DEPARTMENT OF THE TREASURY
FEDERAL INSURANCE OFFICE (FIO)
ADVISORY COMMITTEE ON RISK-SHARING MECHANISMS (ACRSM)
MINUTES –11 MAY 2020

The Advisory Committee on Risk-Sharing Mechanisms (ACRSM) convened at 10:30 am on 11 May 2020 in a Virtual Meeting over the Webex Platform, 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
KEAN DRISCOLL, AIG
JOHN LUPICA, Chubb
EMIL METROPOULOS, Guy Carpenter
WENDY PETERS, Willis Towers Watson
JOHN SEO, Fermat Capital
KEITH WOLFE, Swiss Re

Also Present

LINDSEY BALDWIN, Senior Insurance Regulatory Policy Analyst, Federal Insurance Office
JONATHAN GREENSTEIN, Deputy Assistant Secretary, Financial Institutions Policy, Treasury
RICHARD IFFT, Senior Insurance Regulatory Policy Analyst, Federal Insurance Office (Designated Federal Officer)
STEVEN SEITZ, Director, Federal Insurance Office

Welcome and Opening Remarks

Director Seitz of the Federal Insurance Office (FIO) welcomed everyone to the second 2020 meeting of the ACRSM and extended his wishes that all attendees and their families were doing well. 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. He indicated that the purpose of the meeting was to review the draft report of the Committee concerning the Terrorism Risk Insurance Program (TRIP), and to submit the report to the full Committee for its approval.

Director Seitz introduced Jonathan Greenstein, Deputy Assistant Secretary of the Treasury for Financial Institutions Policy, and Richard Ifft and Lindsey Baldwin of FIO, and thanked the members of the Committee for their ongoing work on the ACRSM, noting that TRIP was an important program for Treasury and was important to the economic stability of the insurance industry.

Director Seitz next provided a summary of certain recent developments concerning TRIP. First, he noted the issuance of two Governmental Accountability Office (GAO) reports concerning TRIP in April 2020, one of which found that TRIP has contributed to market stability while government exposure under the Program has decreased, and the second of which found that industry stakeholders found that the Program's claims process to be clear. Director Seitz noted that the GAO reports did make certain recommendations to FIO, which FIO would be evaluating to determine how best to implement them.

Second, Director Seitz noted that the 2020 TRIP data call would be ending on Friday, May 15, and thanked those companies that had already reported. He noted that the data formed the basis for the reports that FIO issues to Congress concerning the Program, the next of which (on June 30, 2020) would address the effectiveness of the Program. Third, he noted that FIO published a notice in the Federal Register on April 27 seeking comments for use in FIO's upcoming effectiveness report, observed that such comments had been helpful to FIO in the past, and indicated that he would appreciate any comments from stakeholders and the public.

Finally, Director Seitz noted that Treasury had been scheduled to host a portion of the annual conference of the International Forum of Terrorism Risk Insurance Pools in Washington in June 2020, which had been postponed to October 2020, although noted that the situation remained fluid. He indicated that FIO looked forward to meeting in Washington, at an appropriate time, with its counterparts at terrorism risk pools in other parts of the world, as well as with the broad array of stakeholders that participate in the second day of the conference.

Director Seitz closed by indicating that he was looking forward to hearing from the Committee concerning its recommendations for further study by FIO concerning the Program, which remained an important priority for FIO, and turned over the proceedings to Chair Sapnar.

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. Given that this was the first ACRSM Committee meeting held in remote format, he then proceeded to identify each committee member, each of whom then signaled their presence on the call. Chair Sapnar next welcomed to the meeting Jonathan Greenstein, Assistance Deputy Secretary for Financial Institutions Policy at Treasury, who had recently replaced Tyler Williams in that position.

Chair Sapnar next proceeded to review the draft report of the Committee in its entirety. He noted that there had been some changes to the prior draft (reviewed in the February 2020 ACRSM meeting) as the result of further work of the subcommittees, and as a result indicated that the report would be reviewed in its entirety to confirm that it was the report of the full Committee. During his discussion, the report was made available on the computer screens of the attendees of the meeting.

