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

March 31, 2017

The Advisory Committee on Risk Sharing Mechanisms was convened at 10:16 a.m. on March 31, 2017, in the Cash Room 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
KEAN DRISCOLL, Vice President and CEO, Validus Reinsurance, Ltd.
GREGORY HENDRICK*, Chief Executive of Reinsurance Operations, XL Catlin (represented by proxy Sean McGovern)
EDWARD RYAN, Senior Managing Director, Aon Benfield
MICHAEL SAPNAR, President & CEO, Transatlantic Holdings, Inc.
JOHN SEO, Managing Principal, Fermat Capital Management LLC
KEITH WOLFE, President US P&C – Regional & National, Swiss Re

*Represented by proxy

Also Present:

STEVEN SEITZ, Deputy Director, Federal Insurance Office, U.S. Department of the Treasury
DANIEL MCCARTY, Designated Federal Officer, Federal Insurance Office, U.S. Department of the Treasury
RICHARD IFFT, Senior Regulatory Insurance Policy Analyst, Federal Insurance Office, U.S. Department of the Treasury
LINDSEY BALDWIN, Senior Policy Analyst, Federal Insurance Office, U.S. Department of the Treasury
JULIE BOWLER, Vice President of Regulatory Affairs, Atlantic Charter Insurance Company
ELIZABETH HECK, President and CEO, GNY Insurance Company
CHIP RODGERS, Senior Vice President, Real Estate Roundtable
ED WALTER, Professor, McDonough School of Business, Georgetown University and Representative, Real Estate Roundtable
STEF ZIELEZIENSKI, Senior Vice President and General Counsel, American Insurance Association

Introduction

Deputy Director Seitz welcomed all attendees and stated that the focus of the meeting would be to discuss primary insurers and their experience in the marketplace. He added that pursuant to the Project Plan discussed by the Committee at the previous meeting (on December 15, 2016), additional meetings will be held to focus on: (1) the reinsurance market, (2) capital markets, and (3) risk-sharing mechanisms used in other countries. Each meeting will also discuss the interests of commercial insurance policyholders.

Deputy Director Seitz thanked the Committee for attending and re-iterated the importance of the Committee's work. He then recognized Mr. McGovern of XL Catlin, who attended the meeting as a proxy in place of Mr. Hendrick. Deputy Director Seitz also announced and thanked the presenters: Julie Bowler from Atlantic Charter, Elizabeth Heck from GNY Insurance, Stef Zielezienski from the American Insurance Association, and Ed Walter from Georgetown University and the Real Estate Roundtable.

Chairwoman Peters reviewed the structure of the meeting and asked Mr. Wolfe, the Chair of the Direct Insurers Committee, to introduce the first presenter.

Mr. Wolfe stated that the presenters were selected to provide a diverse cross-section of viewpoints to inform the Committee about the direct insurer experience. Two of the presenters represented small U.S. insurers, one of the presenters represented a trade association comprised of many insurers involved in the U.S. property/casualty insurance industry, and the final presenter attended on behalf of a trade association representing policyholders in the real estate industry.

Atlantic Charter Presentation

Mr. Wolfe introduced the first presenter, Ms. Bowler, the Vice President of Regulatory Affairs with Atlantic Charter Insurance Company in Massachusetts. Atlantic Charter focuses on providing workers' compensation insurance with a heavy focus on loss control and loss mitigation, and Ms. Bowler has over 25 years of experience.

Ms. Bowler provided a background of Atlantic Charter, an insurance company headquartered in Boston, Massachusetts which writes workers' compensation coverage. 95% of Atlantic Charter's business is written in Massachusetts, with the remaining 5% written in New Hampshire. Atlantic Charter has been in business for approximately 28 years, and in 2016 wrote approximately $65 million in premium (representing approximately $5 billion in payroll base). The insurer has had an underwriting profit in every year it has been in business, and holds an A rating from A.M. Best. Atlantic Charter holds 5% of the market in Massachusetts.

