

**DEPARTMENT OF THE TREASURY
FEDERAL INSURANCE OFFICE (FIO)
ADVISORY COMMITTEE ON RISK-SHARING MECHANISMS (ACRSM)
MINUTES –5 FEBRUARY 2020**

The Advisory Committee on Risk-Sharing Mechanisms (ACRSM) convened at 2:31 pm on 5 February 2020 in the Cash Room at the U.S. Department of the Treasury, 1500 Pennsylvania Ave. NW, Washington, D.C., with Mike Sapnar, Chair, presiding.

In accordance with the Federal Advisory Committee Act, the meeting was open to the public.

Committee Members Present

MIKE SAPNAR, TransRe, Chair
KEITH BELL, Travelers
JOHN LUPICA, Chubb
EMIL METROPOULOS, Guy Carpenter
WENDY PETERS, Willis Towers Watson
JOHN SEO, Fermat Capital
FRANK TILLOTSON, AIG (Proxy for Kean Driscoll)
KEITH WOLFE, Swiss Re

Also Present

RICHARD IFFT, Senior Insurance Regulatory Policy Analyst, Federal Insurance Office
(Designated Federal Officer)
STEVEN SEITZ, Director, FIO
TYLER WILLIAMS, Deputy Assistant Secretary, Financial Institutions Policy, Treasury

Welcome and Opening Remarks

Director Seitz welcomed everyone to the first 2020 meeting of the ACRSM. He noted that the committee was formed under the Terrorism Risk Insurance Program Reauthorization Act of 2015 to provide advice, recommendations, and encouragement to Treasury regarding the creation and development of nongovernmental risk-sharing mechanisms for protection against losses arising from acts of terrorism.

Director Seitz provided a recap of the last ACRSM meeting in September 2019, at which an update was provided concerning the work of the ACRSM's various subcommittees in developing recommendations, along with a presentation concerning the existing Terrorism Risk Insurance Program (TRIP or Program) mechanics. Director Seitz noted as well that, since the last meeting, the Program has in fact been renewed for an additional seven-year period, which he noted would be the subject of some discussion at the meeting.

Director Seitz also introduced and welcomed Keith Bell, Senior Vice President of Travelers, as a new member of the ACRSM. He then welcomed Frank Tillotson, of AIG, who was participating in the meeting as a proxy for Kean Driscoll of AIG, who was unable to attend. He closed by

indicating that he was looking forward to hearing from the Committee on potential recommendations and next steps for further work on the Program, which he noted was an important priority for the Federal Insurance Office and the Department of the Treasury.

Chair Sapnar welcomed everyone and thanked Director Seitz and FIO for the office's continued work related to the insurance industry and work with the Committee to convene the meeting. He also welcomed Mr. Bell as a new member of the Committee.

Chair Sapnar also noted the recent reauthorization of the Program for an additional seven years, until December 31, 2027. He acknowledged that the reauthorization would require the ACRSM to recalibrate its efforts to some degree, but emphasized that the additional long-term reauthorization made the role of the Committee even more important pending the 2027 expiration of the Program.

Chair Sapnar also reiterated the statutory purpose of the ACRSM to provide FIO and Treasury

- (1) advice;
- (2) recommendations; and
- (3) encouragement

with respect to the creation and development of nongovernmental, private risk-sharing mechanisms, because Congress determined it was a priority to encourage development of the private market in this area. As a result, Chair Sapnar indicated that the Committee should continue to focus on developing suggestions and recommendations on the issues that the ACRSM has previously identified, as well as new issues, so that it would be in a position to provide FIO with initial thoughts and recommendation later this year.

Before summarizing the work of the subcommittees in a PowerPoint presentation, Chair Sapnar requested that Mr. Ifft of FIO provide a summary of how the 2019 reauthorization of the Program affects the Program and FIO's responsibilities under it.

Treasury Update on 2019 Terrorism Risk Insurance Program Reauthorization Act

Mr. Ifft commenced by noting that the 2019 Reauthorization Act was passed by Congress and signed by the President on December 20, 2019, and that it extended the Program until December 31, 2027, subject to the same risk-sharing mechanisms that are in place for purposes of calendar year 2020. He then illustrated this with the aid of slides that were made part of the Committee record.