Report Pages 1-4 (Introduction, Background, and Activities): Chair Sapnar summarized, without objection or comment from the Committee members, the summary information on the opening pages of the Report reflecting the background, membership, and prior activities of the Committee.

Report, Page 5: Chair Sapnar next reviewed the proposed findings of the Committee, which were

(1) Terrorism risk insurance is generally available and affordable with the Program in place;
(2) A cap on potential liability is necessary if insurers continue to be required to make terrorism risk insurance available;
(3) There is an ongoing transfer of exposure for terrorism risk insurance from the government to insurers as the Program remains in place, although that transfer is less pronounced complicated risks presenting large exposures, such nuclear, biological, chemical, and radiological (NBCR) and cyber risks;
(4) There remain questions and uncertainty around the certification process; and
(5) The use of alternative carrier mechanisms can and lead to potential post-loss issues;
(6) Mandatory recoupment and the aggregate industry retention can lead to unintended results;
(7) Cyber coverage and issues should be studied in greater detail; and
(8) Total limits available for NBCR exposures remains an issue.

Upon inquiry, no committee members expressed any disagreement with these findings.

Report, Page 6: Chair Sapnar next proceeded to the proposed recommendations of the Committee for further work and study by Treasury and FIO, which were divided into short-term and long-term recommendations. In the short term, the Report proposed the following activities:

(1) A close study of the evolving cyber market in the context of the Program;
(2) Explore the appropriateness of the Program mechanics (cap, deductibles, and Industry Marketplace Aggregate Retention Amount, or IMARA) are appropriate for NBCR risks, and address the growing uninsured NBCR above the Program cap and the impact of state "fire following" laws on the exposure; and
(3) Further evaluation of the certification process, including the potential certification of events taking place outside the United States but have effects within the United States on U.S. companies. In addition, the subcommittees identified two further recommendations in this area, concerning the potential adoption of a petitioning procedure for the institution of a certification process, as well as consideration of shortened time periods associated with the certification process.

With respect to certification, Chair Sapnar noted that the intent of the additional recommendations was to heighten clarity of the certification process. Upon inquiry, Mr. Bell recommended revising the draft language to state "increasing the requirement to provide public notice" instead of "increasing public disclosure." The rest of the Committee made no objection to this change.

Chair Sapnar next proceeded to the proposed long-term recommendations of the Committee for further work and study by Treasury and FIO, which were as follows:

(1) Evaluation of the impact of indexing the IMARA to TRIP-eligible lines premiums in industry exposure;
(2) Evaluation of the recoupment process, particularly as to whether it should permit the government to recoupment more than it pays under the Program;
(3) Evaluation of alternative carrier mechanisms that can result in the shift of significant terrorism risk insurance to other policyholders, and whether there are ways to limit the incentives to do this;
(4) Evaluate the facilitation of further risk transfer from the federal government to global markets, including the potential use of prefunding mechanisms; and
(5) Consider evaluating availability and affordability of terrorism risk insurance for non-profit entities generally (in addition to the mandated evaluation under the 2019 Terrorism Risk Insurance Program Reauthorization Act).

Upon inquiry, Mr. Bell recommended that the Report be changed to reflect that FIO "should" look at the impact of the IMARA, as distinguished from "could" look as reflected in the existing draft. The rest of the Committee made no objection to this change.

Chair Sapnar then proceeded to move to the Appendix of the Report, which he indicated reviewed in more detail the issues just discussed in the Committee findings and recommendations. He indicated that, accordingly, he would provide a greater summary of this aspect of the Report as distinguished from the findings and recommendations themselves.

