rating bureaus) and the California Workers'

---

[33] TRIA § 104(h).

[34] *See* 81 Fed. Reg. 95310 (December 27, 2016).

[35] Insurers that are not small insurers are subject to different reporting templates that request more information. In the 2017 TRIP data call, Treasury has permitted insurers that did not complete the small insurer template to report the balance of the information unrelated to this Study no later than October 1, 2017.

[36] Treasury estimates that insurers eligible for this reporting exception (approximately 400 in total) represent 0.5 percent of the TRIP-eligible lines premium market, and 4.5 percent of the small insurer market segment. *See* SNL Financial (as of April 13, 2017).

[37] TRIA § 104(h)(3). The data aggregator for the 2017 TRIP data call was Insurance Services Office, Inc.

Compensation Insurance Rating Bureau, thereby reducing the reporting requirements on the industry.

Treasury is required annually to collect information relating to terrorism risk insurance from all participating insurers, including captive insurers[38] and alien surplus lines insurers.[39] Treasury specifically excluded captive insurers from the definition of small insurers, so such insurers were not subject to this Study's analysis of small insurers.[40] Although alien surplus lines insurers were not excluded from the "small insurer" definition, they only participate in the surplus market where the coverages and policyholders insured on a surplus lines basis may differ significantly from risks placed in the admitted market.[41] Therefore, to ensure that the issues identified in the 2015 Reauthorization Act are appropriately addressed, this Study does not address how alien surplus lines insurers participate in the terrorism risk insurance marketplace, or how their participation compares with that of those small insurers that Treasury analyzed.

Based on comparisons to data collected by state regulators, Treasury estimates that insurers reporting in the 2017 TRIP data call comprise at least 88 percent, by premium, of the insurer groups or companies expected to report on the small insurer data template, and at least 98 percent, by premium, of the insurer groups or companies expected to report on the non-small insurer data template. Some portion of the amounts below 100 percent may be attributable to the fact that the analysis was based upon available state data that included certain premium that was not subject to the Program. Treasury will continue to analyze whether more detailed information is available.

---

[38] TRIA regulations define captive insurers as insurers licensed under the captive insurance laws or regulations of any state (31 C.F.R. § 50.4(g)); they are typically formed to insure the risks of parent or other affiliated entities.

[39] Alien surplus lines insurers are non-U.S. insurers that have been qualified by state regulators to participate in U.S. insurance markets on a surplus lines basis. Alien surplus lines insurers do not write in the admitted market, which is comprised of insurers licensed to do business in a particular jurisdiction and are subject to its laws and regulations concerning the provision of insurance coverage. This means that alien surplus lines insurers are only allowed to write insurance for risks that cannot be placed with domestic licensed insurers in the admitted market. *See* 31 C.F.R. § 50.4(o)(1)(i)(B).

[40] *See generally* 81 Fed. Reg. 18950, 18952-53 (April 1, 2016); 81 Fed. Reg. 93756, 93757-58 (December 21, 2016).

[41] Although U.S. "small insurers" may also write insurance in the surplus market, only 7.5 percent of the individual insurers within the small insurer groups that reported in the 2017 TRIP data call identified as surplus lines insurers. In addition, because alien surplus lines insurers do not write in the admitted market, they do not participate in the market for workers' compensation insurance, which is discussed in Section IV.F.

IV. Study of Small Insurer Competitiveness in the Terrorism Risk Insurance Marketplace

As noted above, TRIA requires the studies of small insurers to include an analysis of each of the following six areas:

A. Changes to market share, premium volume, and policyholder surplus of small insurers relative to large insurers;
B. How the P/C insurance market for terrorism risk differs between small and large insurers and whether such a difference exists within other perils;
C. The impact of the Program's mandatory availability requirement under Section 103(c) on small insurers;
D. The effect of increasing the trigger amount for the Program under Section 103(e)(1)(B) on small insurers;
E. The availability and cost of private reinsurance for small insurers; and
F. The impact that State workers' compensation laws have on small insurers and workers' compensation carriers in the terrorism risk insurance marketplace.

This Study analyzes each of these areas. Treasury will continue to analyze these areas in its small insurer study to be issued in 2019.

A. Analysis of Changes to Market Share, Premium Volume, and Policyholder Surplus

This part of the Study examines changes to market share, premium volume, and policyholder surplus of small insurers relative to large insurers. For purposes of this Study, Treasury identified "large insurers" as those insurers larger than the small insurer size threshold and which completed the "non-small" data collection template. The Study analyzes the changes for small insurers from 2006 through 2016 because these are the years during which TRIP has been subject to a Program Trigger, which Treasury uses as a basis for defining small insurers.[42] However, the 2017 TRIP data call, addressing 2016 year-end information, was the first year of mandatory data collection by Treasury.[43] As discussed below, Treasury reviewed state reporting

[42] *See* above at Section II. Although the small insurer definition was not adopted until 2016, Treasury performed this analysis from 2006 to 2016 based on the number of insurers that would have been considered to be "small insurers" under the Program, if the "small insurer" definition had been in effect since 2006.

[43] Treasury performed a data collection in 2016; however, because it was the first year of data collection under the 2015 Reauthorization Act, Treasury made participation in the collection voluntary to reduce the imposition of undue burdens on insurers. *See* 81 Fed. Reg. 11649 (March 4, 2016). Insurers representing approximately 41 percent of the entire terrorism risk insurance market (by premium) responded to the 2016 voluntary data call. Because of the more limited response in the 2016 data call, the Study does not compare results from the 2016 voluntary data call and the 2017 mandatory data call. For more information about the 2016 voluntary data call, *see* "Report on the Overall Effectiveness of the Terrorism Risk Insurance Program," U.S. Department of Treasury (June 2016) (2016 Effectiveness Report), *available at* https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2016_TRIP_Effectiveness_%20Report_FINAL.pdf.

data to draw conclusions for the period from 2006 through 2016, and considered the extent to which this reporting data could be used as a proxy for information collected through a mandatory data collection.

State insurance regulators collect information for P/C lines of insurance from insurers licensed in their respective jurisdictions. This collection by state regulators has not historically included information specific to the terrorism risk insurance component of P/C insurance policies. However, the information collected by state regulators does identify premiums collected by lines of insurance in the state insurance reporting lines. To the extent possible, Treasury has defined TRIP-eligible lines of insurance by reference to state insurance reporting lines; however, there are some differences between the TRIP-eligible lines of insurance and the same lines when used for state reporting purposes. This is because the state reporting lines include certain premium that is not subject to the Program. In the 2017 TRIP data call, the premium reported by small insurers to Treasury for calendar year 2016 was approximately 83 percent of the reported figure made by the same cohort of insurers in the TRIP-eligible lines for state reporting purposes.[44] This 17 percent difference represents premium that those small insurers reported to state regulators, across the various lines, that is not subject to the Program.

The use of the state reporting data for this part of the Study allows for some comparisons to be made from 2006 to 2016; however, it also has some limitations. First, Treasury adjusted the data to account for the premium differential between the TRIP-eligible lines of insurance and the state reporting lines from 2006 to 2016. This was done by assuming that similar amounts of premium in the state reporting lines from 2006 to 2016 represented premium not subject to the Program but still reported for state purposes. Second, the state reporting data used in this analysis was not specific to terrorism risk. Third, the premium writings of small insurers reported in the TRIP-eligible lines of insurance that were not subject to the Program could vary disproportionately over time from the premiums reported in the lines as a whole. For purposes of this initial analysis, Treasury considers the data, as adjusted, to be instructive. Treasury will continue to analyze such market changes in the 2019 study, which will have the benefit of additional responses to future TRIP data calls.

The analysis of market changes from 2006 to 2016 was also affected by the connection between the "small insurer" definition and the Program Trigger. From 2006 to 2016, the Program Trigger increased twice, which affects the number of insurers classified as "small insurers."[45] The increase in the Program Trigger between 2006 and 2007 and between 2015 and 2016 caused the number of insurers classified as "small insurers" to increase because a greater number of insurers were below the policyholder surplus and DEP thresholds. This change in the Program Trigger corresponded with an increase in the market share of small insurers from 2006 to 2007

[44] SNL Financial (as of April 13, 2017) and 2017 TRIP data call. The principal differences are in: (1) the Fire, Allied Lines, and Inland Marine lines of insurance, which for state reporting purposes include personal lines exposures that are not subject to the Program; and (2) professional liability insurance, which is not subject to the Program, but is reported under the Other Liability line of insurance that otherwise is subject to the Program.