The first slide, titled "TRIP Overview: Federal Share 2020-2027," depicted the general structure of the sharing mechanism for the entire period from 2020 to 2027. Initially, the Program is not triggered until the Secretary of the Treasury certifies an act as an "act of terrorism" within the meaning of the statute. As reflected at the bottom of the first slide, there is a \$5 million threshold that must be satisfied before the Secretary certifies an event as an "act of terrorism." Next, there is also a Program Trigger of \$200 million of insured losses in a particular calendar year that must be satisfied before any Federal payments can be made, even if all other conditions

have been satisfied. Finally, a \$100 billion annual aggregate cap limits total insurer and federal payments in any particular calendar year.

Assuming one or more acts of terrorism in a given year are certified, and there have been at least \$200 million in associated insured losses, Treasury will make payments to any insurer that has met its Program deductible, which is measured for each insurer by 20 percent of its TRIP-eligible lines premium in the prior year. The federal share payment for each year during the entire 2020-2027 period is 80 percent of losses sustained by an individual insurer above its deductible.

Although the deductible percentage has not changed, an insurer's deductible will tend to increase over time in dollar terms as its TRIP-eligible lines premium increases. The \$100 billion program cap limits further federal payments as well as insurer payments for any insurer that has satisfied its Program deductible.

Mr. Ifft then discussed the recoupment mechanism, addressing amounts the Government either must, or may, recover as reimbursement for the payments that it may make in connection with the Program. This was illustrated by the second slide, titled "TRIP Overview: Recoupment." The 2019 Reauthorization Act did not modify the recoupment mechanism, except for modifications to the dates by which mandatory recoupment by Treasury must take place in light of the extension of the Program for an additional seven years. The important figure in this calculation is the Insurance Marketplace Aggregate Retention Amount, or IMARA, which is now calculated as the amount that represents the three-year average of aggregated insurer deductibles. The precise figure is based on actual industry premium figures, which Treasury gathers in its annual TRIP data calls. The figure for calendar year 2020 was published by Treasury in December 2019, and is just under \$41 billion. Like the individual insurer deductibles, while the IMARA formula will not change, the IMARA will tend to increase from year to year with the general increase in industry premium figures over time.

Any amounts paid by Treasury that are subject to mandatory recoupment – because insurance industry payments (for deductibles and co-pay amounts combined) are less than the IMARA in a particular year – Treasury must recoup any payments that it makes at a rate of 140 percent of its expenditures. Treasury recoups payments through a surcharge that Treasury will determine (in an amount and for a period that results in the collection of the appropriate amount of money), which it then directs all insurers to impose upon all TRIP-eligible lines policies for the period in question. Treasury imposes the surcharge upon all such policies regardless of whether the policyholder had any terrorism losses or whether it even purchases terrorism risk insurance. Insurers then remit those amounts to Treasury on a rolling basis as they are collected.

Mr. Ifft then noted two additional changes in the 2019 Reauthorization Act that will result in further reporting relating to the Program. First, Congress has required the Government Accountability Office, or GAO, to make a report to Congress within 180 days of enactment of the 2019 Reauthorization Act, which must address (as reflected in an accompanying slide), the following issues:

- (1) the overall vulnerabilities and potential costs of cyber attacks to the United States public and private infrastructure that could result in physical or digital damage;

- (2) whether state-defined cyber liability under a property and casualty line of insurance is adequate coverage for an act of cyber terrorism;
- (3) whether such risks can be adequately priced by the private market; and
- (4) whether the current risk-share system under TRIA is appropriate for a cyber terrorism event.

In addition, GAO is also requested to provide recommendations as to how Congress could amend TRIA “to meet the next generation of cyber threats.”