Report (Appendix Page 8):

Chair Sapnar first reviewed Page 8, which addressed the goals of the Program when enacted in 2003, which was to (1) to provide market stability so that insurers could write terrorism risk insurance, and (2) provide a framework for market stability in the aftermath of a terrorist attack. He noted that the $100 billion Program cap was a significant feature of the Program in light of these goals, in that it allowed insurers to evaluate their maximum loss and then price and underwrite the risk accordingly. Also significant was the sharing of loss between insurers, the government, and policyholders through the recoupment mechanism.

Report (Appendix Pages 9-14):

As noted by Chair Sapnar, Pages 9-10 of the Report address the goals of the Program in more detail. Continuing to move risk to the private sector is part of the goal to have the private market write terrorism risk insurance, as he observed. He noted as well, however, that some alternative risk transfer mechanisms could frustrate the goal of moving risk away from the public sector, which was the reason for looking more closely at those mechanisms. Regarding the goal of providing a framework for stability after a terrorist attack, he indicated that this could be undermined by Program mechanics (as confirmed during the last reauthorization) that will have the effect of shifting significant risk away from the federal backstop.

He noted that this was illustrated in still more detail on Pages 11-13, which demonstrates how overtime the amount of federal backstop will reduce as insurance industry premiums increase – such that while the federal backstop would have addressed approximately three events of the size of the September 11, 2001 Attacks when enacted, that support has now reduced to not even one event of that size. In terms of percentages, he noted that while industry would have paid under the Program 20 percent of a large attack in 2002 with the government paying 80 percent, the figure was now that the private sector would pay somewhat more than 50 percent with the government paying slightly less than 50 percent. He observed that the projections show that over the same period going forward the federal share could reduce to about 10 percent with the private sector paying 90 percent. Although indicting that these changes might have been an intended effect of the Program, Chair Sapnar noted it was something the Committee felt should be examined in further detail. He also observed that operation of the recoupment feature could mean that the government would make money on a terrorism event, which was a consequence worthy of further study in the view of the Committee. As reflected on Page 14 of the Report, now that the Program is extended through 2027, the Committee viewed the issues identified for study as issues that could be considered in any further reauthorization of the Program respecting how risk shifting has altered under it.

Report (Appendix Pages 15-18):

Chair Sapnar next addressed a series of pages discussing in more detail some of the Program mechanics and how they related to the Committee's recommendations. Regarding the Program Cap (Page 15), Chair Sapnar reiterated that the Program Cap was necessary, but also observed that any changes to the cap (because of increasing exposures over time, particularly from NBCR events), or perhaps different caps for different kinds of exposures, would have to be carefully considered because of the balancing of interests among insurers with different kinds of exposures, as well as policyholders with the risk of no recovery for losses above the Program Cap.

For the IMARA (Page 16), Chair Sapnar reviewed the increase in the fixed IMARA amount over time, as well as the impact of having it now indexed to insurer premiums which, based upon premium growth projections, would have the effect of creating a $58 billion IMARA by 2030, as well as the possibility that the government could make money from its application through the recoupment process. As noted by Chair Sapnar, if the IMARA is to be indexed, it makes sense for FIO to consider whether other Program mechanics should be indexed as well.

Regarding the mandatory recoupment process (Pages 17-18), Chair Sapnar discussed how the mandatory process would work in the event of total losses (but some Government payments) below the IMARA, with the risk of recovery well above Government expenditures, given the 140 percent recovery percentage. As he noted, it made sense for FIO to consider whether there was a better recoupment structure available under these circumstances.

Report (Appendix Pages 19-20):

Chair Sapnar next discussed the participation of alternative carrier mechanisms, or captive insurers, in the Program, highlighting how such mechanisms could, even if not intentionally structured to do so, result in shifting most of the terrorism risk exposure of a particular policyholder to all policyholders generally. Chair Sapnar indicated that the request of the Committee to FIO was that it study possible ways to prevent unintended consequences through the use of such mechanism, including but not limited to how the deductibles of such insurers are determined by perhaps using a calculation other than Direct Earned Premium for a single parent captive, since they are not otherwise part of a large insurance company holding system. He also suggested the possible use of a registry showing the participation of such insurers in TRIP, in order to increase transparency by providing more specific details concerning relevant parent entities, deductible figures, and terrorism risk insurance limits assumed. Chair Sapnar also noted that a slide in the Report illustrated the manner in which a loss of the same size might be spread if sustained by a single captive versus a number of large insurance companies, in terms of how the existing Program mechanics would operate.