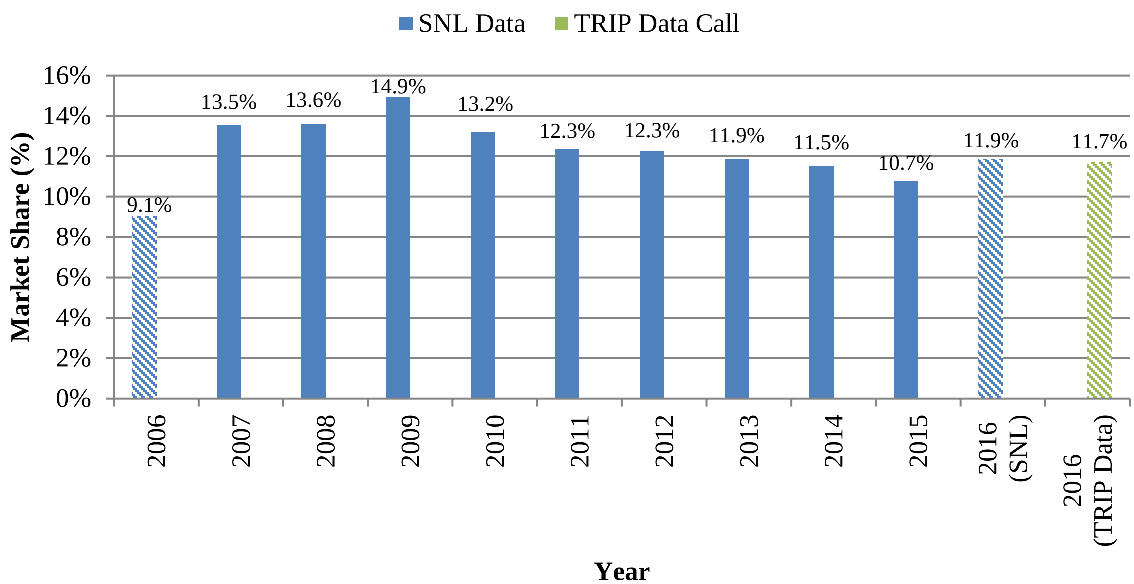
[45] *See* above at note 24.

and 2015 to 2016. This is exhibited by the cross-hatching for the columns indicating years 2006 and 2016 in Figures 1 through 3, below.

From 2007 through 2015, the Program Trigger (and the size classification identifying small insurers) did not change. Therefore, this part of the Study analyzes data regarding small insurers between 2007 and 2015.

Figure 1 illustrates the market share (based on adjusted DEP) of small insurers writing TRIP-eligible lines of insurance, from the inception of the Program Trigger requirement in 2006 through 2016. It highlights that the market share of small insurers as measured by publicly available data collected by state regulators (as adjusted for this analysis) was approximately 11.9 percent in 2016. This figure compares to the market share figure based on the 2017 TRIP data call of 11.7 percent for small insurers. This market share is measured as a percentage of the total data reported by small and non-small insurers under the 2017 TRIP data call.

Figure 1: Market Share by DEP of Small Insurers in TRIP-Eligible Lines (2006-2016)

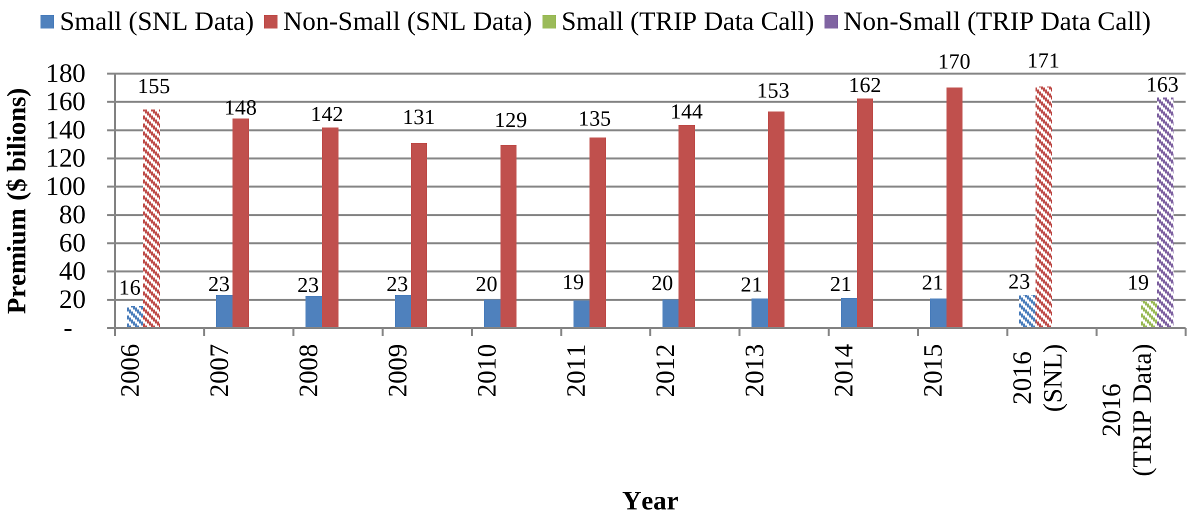


Source: SNL Financial and 2017 TRIP Data Call

Figure 1 also shows that, based on the data used in this analysis, the small insurer market share declined from 13.5 percent to 10.7 percent between 2007 and 2015.

Figure 2 illustrates the premium volume comparison for TRIP-eligible lines for small insurers and non-small insurers from 2006 to 2016. As shown in Figure 2, small insurer premium receipts declined from 2007 to 2015 (from $23 billion to $21 billion). Non-small insurers had increased premiums over this period, which resulted in the gradual decline in market share for small insurers observed above.

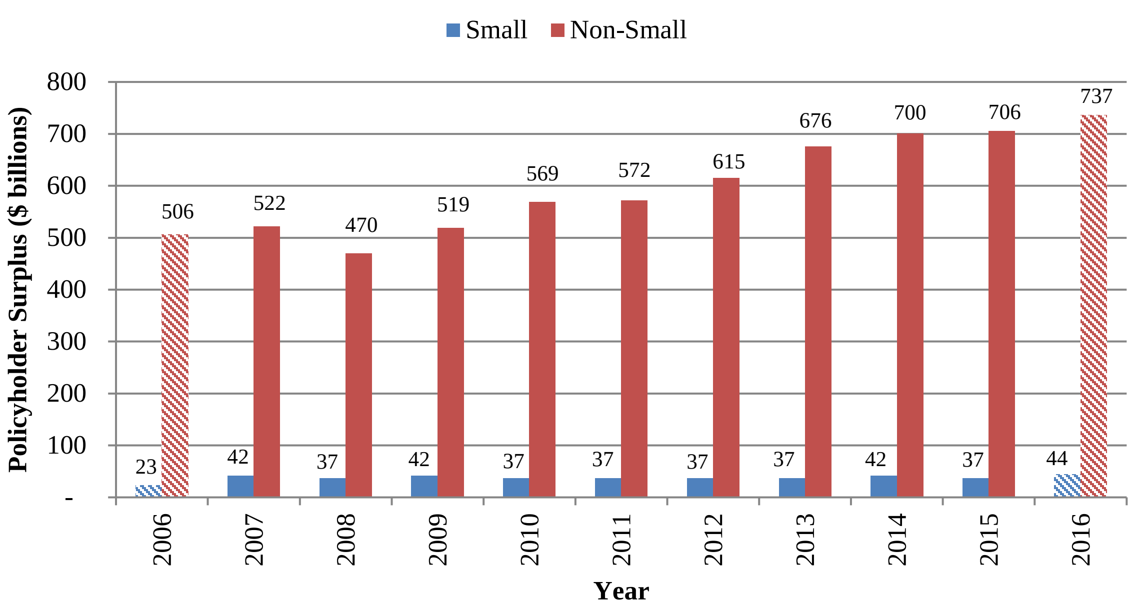
Figure 2: Premium Volume Comparison for TRIP-Eligible Lines
Small Insurers vs. Non-Small Insurers



Source: SNL Financial and 2017 TRIP Data Call

Figure 3 illustrates the policyholder surplus comparison for small insurers and non-small insurers from 2006 to 2016. During the 2007 to 2015 period, the policyholder surplus of small insurers was within the range of $42 billion to $37 billion. The policyholder surplus of non-small insurers generally increased over the same period.