Second, the 2019 Reauthorization Act now requires Treasury to provide an analysis in its biennial Program Effectiveness Reports of the availability and affordability of terrorism risk insurance, which shall include an analysis of such availability and affordability specifically for places of worship. As noted by Mr. Ifft, although FIO has routinely assessed availability and affordability of terrorism risk insurance in its prior Program Effectiveness Reports, it has never analyzed those issues specifically with respect to places of worship, nor does it currently have specific information in its possession relating to the issue. Mr. Ifft stated that Treasury was currently evaluating the best way in which to modify its annual data calls to seek the production of this information, in a way that will enable industry to provide it an efficient and accurate manner.

Presentation of Discussion Draft Report

The meeting then moved to a presentation by Chair Sapnar of a rough draft report (in the form of a PowerPoint presentation), for discussion purposes, of an initial report to FIO presenting recommendations. The slide deck (made part of the Committee record) was reviewed by Chair Sapnar, with comments and questions from the other Committee members as issues were raised. The draft report was expressly characterized as non-final, with the note that issues could be added or subtracted from any final version. Chair Sapnar also noted that goals could ultimately be characterized as long-term versus short term, which had not been done yet. He indicated that the goal remained to provide a final draft to Treasury by April 2020, with the aim that the Committee recommendations could be addressed in FIO’s June 2020 Program Effectiveness Report.

Chair Sapnar briefly reviewed pages of the draft addressing the ACRSM membership and prior activities, including the receipt of information from the various constituencies with an interest in the Program. Subcommittees were assigned work after this initial accumulation of information was received.

The first finding addressed by Chair Sapnar was that it was clear that the insurance industry needs a cap on the liabilities for loss arising from terrorism events in order to properly price and provide coverage. A cap, based upon the available information, is necessary to make sure that terrorism risk insurance remains available and affordable. Mr. Lupica noted that the cap was connected with the mandatory availability requirement of the Program, as it caps what might otherwise be uninsurable exposure; he characterized it as a “critical component” in how the insurance industry views the risk that it is undertaking. Chair Sapnar acknowledged the point, particularly from a direct insurance standpoint, as reinsurers are not subject to any mandatory availability requirement, meaning that direct insurance companies can be caught between a

mandatory offer of coverage and unavailable private reinsurance coverage. As a result, the cap on liabilities and federal backstop are critical to the operation of the Program.

Chair Sapnar next observed the draft finding that there has been and will continue to be a major transference of terrorism coverage from the government to the private sector as a result of the operation of the Program. He noted that this was addressed in the draft by diagrams showing how industry retention amounts continue to increase over time, given the manner in which the Program is currently structured, such that by about 2040 about 100 percent of exposure under the Program would be lodged in the private sector – versus a 60/40 private versus public share currently, which itself represents an increase from a 22/78 private versus public share when the Program inceptioned.

Ms. Peters noted in response that this dynamic may be true as respects conventional terrorism risk, but would not be the case with respect to non-conventional risk – such as nuclear, biological, chemical, and radiological (NBCR) risk, and ultimately cyber risk, where the same transference is not happening. Chair Sapnar acknowledged this was the case, albeit with the exception of workers' compensation, where NBCR risk is covered and the mandatory offer requirement places this risk in the private sector. Mr. Metropoulos observed that, in addition to workers' compensation, there is some NBCR capacity in the private market, although it was “nowhere near” the insurance capacity available for conventional terrorism risk.

Regarding cyber, Chair Sapnar observed that with respect to cyber risk, there was some potential transfer to the public sector under TRIP, although that would ultimately depend upon certification and coverage issues. He noted as well that there have been significant changes in the market, with the move from non-affirmative cyber coverage (which may have been generally within the Program) to standalone cyber coverages, where the peril and its aggregate exposures would be examined more critically by the insurance industry.

