

**UNITED STATES DEPARTMENT OF THE TREASURY
ADVISORY COMMITTEE ON RISK SHARING MECHANISMS
SUMMARY OF PUBLIC MEETING**

December 15, 2016

The Advisory Committee on Risk Sharing Mechanisms was convened at 1:48 p.m. on December 15, 2016, in Media Room A at the U.S. Department of the Treasury, 1500 Pennsylvania Avenue, NW, Washington, D.C., with Wendy Peters, Chair, presiding.

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

Committee Members Present:

WENDY PETERS, Executive Vice President, Financial Solutions – Terrorism and Political Violence, Willis Towers Watson, *Chair*
JONATHAN CLARK, Managing Director, Guy Carpenter & Company LLC (represented by proxy Emil Metropoulos)*
KEAN DRISCOLL, Vice President and CEO, Validus Reinsurance, Ltd.
EDWARD RYAN, Senior Managing Director, Aon Benfield
MICHAEL SAPNAR, President & CEO, Transatlantic Holdings, Inc.
JOHN SEO, Managing Principal, Fermat Capital Management LLC

Also Present:

MICHAEL MCRAITH, Director, Federal Insurance Office, U.S. Department of the Treasury
LINDSEY BALDWIN, Designated Federal Officer, Federal Insurance Office, U.S. Department of the Treasury

*Represented by proxy

Introduction

Director McRaith welcomed the members of the Advisory Committee on Risk Sharing Mechanisms (ACRSM) and convened the meeting. Director McRaith stated that although a market currently exists for terrorism risk insurance, the Committee's purpose is to determine if there is a better way to structure terrorism risk insurance in the United States. If the Committee finds a better way, the Committee should determine if there is a transition process that can occur without disruption to the industry and economy. Director McRaith reiterated the importance of wisely using the Committee's time and expertise, and encouraged the Committee members to use the meeting time to discuss issues that are most useful to them.

Data Availability

Director McRaith asked the Committee to provide feedback on the types of data that it will need to move forward.

Chairwoman Peters stated that it is important for the Committee to have a fundamental understanding of what data is currently available.

Director McRaith provided background on the voluntary data collection performed by the U.S. Department of Treasury (Treasury) in 2016, and commented that the data collection will be used to help inform policyholders about the current market and the effectiveness of the Program. The data collection process will be mandatory going forward, and Director McRaith noted that Treasury is cognizant of the need to respect the data collection burden on the industry while meeting the Department's statutory mandate. He also stated that although Treasury does not collect individual company data, aggregated data will be available for the Committee's use.

Chairwoman Peters suggested that take-up rates and premium volume are the most important data points, and emphasized that it is important to understand the impact on the market and demand if the program is changed. She also noted the importance of understanding who is buying terrorism coverage, and understanding insureds' profiles, locations, and the types of coverage being purchased. Director McRaith confirmed that the data being collected by Treasury should be able to provide answers to these questions.

Director McRaith asked whether it would be helpful to have data on whether insurers are issuing policies with terrorism coverage built-in to the policy, or whether insureds are required to pay extra for terrorism coverage. Chairwoman Peters stated that this information would be helpful, and in general the more data that is available, the better of a position the Committee will be in.

Mr. Driscoll stated that there is a spectrum of possible alternatives to the current structure of the Terrorism Risk Insurance Program (TRIP), however he believes the key question is market capacity, as this is what drives affordability of the product. He suggested obtaining an understanding of the probabilistic outcomes of different disaster scenarios, then framing capacity questions in relation to these scenarios. He also noted that he supported the use of Subcommittees to harvest the full knowledge of the Committee.

Mr. Seo expressed concern with analyzing capacity, noting that the current understanding of market capacity is theoretical because there is no current understanding of what is being paid, and therefore the market cannot react appropriately. He stated that although it is clear that people are currently paying very little, it is more important to understand what insureds would be willing to pay for coverage. Chairwoman Peters concurred and stated that artificial pricing mechanisms are in place, and insurers are not actually pricing risk. Mr. Driscoll suggested that an accurate estimate of price could be obtained by looking at exposure and policy in the data call. He stated that by understanding probable maximum loss, it is possible to work backwards and develop loss cost and an associated premium. This would then help the Committee understand the feasibility of transitioning to a potential future state/program alternative. Mr. Ryan noted that

in looking at total insured value, it would be important to look at the location of exposure, as risk is likely to be concentrated and some of the exposure probably should not have a charge.

Mr. Metropoulos agreed that data is critical to understanding if the current TRIP limits are high enough, as well as understanding exposure, limits and take-up rates.