Figure 3: Policyholder Surplus Comparison
Small Insurers vs. Non-Small Insurers



Source: SNL Financial

In the absence of specific historical terrorism risk insurance data from 2007 to 2015, this Study's use of the state-reported TRIP-eligible lines data for the 2007 to 2015 period is only a proxy for market share information during this period. Based upon this information, however, the market share of small insurers (measured by TRIP-eligible lines premium) experienced a decline relative to the market share of non-small insurers. During the 2007 to 2015 period, the premiums received by small insurers declined, while the premiums received by non-small insurers increased. Policyholder surplus for small insurers during that same period also declined, while the policyholder surplus of non-small insurers increased. As it obtains additional information that is more specific to terrorism risk insurance from future TRIA data calls, Treasury will continue to analyze these areas in subsequent studies.

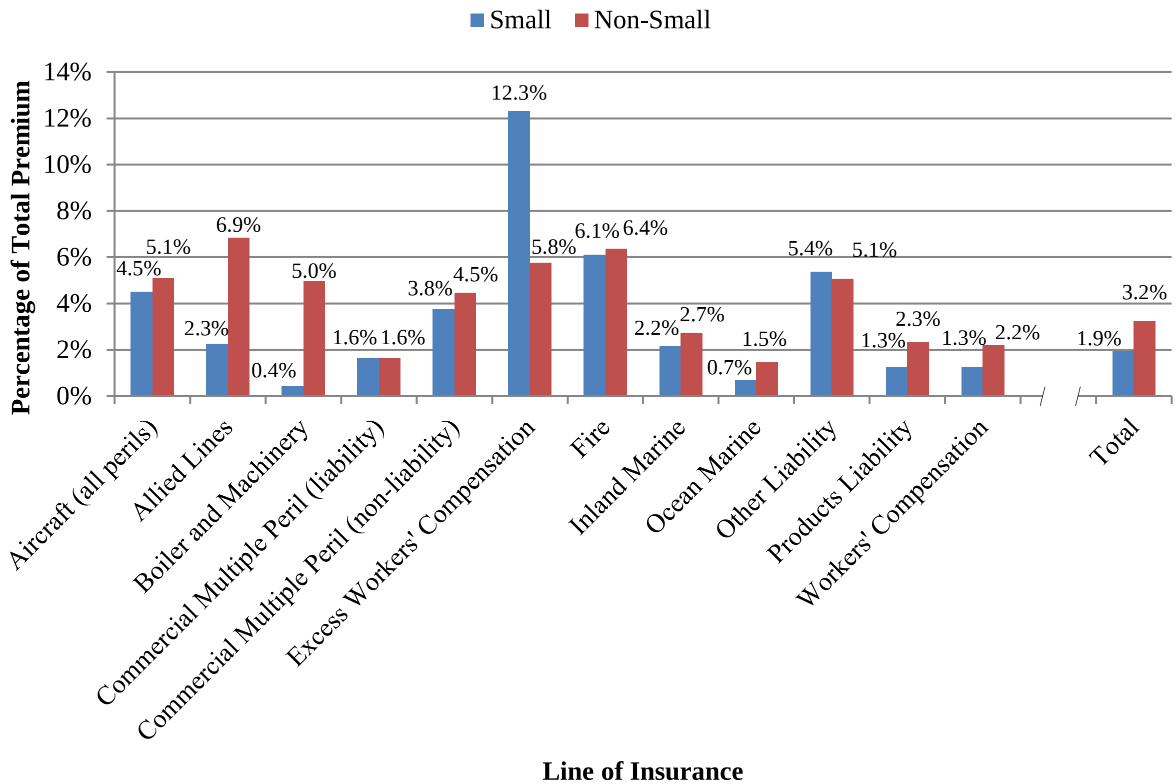
B. Market Differences between Small Insurers and Large Insurers in the Terrorism Risk Insurance Marketplace and Comparison to Other Perils

Information collected through Treasury's 2017 TRIP data call provided new information regarding the role of small insurers in the market for terrorism risk insurance. Based upon that information, this section analyzes premium, take-up rates, geographic scope of writings, and the lines of insurance in which small insurers are more heavily concentrated and comprise a larger share of the overall market.

The price of terrorism risk insurance can be expressed as the percentage of the overall commercial P/C policy premium that is allocated to terrorism risk insurance. In some cases, terrorism risk insurance is provided under commercial P/C policies at no additional charge.

Figure 4 shows, for both small insurers and non-small insurers, the percentage of overall premium charged for terrorism risk insurance. Figure 4 does not include commercial P/C policies where the insurer did not include any charge for terrorism risk insurance.

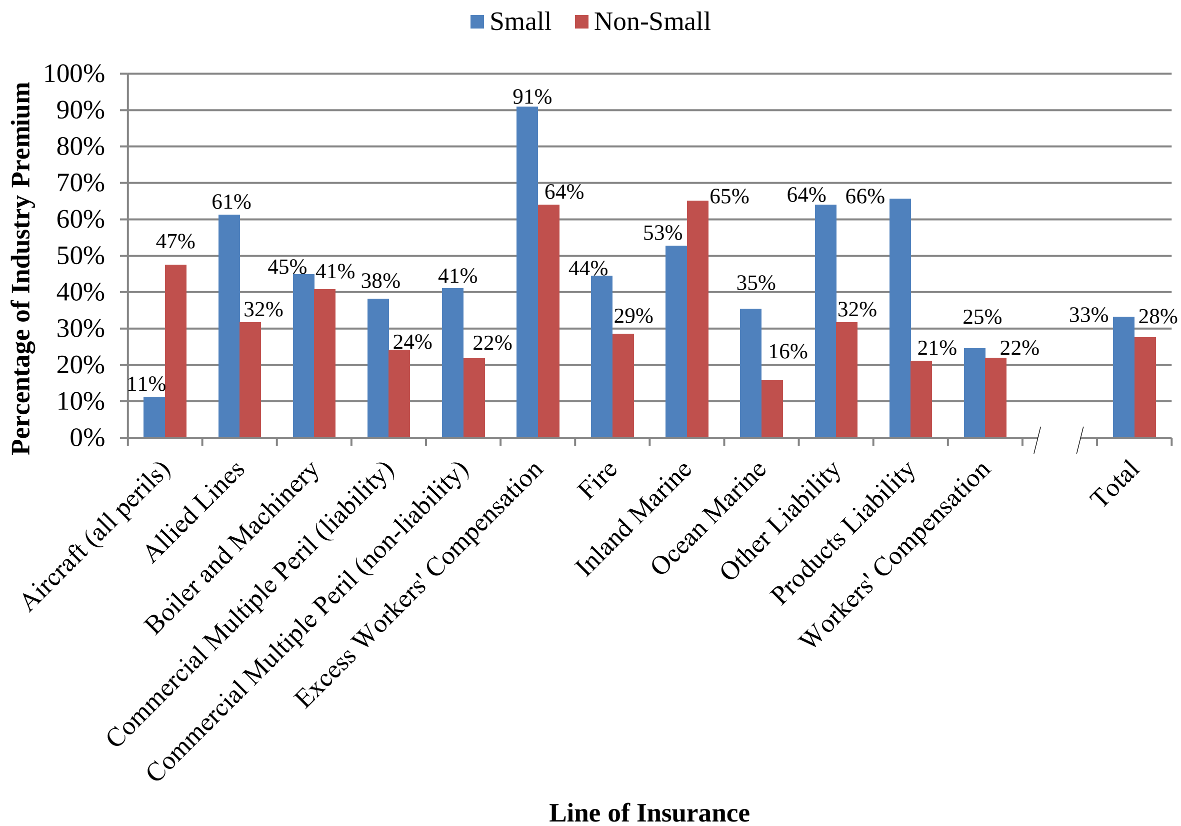
Figure 4: Percentage of Overall Premium Charged for Terrorism Risk Insurance (by Line of Insurance)
Small Insurers vs. Non-Small Insurers



Source: 2017 TRIP Data Call

Figure 5 shows the extent to which small insurers and non-small insurers did not include any charge for terrorism risk insurance. Figure 5 illustrates that, in most lines, small insurers were more likely to include no charge for terrorism risk insurance than were non-small insurers.