In that regard, Mr. Lupica applauded the prior Treasury guidance on the inclusion of standalone cyber insurance within TRIP, but noted that cyber risk continues to evolve and the Committee and FIO should study whether the Program is currently utilizing the correct definitional and trigger language and certification processes to address the risk, particularly where it has emerged as a global exposure. Chair Sapnar agreed and indicated there would be further opportunities to consider the details

Chair Sapnar next addressed uncertainty about the certification process and its timing as another major finding. In that regard, he noted the difficulty this could pose for insurers in terms of determining how and whether to pay out under a policy, and assessing appropriate responsibility. Chair Sapnar indicated that the principal finding is that clarification is needed, with better processes for certification identified. Mr. Bell echoed this point, indicating that there needs to be a clear framework as to how certification determinations are made, even if total certainty in the process is impossible where Treasury will need some amount of flexibility under particular circumstances when making these determinations. Mr. Lupica indicated that having a time frame is critical because of the complexity of the underlying insurance programs, with various deductible, recoupment, and aggregate issues that insurers need to evaluate. Timing needs to be understood in this context. Mr. Metropoulos noted that this timing issue extended to reinsurance contracts as well, observing that there have been some events involving terrorism (noting the

Boston Marathon bombing and the San Bernardino shootings) that were not certified but that resulted in losses that still needed to be addressed, where there was some interplay between reinsurance contracts and how TRIP operates.

Chair Sapnar next addressed the possibility of further studying the manner that non-traditional alternative risk-financing mechanisms, such as but not limited to captive insurers, may be able to access the Program, and whether that should be addressed in some fashion. He indicated, in response to comments from Ms. Peters, that this was not meant to be pejorative but simply something that should be considered along with other issues concerning the Program.

Chair Sapnar next identified the mandatory recoupment requirement, and potential unintended consequences arising from it if Treasury is required to collect sums at the 140 percent recovery figure. He questioned whether that remained the best solution at this point where the industry has a much stronger capital position now than was the case 20 years ago. He indicated that the ramifications of this should be studied, including whether there was a more effective way at this point to pre-fund the Program.

Chair Sapnar next identified cyber as a major concern, which would be addressed further in terms of recommendations, and concluded with NBCR coverage and recoveries, in terms of the exposure in the industry and how such coverage would likely respond post-event, particularly in a loss of significant size.

Chair Sapnar next turned to specific recommendations, including recommendations for further study. The first issue again related to the annual Program cap, which he reiterated remained necessary for the industry, but focused on whether the current \$100 billion figure (which has stayed the same since 2002) remained adequate to provide affordable and enough available coverage. He indicated that this would depend upon a further analysis of how industry policyholder surplus had developed. He cautioned that the \$100 billion cap should not be evaluated as an issue in isolation, but in conjunction with all of the Program mechanics. In that regard, he noted that he did not believe that the cap necessarily should go up, but given the increase in exposures over time the issue was one that should be considered.

Mr. Metropoulos, seconded by Mr. Lupica, noted in response that there could be rating agency implications for insurers of raising the Program cap above \$100 billion figure, given that exposures are continuing to increase and thus insurers are bearing more exposure. Chair Sapnar acknowledged the point, although commented as well that failing to raise the cap could have a significant effect upon policyholders who would be required to take a significant reduction in their recoveries from a large event if total losses were in excess of \$100 billion. Mr. Bell stated that if you did consider adjusting the Program cap you would need to consider what would be the appropriate index adjustment to account for the passage of time and changes in industry exposure. Ultimately the Committee members agreed that the issue needed to be considered from the standpoint of both insurers and policyholders.

Chair Sapnar also observed that the application of the IMARA and recoupment also factors into this, as over time the increase in the IMARA will continue to drive most losses to the private sector. He commented that given this dynamic perhaps the Government should be providing additional protection beyond the Program Cap for significant events, such as a large NBCR

event. Although Chair Sapnar indicated that he did not believe that pre-funding of Program obligations was necessarily the correct approach, he recognized that operation of the various Program mechanics along with the impact of the mandatory offer requirement should be reevaluated over time.

Regarding alternative risk transfer mechanisms and TRIA, Chair Sapnar indicated consideration should potentially be given to whether resources beyond those of the risk transfer mechanisms themselves should be considered in determining the retentions of such entities under the Program. Beyond identifying it as an issue for further study, however, Chair Sapnar had no further comments, and no other Committee member commented on the point.