Report (Appendix Pages 21-22):

Chair Sapnar next addressed the role of cyber insurance within the Program. He noted at the outset Treasury's 2016 guidance on the subject, which confirmed that stand-alone cyber coverage and coverage otherwise written in TRIP-eligible lines of insurance was subject to the Program. He observed, however, that the issue of cyber coverage under the Program was complicated in light of the nature of the risk. In particular, noting that TRIP is for the most part limited to damage taking place within the United States, he questioned how the Program might respond to events that took place outside the United States, but still have an effect on U.S. interests. In particular, he noted the NotPetya cyber attack which took place outside the U.S., and stated that it would likely present a gray area under TRIP in light of the likely motivations behind the attack. Such uncertainty over attribution would likely cause delays in the certification timeline, which could be of great importance to insurers.

As a result, Chair Sapnar stated that the Committee felt that FIO should examine a large number of cyber-related issues in the context of the Program, in terms of how they impact the coverage of the Program and the developing cyber market more generally. Those issues, as identified in the Report, include (1) the types of cyber operations and how they occur; (2) the various types of economic loss associated with cyber operations; (3) the effects and severity of cyber operations and potential impact on certification; (4) whether being unable to determine the intent or attribution behind a cyber attack could impact certification; (5) how certification would work for events occurring outside the U.S. that impact U.S. citizens and U.S. companies; (6) review current definitions of cyber liability and insured loss to ensure the intended scope of coverage; (7) explore aligning the definitions of terrorism across federal agencies; (8) consider the impact war exclusions have on cyber coverage under TRIA; (9) review the current certification regulations to determine if adequate transparency and certainty exists; and (10) engage further with the International Forum of Terrorism Risk Insurance Pools (IFTRIP) to account for potential interaction with other pools and to minimize any gaps given the global nature of cyber exposure.

Report (Appendix Pages 23-25):

Regarding NBCR exposures, Chair Sapnar noted the fact that many private reinsurance contracts limit exposure for NBCR losses (as well as specifically for exposures at certain locations). He also observed that many direct insurers may exclude NBCR exposures, with the exception of workers' compensation, such that the total amount of coverage for NBCR exposures may be limited. Whatever the coverage available, however, Chair Sapnar indicated that it would be less supported by the private market than other terrorism risk exposures.

Chair Sapnar noted that the analysis of the ACRSM, as set forth in the Report, was that NBCR events presented a far greater risk of financial loss (based upon modeling scenarios) and would constitute a significant proportion of total P&C capital – a risk that would become more likely with the passage of time. The aggregation risk presented by terrorism in conjunction with difficulty in modeling NCBR exposure from a frequency and severity standpoint has as a result limited the development of private reinsurance capacity in this area, thus making the TRIP backstop important, and requiring further analysis of those issues. In particular, Chair Sapnar indicated that the Committee believed that an analysis of whether the Program Cap, with respect to NCBR exposures, was adequate or appropriate and, if not, how could that be addressed, given the potential exposure versus industry capital. As part of this analysis, Chair Sapnar suggested that consideration should be given to how state "fire following laws" and information from the TRIP data calls reflect what portion of NCBR modeled losses may be insured and uninsured by state. He also indicated that such an analysis should also consider the potential impacts upon other lines of insurance business that are not currently eligible under the Program.