Figure 5: $0 Premium Charged for Terrorism Risk Insurance
Small Insurers vs. Non-Small Insurers

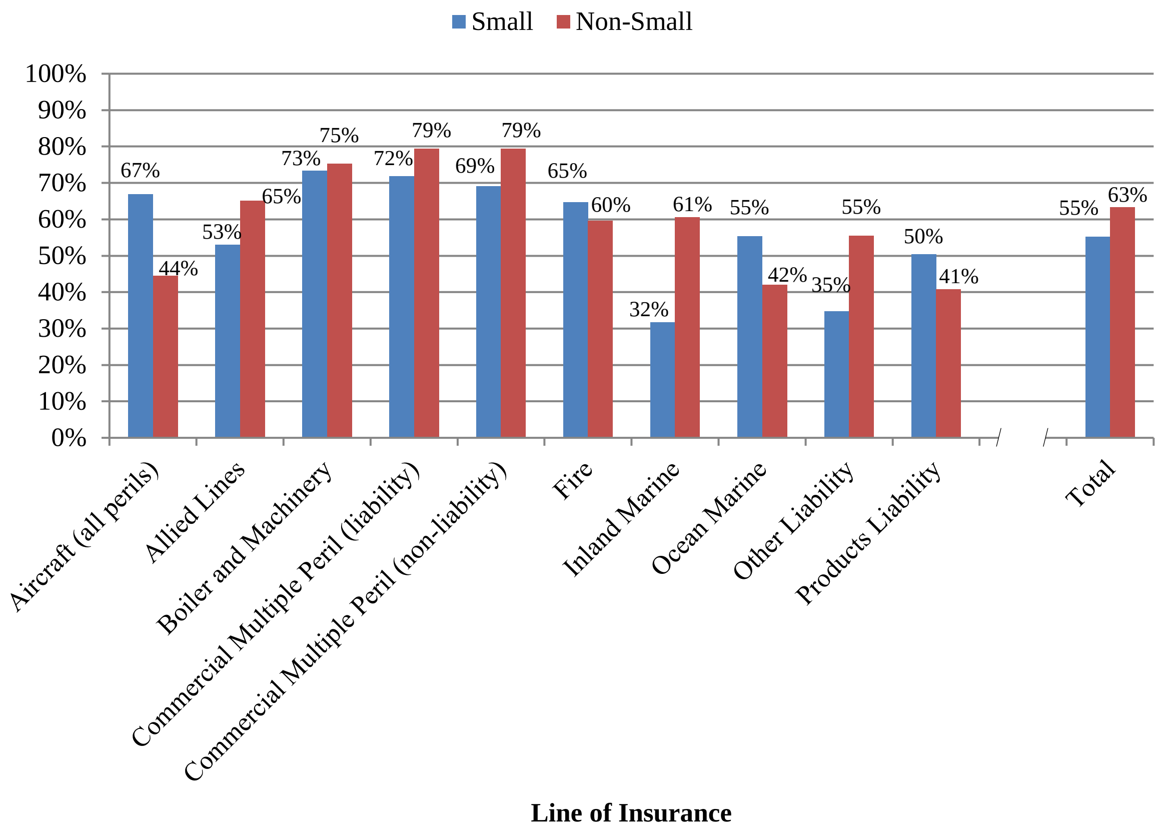


Source: 2017 TRIP Data Call

Based on the data received in the 2017 TRIP data call, Figures 4 and 5 illustrate that small insurers charged proportionally less premium for terrorism risk insurance than non-small insurers. As Figure 4 illustrates, when a premium is charged for terrorism risk insurance, the percentage of the total policy premium relating to terrorism risk premium for small insurers is, for most lines, smaller than the percentage indicated for larger insurers. Measured against all TRIP-eligible lines combined, small insurers charge a lower premium than non-small insurers. Figure 5 also demonstrates that small insurers are more likely than non-small insurers to charge no premium for terrorism risk insurance. However, it should be noted that the available data does not provide any information concerning the nature of the risks being insured, which will affect the premium being charged.

Figure 6 illustrates the take-up rates for terrorism risk insurance for small insurers and non-small insurers. Figure 6 demonstrates the difference between small insurers and non-small insurers in the take-up rates for terrorism risk insurance by their policyholders. When measured by premium, the policyholder take-up rate for policies written by small insurers was generally lower, in most individual lines as well as in the TRIP-eligible lines of insurance as a whole, than that of non-small insurers.

Figure 6: Take-Up Rates for Terrorism Risk Insurance
Small Insurers vs. Non-Small Insurers[46]



Source: 2017 TRIP Data Call

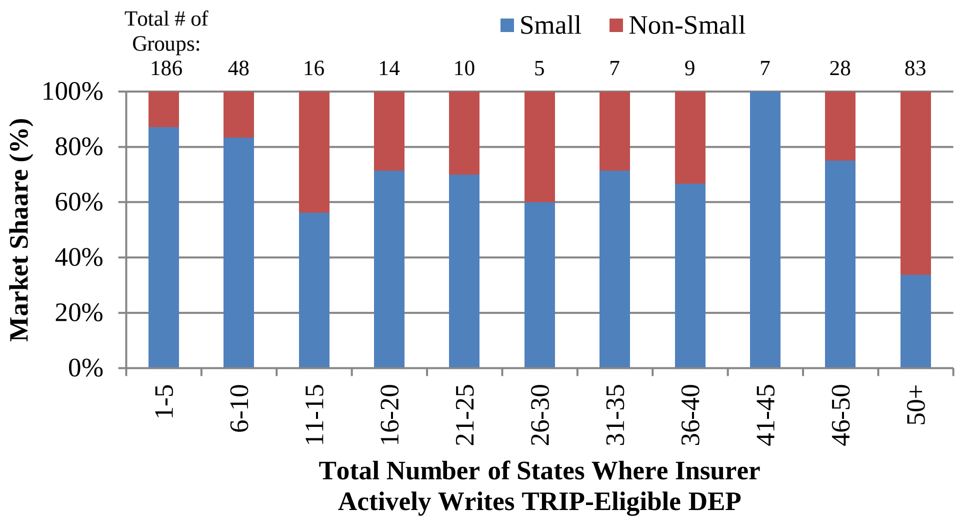
Figure 7 illustrates the geographic scope of written premiums for small insurers and non-small insurers, and reflects that small insurers insure risks within a smaller geographic footprint than larger insurers. Figure 7 compares the geographic scope of small insurers to that of non-small insurers. Based on the data, small insurers appear to operate on a regional basis in a smaller number of states than non-small insurers, even though they may have a significant presence in individual local markets.[47]

---

[46] This figure includes take-up rates for all TRIP-eligible lines except workers' compensation. As a matter of state law, workers' compensation policies must provide coverage for terrorism risk, and the effective take-up rate for this line is therefore 100 percent. *See* Section IV.F (discussing workers' compensation insurance).

[47] *See* Atlantic Charter's remarks to the Advisory Committee on Risk-Sharing Mechanisms (March 31, 2017) (Atlantic Charter Remarks), p. 7, *available at* https://www.treasury.gov/initiatives/fio/acrsm/Documents/Presentation_Atlantic_Charter.pdf.