Chair Sapnar next observed that while the 2019 Reauthorization Act addressed various issues as to which Congress has requested further study, the Committee believes that the list should be expanded upon, including to address the coverage of cyber events outside the United States that threaten or impact United States businesses, but where it is unclear whether they are meant to influence U.S. policy or threaten the United States. Because of the potential size of such events, Chair Sapnar raised the issue of whether the Program should be broader in nature to cover such exposures. Director Seitz observed that the study requirement under the 2019 Reauthorization Act was directed to GAO although FIO has been actively considering the same issues. Chair Sapnar acknowledged that the Committee intended to expand the list of issues to be considered respecting cyber insurance in terms of what it would be requesting FIO to evaluate. Mr. Bell observed that consideration should also be given as to whether there is Program coverage for acts impacting non-U.S., international operations, but where the target is really U.S. interests, which might not be immediately obvious. Ms. Peters stated that in her view the principal question is whether the whole definition of what cyber-related coverage is available under TRIA should be bifurcated from the existing definition, since it cannot be readily slotted into other terrorism risk exposures, whether conventional or NBCR. Ms. Peters also indicated that consideration should be given to whether the size of the event (and not just its nature) should be considered in determining the availability of coverage under TRIA. Although acknowledging that this issue has come up under TRIA in the past, she indicated that because cyber is such a different exposure from all other types of terrorism risk that care should be taken in not just lumping it into a more generic definition.

Chair Sapnar agreed with Ms. Peters' statements, and observed that there has been some discussion (not necessarily limited to cyber) as to whether there should be some sort of parametric or index trigger that forces a certification process in an expeditious way pursuant to a certain timeline. He indicated that this is something that could be further discussed within the subcommittees as to whether to incorporate this into proposed recommendations by the full Committee. In that regard, he indicated that this could be indicated for any type of event, whether cyber or not, although he observed that it could be particularly relevant to a cyber-related loss.

Regarding NBCR, Chair Sapnar noted that realistic modeling places various NBCR-related scenarios as generating losses above the current \$100 billion Program Cap, and that this needs to be studied further. He indicated, however, that increasing the Program Cap was not the only way in which to address this issue, as there could be other ways to transfer or finance risk above \$100 billion, either through pre-funding mechanisms or capital markets with parametric triggers that

could provide some certainty to the marketplace should some event of this size occur. Mr. Metropoulos noted that if NBCR is being considered in this regard the modeling should address other lines of business that will be impacted, such as liability or health care – whether currently TRIP-eligible or not.

Chair Sapnar next turned to the pre-funding issue, noting that it is something that is done by other countries. He acknowledged that pre-funding would constitute a major shift in philosophy in terms of how the Program has operated to date, although felt that the issue should continue to be studied since when costs such as this are deferred there is not the same focus on the risk being insured, from a risk management standpoint, as there would be otherwise. This could ultimately impact the premium charged, as companies may otherwise be lax in their charges if there is not the focus on the risk that would be required if exposures were pre-funded. He also observed that if the Program were to be expanded in some fashion it would perhaps be possible to do that through pre-funding or some other approach different from the current Program mechanisms.

Chair Sapnar observed, however, that this could be a “Herculean” task given the prior history of the Program, although indicated that given the complexity of the issue it should probably be subject to further study as distinguished from current recommendations. Mr. Bell noted that if it is to be considered relevant benchmarks will include the appropriate triggers for setting aside funding, how funding can be taken down if not needed, and the total amounts to be carried and relevant tax consequences. Mr. Seo observed that, as a member of the subcommittee considering pre-funding issues, the subcommittee may be able to make recommendations providing some of the benefits of pre-funding but short of actually requiring pre-funding. He indicated in that regard that increased staffing at FIO devoted to pursuing some of the benefits that might otherwise take place in a risk transfer situation might allow for some of these benefits to be accomplished without actual pre-funding.

Chair Sapnar then returned to the certification process, noting some industry frustrations over when and how events might be certified, and how long that could take. He also acknowledged, however, that such issues may also present political ramifications, and that Treasury would require some degree of flexibility in the process, although indicated further study and evaluation was indicated. Chair Sapnar indicated that he felt that the Committee should ultimately put certification to the top of the list of recommendations for FIO. Mr. Lupica agreed that certification was an important prior in the ordering of issues, along with further clarification on cyber-related coverage under the Program.