Ms. Bowler then described the operating environment in Massachusetts, and described it as regulatory-heavy. Massachusetts has administrative controls (rather than loss pricing), and holds a hearing every two years with the Attorney General, Commissioner of Insurance, and industry to determine all rates. Massachusetts also has the largest residual market in the country, with 18% of workers' compensation risks written through the residual market. This residual market is divided into two programs: an assigned risk pool and a voluntary direct assigned carrier program. Six insurers are part of the voluntary direct assigned carrier (VDAC) pool, including Atlantic Charter. In the voluntary pool, insurers voluntarily take risks onto their balance sheet and manage them independently (earnings and losses are not pooled with other carriers). 55% of the residual market in Massachusetts is written through VDACs.

Ms. Bowler stated that Atlantic Charter focuses its business on health care risks with a large concentration in the Boston area, and also writes policies for schools and plastics manufacturers. Ms. Bowler stated that Atlantic Charter has attempted to manage its aggregation risk, and will not write policies in towers or the downtown financial district. However, Atlantic Charter does write campus risks and has high exposure if an event occurs during a shift change.

Ms. Bowler stated that in the past, A.M. Best targeted 30 small to medium (primarily workers' compensation) insurers, including Atlantic Charter, as being at risk of a rating downgrade if TRIA was not reauthorized, due to small capital base and concentration of risk. Atlantic Charter believes Congress should consider strengthening TRIA's protections for workers compensation, as workers' compensation plays a special role in society, and the market is dominated by small and medium insurers.

Ms. Bowler stated that the TRIA Program Trigger leaves small and medium insurers with significant exposure, particularly if there is a regional event that affects workers' compensation lines but does not trigger the TRIA Program Trigger (currently $140 million, and increasing by $20 million a year through 2020).

Ms. Bowler stated that workers' compensation insurers have a limited ability to mitigate risk. Ms. Bowler reiterated that benefits and coverages are prescribed by state law, and cannot be modified by the buyer or seller, and that benefits could be potentially unlimited depending on the injury. She also noted that workers' compensation lines are not permitted to limit coverage for conventional terrorism or nuclear, biological, chemical, or radiological (NBCR) attacks. Workers' compensation carriers are also capped on the amount they can collect for premium ($0.03 per $100 of payroll). If a high risk is declined in the voluntary market, it is guaranteed coverage in the residual market, where losses are shared by the same insurers who are seeking to limit their exposure.

Ms. Bowler explained that Atlantic Charter invests heavily in front-end loss control and engineering workplaces to reduce injuries, as well as in back-end nurse case management to manage claims and return workers to work, however the company is constrained in its ability to limit terrorism exposure. Accordingly, TRIA is critical because it transfers catastrophic risk to the federal government, then spreads losses broadly to the entire property and casualty policyholder base in order to reduce an insurer's risk of insolvency.

Ms. Bowler reiterated that small insurers are generally highly specialized and serve niche markets. She stated that 78% of carriers in the workers' compensation market are small or mid-size carriers, representing 25% of premium. Along with A.M. Best (as outlined above), Fitch stated in 2013 that that workers' compensation carriers were particularly vulnerable to ratings downgrades if TRIA was not authorized. Ms. Bowler warned that if this happened, regional insurers would pull back from the market, and national insurers would be unable to absorb risks in the voluntary market. This would force employers into the residual markets, where they would pay higher premiums. In addition, as the residual market grows, risk exposure transfers back to the insurers initially seeking to shed that exposure.

Ms. Bowler emphasized that increasing the Program Trigger to $200 million creates significant risk if a regional event occurs that exceeds an insurer's deductible, reinsurance, and surplus, but does not meet the Program Trigger. This could cause insurer insolvencies, as well as a reduction in ongoing capacity. Insolvencies create pressure on remaining insurers through the residual market, in addition to guaranty fund assessments. The costs of a catastrophic terrorism event would be borne primarily by businesses and taxpayers in the state where the event occurred, inhibiting recovery, rather than spreading risk across the country as TRIA was originally designed to do. Atlantic Charter believes that TRIA is working well at a small cost to taxpayers, and it keeps insurers fully engaged. Ms. Bowler also stated that workers' compensation insurers should not be subject to an increased program trigger, deductible, or co-insurance. She also suggested that TRIA should have the ability to be activated for a substantial regional event.