Figure 7: Geographic Scope of Written Premiums
Small Insurers vs. Non-Small Insurers

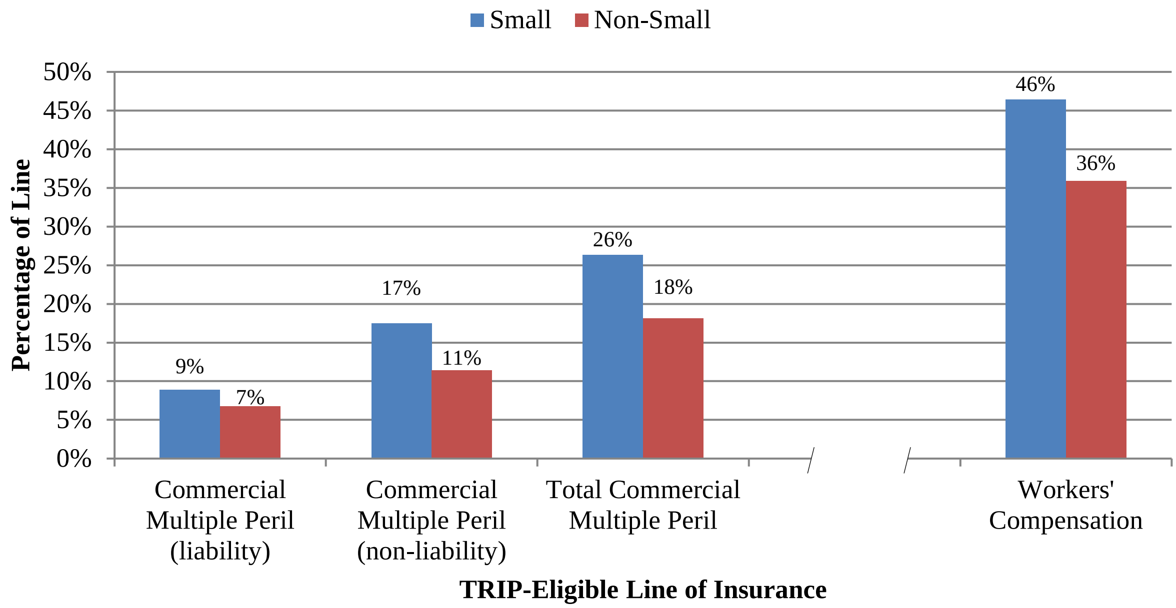


Source: SNL Financial

Figure 8 shows that the TRIP-eligible insurance of small insurers is more heavily concentrated in certain lines of insurance than is the case for non-small insurers, and as a result, such small insurers have a larger share of the overall market in these lines. Figure 8 illustrates that small insurers write a larger portion of their TRIP-eligible lines premium within: (1) the commercial multi-peril (CMP) lines; and (2) the workers' compensation line, as compared to larger insurers. CMP products provide coverage for multiple lines of insurance within a single policy, and tend to be marketed towards small- to medium-sized businesses.[48] Workers' compensation insurance, which is discussed in greater detail in Section IV.F below, provides insurance for workplace injury benefits available under state workers' compensation systems.

[48] *See generally* "Understanding Business Owners Policies (BOPs)," Insurance Information Institute, *available at* http://www.iii.org/article/understanding-business-owners-policies-bops.

Figure 8: Percentage of TRIP-Eligible Lines Premium Written within the CMP and Workers' Compensation Lines
Small Insurers vs. Non-Small Insurers



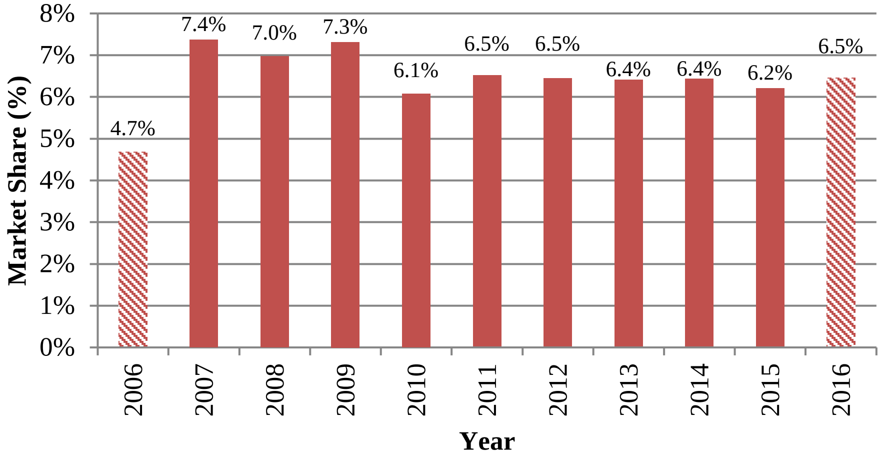
Source: 2017 TRIP Data Call

The information collected in the 2017 TRIP data call shows differences between the participation of small insurers and non-small insurers in the terrorism risk insurance marketplace. This information did not reflect any particular differences presented by other perils.[49] However, for purposes of this comparison, it may be instructive to examine market share information for small insurers in the P/C lines of insurance that are not subject to the Program.

Figure 9 provides the market share, by DEP, of small insurers and non-small insurers in P/C lines not subject to TRIP. Based on the data reported to state regulators, Figure 9 illustrates that the market share of small insurers measured by DEP in P/C lines of insurance not subject to the Program decreased from 7.4 percent in 2007 to 6.2 percent in 2015.

[49] For the reasons discussed in this Study, terrorism risk insurance presents a number of issues that are limited to the terrorism risk insurance marketplace, such as in the areas of aggregation of losses and workers' compensation insurance.

Figure 9: Market Share (DEP) of Small Insurers in P/C Lines of Insurance Not Subject to TRIP (2006-2016)



Source: SNL Financial

C. Mandatory Availability Requirement

This Study is an initial analysis of the impact of the mandatory availability requirement on the market competitiveness of small insurers. Treasury did not receive any formal public comments on this subject when it sought input for the Study in the Federal Register.[50] Treasury is not making conclusions regarding this issue in this Study, and will continue to evaluate whether the mandatory availability requirement is having any market impacts on small insurers in the TRIP-eligible lines of insurance.

The mandatory availability requirement under TRIA requires insurers offering certain lines of commercial P/C insurance for U.S. risks to "make available" coverage for terrorism risk on terms that do not differ materially from the terms, amounts, and coverage limitations applicable to losses arising from events other than acts of terrorism.[51] TRIA does not place pricing restrictions on insurers,[52] although state law rating requirements may define or limit what an insurer may charge for terrorism insurance. If the prospective policyholder does not accept the mandatory offer, the parties may negotiate a different arrangement for terrorism risk coverage which is not on the same terms as provided for other risks.[53] To the extent an insurer does not regularly offer coverage for a particular risk under a line of insurance (for example, with respect to losses arising from Nuclear, Biological, Chemical or Radiological (NBCR) events), it is not required to offer coverage for these risks because of the mandatory availability requirement.[54] Additionally,

[50] *See* 81 Fed. Reg. 95310 (December 27, 2016).

[51] TRIA § 103(c); 31 C.F.R. §§ 50.20(a), 50.22(a).

[52] *See* 31 C.F.R. § 50.22(a).

[53] 31 C.F.R. § 50.21(c).

[54] TRIA § 103(c)(2); *see* 31 C.F.R. § 50.22(b).

as a condition for receiving federal payments under the Program, participants must meet certain documentation requirements under TRIA and its implementing regulations concerning compliance with the mandatory availability requirement.

Because terrorism risk insurance must be offered in connection with P/C insurance lines subject to TRIP, the mandatory availability requirement could have an impact on the manner in which such insurance is underwritten. For example, one difficulty with insuring losses arising from acts of terrorism is the aggregation risk potentially presented by an act of terrorism. A large-scale terrorist event can have a significant impact across multiple lines of insurance, and affect a large number of insured risks within a limited geographic area.

Among other options, insurers may tend to manage aggregation of the risk that they assume within a particular geographic area, or within proximity to a location considered to be a potential target for terrorist activity. Insurers of all sizes may employ this analysis when deciding whether to write policies that are subject to terrorism risk.[55]

Additional factors that are external to TRIA may also influence whether insurers offer terrorism risk insurance, irrespective of the mandatory availability requirement. First, in a number of lines of insurance and jurisdictions, terrorism risk insurance must be provided under state law.[56] In these situations an insurer must offer terrorism risk insurance – irrespective of the mandatory availability requirement. Second, the ability to offer terrorism risk insurance with other coverages may be important in order to compete in certain U.S. insurance markets, in particular those defined by large metropolitan areas. Take-up rates for terrorism risk insurance vary by jurisdiction and locality, and higher percentages of policyholders generally purchase terrorism risk insurance in major metropolitan areas.[57]

Treasury will continue to analyze this issue and report on the subject in 2019.

D. Impact of the Increasing Program Trigger Amount

This section considers the impact on small insurers of increasing the Program Trigger, and assesses this impact over time.