Proposed Project Plan

Overall Objectives

Director McRaith reviewed the proposed project plan with the Committee members. He first reviewed the initial threshold question for the Committee of whether TRIP should be restructured, and if so, what the potential alternative should be. If an alternative is identified, the Committee will need to identify a transition plan. Director McRaith noted that a program that disrupts economic activity will not receive support, even if the end goal is desirable.

In discussing whether TRIP should be restructured, Mr. Metropoulos noted that capacity in the absence of the Terrorism Risk Insurance Act (TRIA) is untested, however TRIA and its reauthorizations have allowed the industry to slowly absorb more capacity without economic disruption. Mr. Sapnar agreed, and stated that it is unclear whether the industry can withstand an event. He also stated that TRIP does have shortcomings on both ends, as it has a cap as well as an industry retention amount. He therefore suggested it would be helpful to identify shortcomings of the current Program and proceed from there.

Timeline

Director McRaith noted that the proposed timeline for the project was established to coincide with the possible renewal of TRIA, so that the Committee would be able to conclude a report in advance of the Program's expiration and provide valuable information to policymakers considering whether to renew the Program. He also stated that the timeline was not binding but was proposed to serve as a guideline to help the Committee structure their work. Chairwoman Peters agreed that it was important to ensure that the Report reaches policymakers in time to be valuable for considering the Program's renewal.

Chairwoman Peters asked about whether the end of members' appointments to the Committee would affect the timeline, and Director McRaith confirmed that Committee members can be re-appointed to the Committee, assuming they are interested in continuing to serve. Ms. Baldwin also confirmed that most member appointments will end at the same time, as the majority of the Committee members were appointed at the same time.

Considerations for Subcommittees

Director McRaith reviewed considerations for all subcommittees, and noted that the list presented was not exhausted but was intended to serve as a starting point for discussion and research. A list of these considerations, as well as questions posed for the specific proposed

subcommittees, is available in the proposed project plan and available on the ACRSM website at <https://auth.treasury.gov/initiatives/fio/acrsm/Pages/default.aspx>.

Director McRaith then asked the Committee for feedback regarding the list of proposed Considerations.

Mr. Metropoulos stated that the list was comprehensive, but noted that there are certain areas, such as workers' compensation, which face unique issues, and stated the Committee should focus on these areas in its work. He suggested having a representative from the National Council on Compensation Insurance (NCCI) to provide in-depth information on the workers' compensation market. Chairwoman Peters stated that she believes the main issues facing workers' compensation relate back to modeling, because the highest potential for loss exists within pockets of concentration. These pockets skew the market and make it difficult to accurately model risk.

Chairwoman Peters also suggested that the Committee consider how the "make-available" provision in TRIA skews the market. Mr. Ryan expanded on this and suggested the Committee also explore whether a make-available provision could be required in an alternative to the Program.

Mr. Driscoll suggested reviewing post-funding structures, stating that they can produce both positive and negative unintended consequences. He also suggested that capacity in the reinsurance market serves as a good proxy for understanding pricing, and therefore recommended exploring existing transfers of risks to third-parties. Mr. Sapnar noted that the United States is the only post-funding government system, and that all other countries use a pre-funding system. He therefore stated it is important to look at whether post-funding is the best approach. Mr. Ryan questioned whether TRIP should really be considered a "post-funding" mechanism, because the aggregate market retention requirement could ultimately result in zero outlay from the government.

The Committee then discussed the operation of terrorism insurance pools in other countries. Director McRaith interpreted "post-funding" in the United States as meaning there is no pool of funding set aside to be used in the case of a certified event (other than the industry pool of funds collected through premiums). Mr. Sapnar noted that the industry is not necessarily collecting these premiums to use for terrorist events, but rather allocating a certain amount of premium towards terrorism (when reporting) after the premium is collected. He also commented that the UK government is distributing data to pool members to help inform their behavior and understand the aggregation of risk, which helps improve the accuracy of pricing.

The Committee discussed whether the size of the U.S. economy makes pooling less feasible in the United States. Mr. Seo suggested that the size of the economy actually provides an advantage. Mr. Metropoulos added that the size of the economy makes matters more complex, but it could nonetheless serve as an advantage. Mr. Ryan discussed the importance of establishing a premium in pool model, but cautioned against assigning a premium before an accurate model is developed.