Chair Sapnar next turned to the coverage afforded non-profit organizations under the Program. Mr. Ifft clarified that to date the reporting requirement that FIO has under the 2019 Reauthorization Act is for places of worship only (which was not subject to further definition at this point), and not for all non-profit organizations.

Mr. Sapnar noted that the current working draft does not represent any final positions of the Committee, as further discussions and subcommittee work are taking place. He did observe, however, that he considered issues around the Program Cap as deserving a very serious look at the ramifications if it were to be increased, particularly where it is clear that a cap is definitely needed. Regarding issues in the lower, “working layer” of the Program, Chair Sapnar noted that various issues had been raised, and inquired as to whether any of the other Committee members

felt that anything else needed to be raised. In that regard, Mr. Seo observed that while he felt the Program has been achieving its goals, he remains concerned about what would happen after a major event had taken place. In that regard, he questioned whether the Committee should be looking at creating some mechanisms around the IMARA that would allow under appropriate conditions for the IMARA to be reset to a much lower level, consistent to what was in place when the Program incepted, in response to that significant loss event. He indicated that this was because while he did not question the ability of the market to respond to a single large event he did not believe that there would be sufficient availability of coverage for a second large event. Mr. Seo felt that resetting the IMARA to a lower level, for purposes of the second event, would be helpful to address that situation.

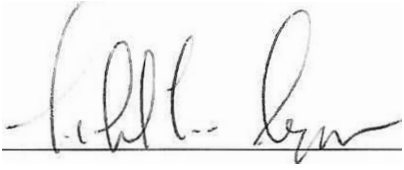
Chair Sapnar acknowledged the point, as well as the fact that the Committee had discussed it previously, and indicated that it should have been included in the draft presentation. He did note, however, that in this situation the Program Cap would likely be implicated, such that insurers would not necessarily be exposed for losses from the second event, on a going forward basis. In that regard, however, he noted that this was not a particularly good result, either, in light of its impact upon policyholders, thus emphasizing the need for further study. He also noted the problem with the interaction between an exhausted Program Cap and the mandatory offer, which could result in an insurer offering coverage for at least a portion of a year where that coverage was effectively exhausted already. Mr. Lupica agreed that there could be uncomfortable timing issues presented for an insurer, particularly where it might take some time to fully quantify the total amount of losses in a year that was so impacted.

Chair Sapnar next mentioned again the recoupment process, and questioned whether the amount and recovery multiplier still made sense under the present circumstances. He noted as a reminder that recoupment is absorbed by the private market in general, and the private business/policyholder community in particular. He then proceeded to reiterate the other issues that had been raised earlier (alternative risk transfer, cyber, NBCR, encouraging behavior associated with pre-funded mechanisms even if pre-funding is not accomplished, etc.) and observed that the Committee's recommendations would need to be focused and prioritized, even if all of the issues were ultimately presented in a report to FIO. Regarding certification, Mr. Metropoulos noted as well that it would perhaps be helpful to have explanations as to why certain losses may not have been terrorism or eligible under TRIA (raising in particular the Las Vegas shootings) when considering the entire certification issue.

Chair Sapnar concluded by acknowledging all of the work and time of the Committee members and their respective staffs in putting together the current draft, and pointed out the great deal of thought and discussion that has gone into the identification of issues for consideration. He noted that this work was being done at a very busy time of the year for the industry, and appreciated that effort to keep the work of the Committee on schedule.

Upon confirming that none of the other Committee members had any further questions or comments, at 3:31 pm Chair Sapnar concluded the meeting.

I hereby certify these minutes of the February 5, 2020 Advisory Committee on Risk-Sharing Mechanisms public meeting are true and correct to the best of my knowledge.

A handwritten signature in black ink, appearing to read "Mike Sapnar", is written over a horizontal line.

Mike Sapnar
Chair