Two thresholds must be satisfied before a participating insurer will be eligible for federal payments in connection with insured losses arising from an act of terrorism. First, an insurer

---

[55] *See generally* "Terrorism Risk Insurance: Market Challenges May Exist for Current Structure and Alternative Approaches (GAO-17-62)," U.S. Government Accountability Office (January 2017), pp. 18-19, *available at* http://www.gao.gov/assets/690/682064.pdf.

[56] The principal example here is the workers' compensation line of insurance. *See* Section IV.F.

[57] *See, e.g.*, "2016 Terrorism Risk Insurance Report," Marsh & McLennan Companies (July 2016), p. 10 (a "higher percentage of companies in the Northeast (72%) purchased property terrorism insurance than in any other region, likely attributable to the concentration of large metropolitan areas, including Washington, DC, and New York"), *available at* https://www.marsh.com/content/dam/marsh/Documents/PDF/US-en/2016%20Terrorism%20Risk%20Insurance%20Report.pdf.

must satisfy its TRIP deductible, which is 20 percent of its TRIP-eligible premium earned during the previous calendar year.[58] Second, even if a particular insurer satisfies its individual deductible, the total aggregate insured losses across the industry must exceed the Program Trigger before any federal payments can be made.

Thus, an insurer with a deductible lower than the Program Trigger could satisfy its deductible, but have its losses fall short of satisfying the Program Trigger. There could also be cases in which other participating insurers will also experience losses from the same act or acts of terrorism, and together their combined losses will satisfy the Program Trigger, such that a small insurer that has exceeded its own deductible will be able to obtain a recovery. Nonetheless, the Program Trigger requirement could operate to preclude recovery for one or more small insurers, in a way that larger insurers may not face.

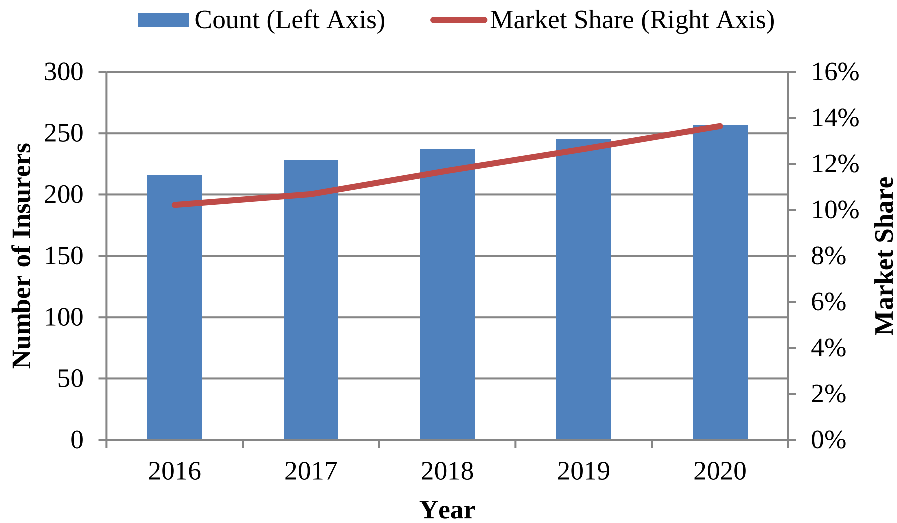
There are more than 200 domestic U.S. insurance groups subject to the TRIA data call that are currently classified as small insurers that could be subject to this exposure.[59] Figure 10 provides a projection of the potential increase in the number of small insurers caused by the prospective increase in the Program Trigger through 2020.[60] Figure 10 illustrates that an increasing number of insurers will be subject to this potential exposure over the next few years. As shown in Figure 10, Treasury projects that the number of "small insurers" is likely to increase in the future based on the assumption that the Program Trigger will increase at a rate faster than likely market growth in TRIP-eligible lines premium and policyholder surplus.

[58] TRIA § 102(7); *see* Section II above.

[59] This analysis does not include those small insurers that write TRIP-eligible lines premium of less than $10 million that were excused from reporting. This subset of insurers also could be affected.

[60] This projection of the increase in the number of small insurers caused by the projected market growth of TRIP-eligible lines DEP and policyholder surplus is based upon Treasury's analysis of 2017-2020 Gross Domestic Product forecasts to model DEP and policyholder surplus changes for individual insurance groups writing TRIP-eligible lines premium.

Figure 10: Projection of Potential Increase in Number of Small Insurers Due to Increase in Program Trigger



Source: SNL Financial

Therefore, based on the projection that the Program Trigger is increasing at a rate faster than insurer deductibles are likely to grow in the future, more insurers over time could experience losses that satisfy their Program deductible, but do not satisfy the Program Trigger. These losses would remain ineligible for federal reimbursement. In addition, insurers currently classified as small insurers will be further removed from the Program Trigger over time because the difference between their deductibles and the Program Trigger will increase. Therefore, small insurers could be more likely to incur a loss in excess of their deductibles, yet not large enough to satisfy the conditions for federal reimbursement under the Program.

Based on the 2017 TRIA data call, the Program Trigger has an impact on small insurers participating in the Program that is not faced by larger insurers. Commenters observed that this effect on small insurers, which could result in a "massive increase in their liabilities," could ultimately limit "the insurance coverage [small insurers] are able to provide for main street businesses."[61]

E. Availability and Cost of Private Reinsurance for Small Insurers

This section considers the availability and cost of private reinsurance for small insurers, in the context of information collected during the 2017 TRIP data call regarding their reinsurance purchases for terrorism risk insurance.

---

[61] Comments of Property Casualty Insurers Association of America on Small Insurer Study (February 27, 2017) (PCIAA Comments), p. 1, *available at* https://www.regulations.gov/document?D=TREAS-TRIP-2017-0002-0008.

It is difficult to assess the availability and cost of private terrorism risk reinsurance for small insurers for several reasons. Since reinsurance is not a TRIP-eligible line of business, reinsurers are not considered Program participants, and thus are not subject to Treasury's TRIP data calls. Reinsurance is neither subject to standard terms and rates, nor to the range of state-level reporting requirements applicable to admitted insurers. In addition, many factors affect the pricing of reinsurance – such as the reinsurance limits sought and obtained, the price of the underlying risk covered by the reinsurance, the amount of available information concerning that underlying risk, the prior claims history between an insurer and its reinsurers, and general market conditions when the reinsurance is purchased. Furthermore, reinsurance agreements often cover multiple risks, so it can be difficult to isolate and assess how reinsurance specifically responds to terrorism risks.

A small insurer that is concerned about its ability to obtain recovery under the Program for losses above its deductible may attempt to cover this exposure by purchasing reinsurance. For example, a small insurer could purchase reinsurance that provides reimbursement for any losses experienced above the insurer's deductible if an act of terrorism is certified but the Program Trigger is not met by aggregate industry insured losses. Whether purchase of such reinsurance is practical (assuming that it is available) will depend in part upon the cost of the reinsurance and the insurer's assessment of its ability to bear the loss without reinsurance.