Chairwoman Peters stated that the ultimate idea of a pool is to lessen government involvement, although the government may be the ultimate backstop. Mr. Driscoll said that government involvement can also lessen because of increased private market alternatives. He noted that participation in PoolRe (the UK pool) is diminishing because the private market is discovering better ways to provide terrorism coverage. He stated that participation in the National Flood Insurance Program (NFIP) is decreasing for the same reason. He stated it is therefore important to build a mechanism where the private market is able to fill in the gaps of the government program. Mr. Metropoulos commented that the private market is currently doing this under TRIP with respect to deductibles and co-shares. He stated that although it would be a good idea to examine international pool structures, the United States faces unique issues (such as the size of its economy and workers' compensation) and therefore may require a different solution.

The Committee then turned to a discussion of take-up rates. Director McRaith said that take-up rates are critical because a primary goal of TRIP is to ensure that insureds have terrorism coverage. However, he suggested that another goal is to rationalize prices to ensure they accurately reflect risk, take-up rates could be decreased, which would not serve the goal of keeping private capital available for businesses after an event. He also suggested that it can be difficult to enforce mandatory take-up by insured, and pointed to difficulties faced by the NFIP as an example.

Mr. Sapnar suggested that the NFIP isn't a good comparison to terrorism, and stated that terrorism insurance needs to have a public and private partnership. He also cautioned against creating a system that encourages behavior which creates additional risks.

Mr. Seo stated that generally insurers are not charging for terrorism coverage, as when they attempt to levy an additional charge, it is viewed by insureds as a ploy to get more money, as opposed to being used to support capital requirements. He therefore believes that the market will recoil from an increase in terrorism pricing, as there is a lack of trust when a price increase occurs, and insureds do not have an accurate understanding of the Federal backstop mechanism.

Director McRaith asked the Committee to consider how to reconcile the interest in high take-up rates with the desire for actuarially-justified rates (which would likely increase the cost of premiums).

The Committee discussed Treasury's recent regulations on Treasury's process for certification of an act of terrorism. Mr. Sapnar asked whether a concrete timeline was included in the rule. Director McRaith stated that set milestones for certification are unreasonable due to the complexity of making a determination about whether an act of terrorism has occurred, but confirmed that if an event satisfies the statutory criteria to be certified as an act of certification, the public will be notified that a certification process has commenced. Mr. Sapnar questioned whether this process could potentially create situations in which insurers would face significant financial impairment prior to a decision by Treasury, and Director McRaith suggested that this question be considered by the Committee, as TRIA was structured following the terrorist attacks of 9/11, and changes in the nature of threats could potentially warrant changes to the Program structure.

Mr. Metropoulos agreed that the nature of risks has changed, and suggested the Committee look at whether other loss scenarios should be included in TRIP, such as cyber events (which were not contemplated at the time TRIA was originally passed). Director McRaith agreed and asked the Committee to consider what their clients are currently requesting to cover in terms of risks. Chairwoman Peters and Mr. Metropoulos both stated that clients are requesting broader business interruption coverage, and asking about non-physical damages such as loss of attraction. Director McRaith then noted that the events in Orlando and Boston serve as examples where areas were closed off for an extended period of time and businesses within the perimeters experienced business interruptions.

Mr. Driscoll stated that cyber is arguably the fastest growing line of insurance, and he believes that inclusion of cyber within TRIP should be limited to truly catastrophic events, because TRIP is not a natural home for cyber coverage, and the industry should innovate to address cyber loss needs. Mr. Metropoulos agreed with this assessment.

The Committee then discussed considerations related to the reinsurance market. For purposes of facilitating discussion, Director McRaith asked the Committee whether it would be feasible to set up a \$100 billion minimum threshold for TRIA participation, wherein the private market would handle all losses beneath the threshold. Director McRaith also asked what the timeline would need to be to transition to this mechanism, assuming it was feasible. Mr. Seo says that there is a threshold of approximately \$50 billion in the reinsurance and catastrophe market (with respect to hurricane and earthquake losses), under which the market is operational and solvent, which therefore implies that a \$100 billion threshold would be very high. Mr. Sapnar noted that this threshold would also include the retention of primary insurers in addition to the reinsurance market, and therefore it might be feasible. Chairwoman Peters suggested that the biggest issue with this proposed mechanism is that it is currently difficult to know what the industry's capacity is. Mr. Driscoll agreed that there is a data issue and suggested it is important to understanding capacity before laying down constructs.

With respect to capital markets, Mr. Seo suggested that a deliberate effort would be required to open capital markets to support terrorism risk, but it would be feasible to do so. Mr. Driscoll stated that terrorism risk is correlated to economic performance, as opposed to a risk such as a hurricane, where a market downturn does not create the risk of triggering an event). However, he noted that although non-correlation for other risks is a benefit, it does not drive the capital markets, and therefore would not be an impediment to the creation of a market for terrorism risk. Mr. Metropoulos also raised the concern that there are challenges with tail risks, such as liability and workers' compensation, in capital markets.