Report (Appendix Page 26):

Chair Sapnar next discussed the fact that the Program was not subject to any sort of pre-funding mechanism (relying instead upon the post-loss recoupment mechanism). He acknowledged that this had worked well for the last 20 years (in an environment without any losses) but indicated that the issue of pre-funding should be looked at more carefully. In the absence of pre-funding, he stated, the pricing of terrorism risk becomes more difficult, and it is accordingly more difficult for Treasury and FIO to administer the Program without the benefit of full risk and pricing information.

Recognizing, given the reauthorization, this situation was not likely to change in the near term, Chair Sapnar indicated that the Committee instead made recommendations that would permit FIO to develop tools that might otherwise come about with the existence of a pre-funded Program, such as terrorism risk modeling and mitigation efforts that would permit the further transfer of risk to the private market. He suggested that this could come about by investing in further FIO staffing that would permit the development of such initiatives on modeling and risk mitigation that would permit further exploration into the transfer of risk to global markets, including the effect that pre-funding mechanisms might have on such a transfer.

Report (Appendix Page 27):

Regarding Certification, Chair Sapnar stated that to facilitate economic recovery it is necessary to have a definitive determination of whether an act of violence constitutes an act of terrorism under the Program. In that regard, he noted that there is currently no prescribed time period within which the Secretary of the Treasury must declare that an act is not an act of terrorism. He acknowledged Treasury's 2015 Study on the Certification Process, in which Treasury stated that the uncertainty of how long the investigation of an act of terrorism might take prevented the adoption of a process governed by strict timelines.

In order to prevent potential economic uncertainty that could arise in this situation, after an event takes place, Chair Sapnar suggested that the issue be addressed administratively by FIO to arrive at a resolution of the current uncertainty. He also indicated that, in the context of cyber, this could include issues presented by the certification of cyber events taking place outside the United States but leading to some damage within the United States, and the manner in which a certification process would take place in that situation.

Report (Appendix Page 28):

Chair Sapnar concluded the discussion of the draft Report by addressing the availability and affordability of terrorism risk insurance for non-profit entities generally. He noted that in the past numerous studies had been commissioned (from Treasury as well as the Government Accountability Office) to evaluate the availability and affordability of terrorism risk insurance – most recently in the 2019 Reauthorization Act to address the availability and affordability of terrorism risk insurance for places of worship. As reflected in the Report, the suggestion is that this study be expanded to evaluate the availability and affordability of terrorism risk insurance for non-profit entities (as organized under Internal Revenue Code Section 501(c)(3)) more generally.

At this point, having concluded his presentation of the material in the draft Report, Chair Sapnar then opened up the discussion to the full Committee, in order to determine that the Report presented represented the thinking of the Committee, and set forth its findings and conclusions.

Mr. Wolfe commented in response that he thought the document was comprehensive and well thought out, and thanked Chair Sapnar for leading the effort. Chair Sapnar responded by thanking all of the Committee members for their efforts, particularly during the time period that the Report was finalized. He then formally presented the document to FIO as the Committee's Report, subject to the revisions identified during the course of the meeting.

Director Seitz thanked Chair Sapnar and the Committee for their work, accepted the Report as the findings and recommendations of the ACRSM, and indicated that FIO looked forward to continuing to work with the Committee on the recommendations and initiatives identified in the Report. In that regard, he confirmed that he hoped the Committee members would continue to be available during the balance of their terms to work with FIO on the issues identified and on the implementation of the recommendations. He suggested that this would involve less work than the commitment to date but indicated that meetings once or twice a year to work through the recommendations would be helpful for FIO.

For his part and on behalf of the Committee, Chair Sapnar indicated that he would be happy to do that, and hopefully in the context of a meeting at Treasury where the Committee could sit down with FIO to discuss and evaluate the Committee's recommendations.

Upon confirming that there was no new business, and without any further comments from the Committee, Chair Sapnar again thanked the Committee, and Committee staff, for their work and at 11:19 am concluded the meeting.

I hereby certify these minutes of the May 11, 2020 Advisory Committee on Risk-Sharing Mechanisms public meeting are true and correct to the best of my knowledge.

Mike Sapnar
Chair