Historically, reinsurance markets have been cyclical, and the broader market for reinsurance is currently characterized as "soft," meaning that reinsurance premium rates are relatively low and availability is relatively high.[62] Although a range of macroeconomic factors play a role in the reinsurance market, current conditions are generally viewed as resulting from relatively benign catastrophe losses experienced by reinsurers in recent years, leading to significant traditional reinsurance market capacity, augmented by growing capacity from the capital markets, available to support risk transfer from the primary insurance market.[63]

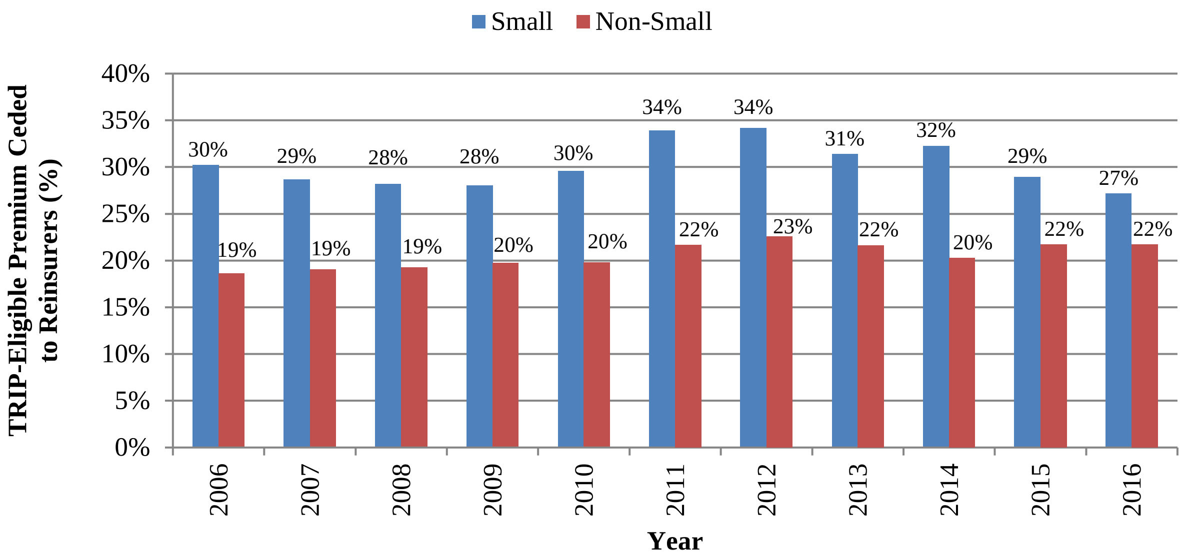
Treasury found that small insurers tend to transfer, or cede, a greater proportion of their direct premiums to reinsurers than larger insurers. Figure 11 illustrates the portion of premiums of TRIP-eligible lines ceded by direct insurers to reinsurers of small insurers and non-small insurers.

---

[62] *See generally* "IAIS Global Insurance Market Report (GIMAR) 2016," International Association of Insurance Supervisors (January 31, 2017), p. 3 ("Non-life (re)insurance continues to be subject to soft market conditions. Premiums charged by non-life (re)insurers in the commercial lines, property and catastrophe markets remain under pressure, partly due to increasing competition, while investment yields are declining gradually. Competition is especially strong in the reinsurance market."), *available at* https://www.iaisweb.org/file/64547/2016-global-insurance-market-report.

[63] *See, e.g.*, L. S. Howard, "Is Soft Market Bottoming? A.M. Best Points to Some Promising Signs," Insurance Journal (January 10, 2017), *available at* http://www.insurancejournal.com/news/international/2017/01/10/438420.htm.

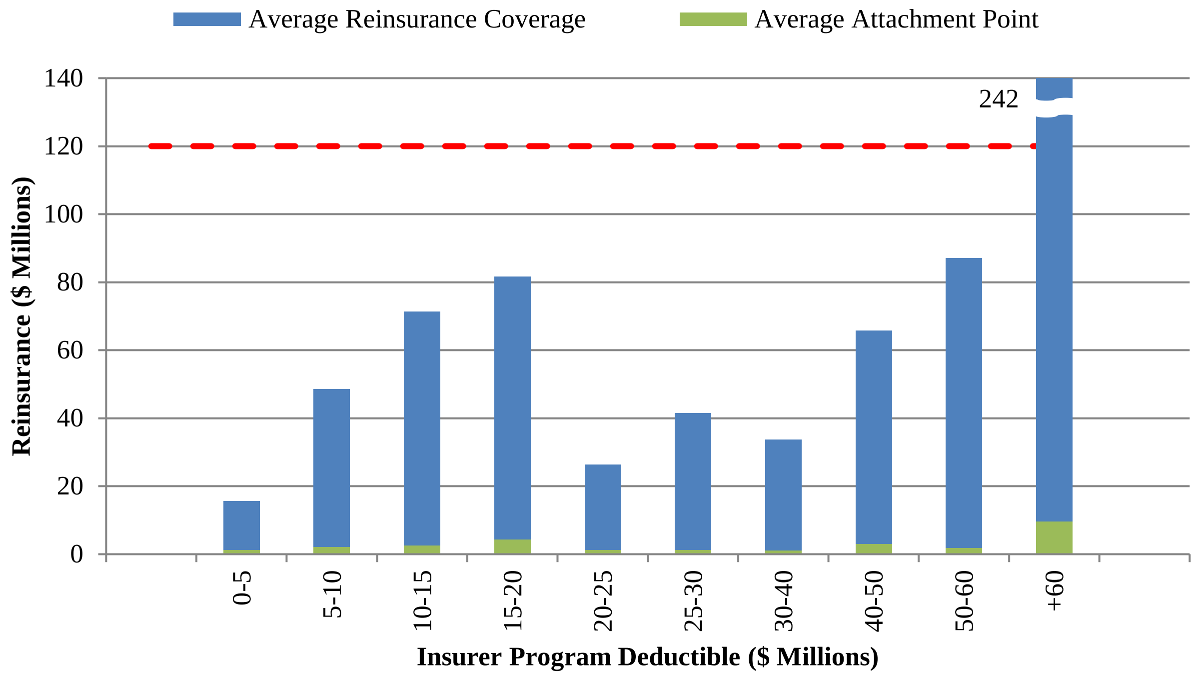
Figure 11: Proportion of TRIP-Eligible Lines Premiums Ceded by Insurers to Reinsurers Small Insurers vs. Non-Small Insurers



Source: SNL Financial

Although the 2017 TRIP data call did not collect data from reinsurers, it did collect certain information from insurers concerning their purchases of reinsurance for terrorism risk. In this Study, Treasury compared the amount of such purchased reinsurance with the Program deductibles of small insurers to assess whether the private reinsurance would cover the possible exposure between the insurer's deductible and the Program Trigger. Figure 12 illustrates the manner in which reinsurance purchases of small insurers provide protection for potential exposures within and above deductibles up to the Program Trigger.

Figure 12: Comparison between Small Insurer Deductibles and Reinsurance Purchases, Illustrating Position between Reinsurance Limit and Program Trigger



Source: 2017 TRIP Data Call

Figure 12 illustrates the extent to which small insurers have obtained reinsurance for losses within their deductibles, as well as for amounts above their deductibles up to the Program Trigger. Based on the 2017 TRIA data, approximately 77 percent of small insurers have obtained reinsurance that may cover some portion of losses exceeding the insurer's TRIP deductible. Therefore, when divided into categories by the size of their Program deductibles (horizontal axis), the 2017 TRIA data illustrates that average reinsurance purchases (vertical axis) are typically in excess, for most size categories, of the Program deductibles. Figure 12 suggests that small insurers generally do not purchase reinsurance from "dollar one" of their exposure. Rather, the reinsurance is generally purchased to apply at some higher loss amount (beginning at the attachment point), below which the small insurer remains exposed to the losses.

Figure 12 also reflects that a large percentage of small insurers face significant exposure between their TRIP deductibles and the Program Trigger which has not been addressed by private reinsurance. This is illustrated by the space in Figure 12 above the blue reinsurance purchase bar and below the red dotted Program Trigger threshold line. Only 11 percent of the reporting small insurers have closed this gap, and most of these small insurers are at the upper limit of the small insurer threshold.

In general terms, and based on the 2017 TRIA data, Treasury finds that small insurers purchase significant amounts of reinsurance for losses up to their deductible obligation under the Program. In contrast, there is less reinsurance protection for losses between an insurer's deductible and the Program Trigger amount. This differential could demonstrate that generally such coverage is not affordable or readily available.[64] But it could also be based upon an insurer's assessment that it is unlikely to sustain losses up to the Program Trigger, or that it can afford to sustain such losses, or that its portfolio of insured risks is such that in the event of a large loss situation caused by an act of terrorism the losses of unaffiliated insurers could satisfy the Program Trigger. Treasury will consider how to obtain and further analyze appropriate data providing additional information concerning the price and availability of private terrorism risk reinsurance for small insurers. Treasury will continue to analyze this issue and report on the subject in 2019.

F. Impact of State Workers' Compensation Laws

The workers' compensation system provides an important mechanism for the protection of U.S. workers from the consequences of employment-related injuries. To provide that protection, however, certain aspects of the system have the effect of increasing the aggregation exposures of insurers participating in this market to losses from terrorism, possibly presenting solvency issues, particularly because these policies provide coverage for workers' compensation benefits as defined by state law and are not subject to express limits of liability.