Director McRaith suggested that other paradigms may have components of interest and value for the Committee, and suggested it would be helpful for individuals affiliated with other programs to speak at future Committee meetings. Chairwoman Peters agreed that it would be helpful to look at the reinsurance mechanisms supporting other programs. Mr. Sapnar suggested that the subcommittee exploring other programs should also examine the strengths and weaknesses of the current TRIP program.

Director McRaith also encouraged the Committee to recognize the importance of consumer interests.

Timeline

Director McRaith proposed that the Committee meet quarterly and hold a total of four meetings before October 31, 2017, with subcommittee calls held between the meetings. The Committee agreed to this meeting schedule.

Chairwoman Peters inquired about access to peripheral support services, such as external data forms. Director McRaith that Treasury staff are available to assist and will draft the Report for the Committee's review, based on the conclusions developed by the Committee, however external resources will not be paid to provide support.

Director McRaith suggested that the Committee members type up their thoughts on the first questions that need to be answered by the Committee.

Subcommittees

Director McRaith proposed the creation of five subcommittees: Direct Insurers, Reinsurance, Capital Markets, Exploration of Terrorism Risk Approaches in Other Countries, and Consumer Interests.

Mr. Seo questioned whether the Consumer Interests subcommittee should be combined with the Direct Insurers subcommittee. Mr. Metropoulos responded that although these two subcommittees overlap, they serve different constituents and consumer interests are important. Chairwoman Peters concurred that the subcommittees should remain separate.

Mr. Sapnar suggested that the work of the subcommittees may need to be sequential, with some questions addressed before others can be considered.

Keith Wolfe (absent) was selected to chair the Direct Insurers subcommittee. Mr. Metropoulos (on behalf of Mr. Clark), Mr. Ryan, and Chairwoman Peters volunteered to serve on the subcommittee.

Mr. Driscoll was selected to chair the Reinsurance subcommittee. Mr. Sapnar and Mr. Seo volunteered to serve on this subcommittee.

Mr. Seo was selected to chair the Capital Markets subcommittee. Additional subcommittee members were not selected at the time of the meeting.

Mr. Sapnar was selected to chair the Exploration of Terrorism Risk Approaches in Other Countries subcommittee. Chairwoman Peters and Mr. Seo volunteered to serve on this subcommittee.

Mr. Ryan was selected to chair the Consumer Interests subcommittee. Mr. Metropoulos volunteered to serve on this subcommittee, on behalf of Mr. Clark. Mr. Ryan proposed changing the name of the Consumer Interests subcommittee, however no determination was made on whether a name change would occur.

The Committee discussed whether additional lines of business should be able to access TRIP. Mr. Sagnar suggested, for example, that Personal Lines, should be considered. Mr. Metropoulos noted that the Committee would discuss what lines of business to include in TRIP going forward, and Personal Lines would be part of this discussion.

Next Steps

Director McRaith reviewed the Committee's discussion of questions to be discussed, and reiterated that the Committee members were selected for their expertise and perspective. As a result, he stated that he expected they had very clear views on certain matters, and while those views would be supported, it would be most helpful for the Committee to obtain a consensus on a path forward.

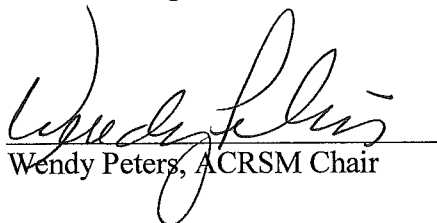
Director McRaith asked the Committee to select four dates for public meetings prior to October 31, 2017, and within 7 days, to provide a hierarchy of questions to be answered that would assist in framing an agenda for these meetings. Director McRaith noted that it would be possible to hold meetings in other locations, as well as longer meetings, if this would facilitate the Committee's work.

Mr. Metropoulos inquired about whether meetings could be closed to the public if the Committee would be discussing confidential or proprietary data. Director McRaith confirmed that Treasury would speak to its subject-matter experts on the Federal Advisory Committee Act (FACA) to verify if this was a possibility.

Chairwoman Peters stated she would reach out to Mr. Wolfe (absent), who previously agreed to inquire about each member's schedule and arrange meeting dates.

At 3:50 P.M., Director McRaith concluded the meeting.

I hereby certify these minutes of the December 15, 2016 Advisory Committee on Risk Sharing Mechanisms public meeting are true and correct to the best of my knowledge.


Wendy Peters, ACRSM Chair