State workers' compensation systems provide compensation, on a no-fault basis, for the workplace injuries of employees, including disability and death. The costs of medical care and treatment, rehabilitation, loss of wages, and other financial hardships resulting from the employee's injury are covered.[65] Because payments under workers' compensation policies are limited only by the scope of workers' compensation benefits available under state law to employees entitled to the payment of those benefits, payments under a workers' compensation policy could be essentially unlimited.[66] On the other hand, the ability of insurers to collect sufficient premium to cover potentially unlimited costs is limited. Workers' compensation insurance is subject to specific pricing rules under state law, which may not allow for much pricing flexibility.[67] As a result, a large-scale act of terrorism could create significant aggregation

[64] *See* Remarks to the TRIA Federal Advisory Committee by the Greater New York Mutual Insurance Company (May 31, 2017), p. 5 (noting that while direct insurance rates are regulated, reinsurance rates are not, such that small insurers might not be able to pass along such costs to policyholders which puts small insurers at a competitive disadvantage relative to larger insurers that may not require as much reinsurance), *available at* https://www.treasury.gov/initiatives/fio/acrsm/Documents/Remarks_GNY.pdf**.**

[65] A summary of the U.S. workers' compensation system is available in the 2016 Effectiveness Report, pp. 21-22.

[66] *See* Michael Dworsky and Lloyd Dixon, "The Impact on Workers' Compensation Insurance Markets of Allowing the Terrorism Risk Insurance Act to Expire," RAND Corporation (2014), pp. 5-6, *available at* https://www.rand.org/content/dam/rand/pubs/research_reports/RR600/RR643/RAND_RR643.pdf.

[67] *See, e.g.,* Submission by the National Council on Compensation Insurance to the Advisory Committee on Risk-Sharing Mechanisms (June 5, 2017) (summarizing the development of terrorism loss costs controlling the premium charge for workers' compensation insurance under state law), *available at* https://www.treasury.gov/initiatives/fio/acrsm/Documents/National_Council_on_Compensation_Insurance_June_2017.pdf.

risks for workers' compensation carriers, particularly in the event of broad-based losses arising from an NBCR event.[68]

Because insurers cannot decline to cover terrorism risk (including NBCR-related terrorism risk) in connection with workers' compensation insurance, workers' compensation carriers must find other ways to manage their aggregation risk – including by declining certain risks altogether. For example, insurers may avoid writing policies that could provide substantial accumulation of exposures in the same location. This could present challenges for insurers conducting business in large metropolitan areas with dense populations, as well as for employers seeking insurance coverage in those areas.

To the extent a particular policyholder cannot obtain coverage from an insurer in the "voluntary" market, it may need to obtain insurance in the residual market, which must provide coverage to all applicants.[69] Such coverage generally comes with a higher premium. To remain in the worker's compensation market, insurers could use reinsurance to help manage aggregation risks.

The 2017 TRIP data call analyzed whether the reinsurance purchased by insurers to cover losses in TRIP-eligible lines included coverage for NBCR risks associated with workers' compensation insurance. Based on the 2017 TRIP data call, a significant number of small insurers did not have reinsurance coverage for workers' compensation losses caused by NBCR risks. However, the minority of small insurers that did obtain reinsurance coverage for this type of risk were generally able to do so at similar limits compared to their conventional terrorism reinsurance policies. More than 80 percent of small insurers reported that their reinsurance agreements did not cover NBCR risks for workers' compensation. Of the remaining small insurers that obtained reinsurance for this risk, 45 percent were able to obtain the same or higher limits as the limits under their conventional terrorism reinsurance. The remaining 55 percent of insurers obtained this coverage at moderately lower limits than their conventional terrorism risk limits. On average, insurers obtained NBCR limits – in those circumstances in which reinsurance was obtained for NBCR risks – that were approximately 90 percent of their conventional terrorism limits.

---

[68] *See, e.g.*, "Terrorism Risk Insurance: Report of the President's Working Group on Financial Markets," (September 2006), pp. 72-73 (noting estimates of modeled NBCR event exposures up to $158 billion in property losses and $484 billion in workers' compensation losses), *available at* http://www.pciaa.net/docs/default-source/default-document-library/pres_wkg_grp_rpt_9-06.pdf; Charles Meade and Roger C. Molander, "Considering the Effects of a Catastrophic Terrorist Attack," RAND Corporation (2006), pp. 6-7 (estimating potential losses arising from explosion of 10-kiloton nuclear bomb in a shipping container as exceeding $1 trillion), *available at* http://www.rand.org/content/dam/rand/pubs/technical_reports/2006/RAND_TR391.pdf.

[69] A residual market exists to provide insurance coverage for those who cannot obtain coverage in the regular, or voluntary, market. Insurers operating in a particular jurisdiction are usually required to participate in residual markets as a condition of doing business in the voluntary market. The extent of their participation in the residual market is generally based upon their share of the voluntary market. Depending upon the jurisdiction, insurance costs in the residual market may be higher, or may effectively be subsidized through assessments on taxpayers or insurers, which may then be passed on to all policyholders in the jurisdiction. *See, e.g.*, PCIAA Comments, p. 2; Atlantic Charter Remarks, p. 8**.**

In contrast, although a much higher percentage of non-small insurers (approximately 49 percent) held reinsurance coverage for NBCR risks associated with workers' compensation coverage, the limits under this reinsurance were much lower than the limits for conventional terrorism risk (approximately 52 percent on average).

If large workers' compensation losses fall disproportionately upon a small number of participating insurers, TRIP provides a backstop that operates as a risk-spreading mechanism across the industry. In this circumstance, as observed in Treasury's 2016 Effectiveness Report, the Program could be the determining factor in ensuring an insurer's solvency.[70] The Program operates in this fashion irrespective of the size of the insurer participating in the workers' compensation market, but may be more critical for those insurers falling into the "small insurer" category, which may have less policyholder surplus available to face the unpredictable workers' compensation losses that could arise from an act of terrorism.

[70] "TRIA effectively allows insurers to continue to participate in the workers' compensation insurance markets when, in the absence of a government backstop for the terrorism risk, they might be forced from the market altogether." 2016 Effectiveness Report, p. 22, note 69.

V. Conclusion

Small insurers are a significant component of the market for terrorism risk insurance in the United States.

While the market share of small insurers subject to the Program has gradually decreased over the period where the Program Trigger remained constant, this decline is generally consistent with the analysis of market share information for P/C lines of insurance not subject to TRIP. There has also been a decline for small insurers in the premium received and policyholder surplus in TRIP-eligible lines of insurance. Small insurer market share, premium, and policyholder surplus will potentially increase in the future because of the annual increase in the Program Trigger through 2020.

Based on the 2017 TRIP data call, small insurers charge less than non-small insurers for terrorism risk insurance, and are more likely to charge no premium for such coverage. Additionally, the take-up rate for terrorism risk insurance of small insurers' policyholders is lower than the take-up rate of larger insurers' policyholders. Small insurers tend to operate on a regional basis, in fewer states than larger insurers, and their insurance writings are more heavily concentrated than those of larger insurers (such that they have a larger share of the overall market in those lines) in the commercial multi-peril and workers' compensation lines of insurance.

This Study is not making conclusions regarding the impact of the mandatory availability requirement on the market competitiveness of small insurers. Treasury will continue to evaluate whether the mandatory availability requirement is having any market impacts on small insurers in the TRIP-eligible lines of insurance.

The Program Trigger requirement can operate to prevent reimbursement for small insurers that sustain terrorism losses in excess of their Program deductibles. Small insurers may purchase private reinsurance to avoid this potential challenge. The 2017 TRIP data call indicates, however, that most small insurers do not purchase sufficient private reinsurance to address this issue. Although small insurers may otherwise be protected by the existence of losses of other insurers that satisfy the Program Trigger, this will vary from case to case, depending on the size of insured losses arising from the act or acts of terrorism.

Terrorism risk insurance must be provided as a component of workers' compensation insurance under state law. Therefore, this potential risk for small insurers of unreimbursed losses in excess of Program deductibles could be more pronounced in connection with this line of insurance. Small insurers have a larger share of this market, which is subject to potentially unlimited losses and significant aggregation risks.