Ms. Bowler provided a list of questions she believed the Committee should consider when determining if terrorism risk insurance can be put in the private market: (1) Workers' compensation carriers have a statutory obligation to provide terrorism coverage for unlimited amounts and an unlimited number of occurrences; would reinsurers provide coverage for those same statutory obligations on an unlimited basis for an unlimited number of events? (2) Workers' compensation carriers are constrained by how much they may charge the employer for unlimited terrorism coverage; would reinsurers limit the cost for that capacity to what can be collected from the policyholder? (3) How much capacity are reinsurers willing to dedicate to the workers' compensation line of insurance? (4) Would reinsurers cover residual market exposures? (5) We are currently in a soft market with excess capacity, what happens when that capacity dries up – either due to global non-terrorism events or in the wake of a substantial U.S. terrorism event? Ms. Bowler also noted that it made little sense for Atlantic Charter to purchase reinsurance simply to keep up with an escalating TRIP gap when the insurer's business profile has not changed.

Ms. Bowler closed her presentation by reiterating her request that the Committee consider the unique role of workers' compensation, the small surplus of most workers' compensation insurers, the long-tail nature of the business, its nearly unlimited benefit structure, and the reliance that employers and workers have on a well-functioning workers' compensation market as well as the role TRIA plays in that well-functioning market.

Ms. Bowler stated that Atlantic Charter currently has $20 million in reinsurance. Mr. Driscoll asked about Atlantic Charter's maximum exposure at a single location, and Ms. Bowler confirmed this at about 536 lives, however noted that risk is elevated during shift changes. She stated that although the probability of this happening is very small, but risk is significant if it does occur.

Mr. Driscoll then asked Ms. Bowler whether she had insight into how the $0.03 terrorism rate was established. Ms. Driscoll stated she assumed that she assumed that was the amount the employer community would be willing to pay, and that Massachusetts was very tough on rate increases because purchase of workers' compensation insurance is mandatory. Furthermore, she emphasized that other states are permitted to consider loss costs in their rates, but Massachusetts is one of seven states with administrative pricing that does not have this flexibility.

Mr. Seo asked whether the costs resulting from the non-renewal of TRIA would be included in considered by the states when setting rates. Ms. Bowler said responded that there was no guarantee that this would happen, but she would recommended that the underlying costs be built into the law. She urged the Committee to consider that even if Congress passes a law, when a state has control over pricing, the industry will get squeezed in that state. As a result, insurers should be able to pass along the cost of reinsurance.

Mr. Sapnar asked whether Atlantic Charter's ability to purchase additional reinsurance was constrained solely by premium, or whether there were also capacity issues in purchasing additional reinsurance. Ms. Bowler confirmed there was additional capacity in the market, but it was not an efficient use of capital to purchase it. She also confirmed that all insurers in the market charge the same amount as it is built into the rate.

Mr. Sapnar inquired whether Atlantic Charter has a risk management program specifically for terrorism or if it focuses more on general aggregation. Ms. Bowler stated that Atlantic Charter focuses more on an aggregation model, and from a client perspective it evaluates risks before writing them, and uses a program to evaluate and mitigate hazards. The company does not have any programs specifically focused on terrorism risk.

Mr. McGovern asked Ms. Bowler for her opinion about the 12-day lapse in TRIA (and what Atlantic Charter planned to do if TRIA was not renewed. Ms. Bowler stated that during the gap, Atlantic Charter did not write new business, and it examined its existing book to decide which policies would not be renewed. Atlantic Charter and other insurers spoke with the state bureau to request that discarded risks would not be reassigned to them through the residual market, however the insurers participating in the mandatory pool also wanted to avoid these risks, and there was discussion of creation of a third pooling mechanism for terrorism only.

GNY Insurance Presentation

Mr. Wolfe introduced Elizabeth Heck, President and CEO of GNY Insurance. Ms. Heck has been with GNY for approximately 15 years, and has served as President and CEO for half that time.

Ms. Heck provided a brief background of GNY. GNY was formed in 1914, when there was significant immigration into the Lower East Side of Manhattan. Tradespeople purchased tenement houses but found they could not purchase insurance in the general marketplace, so they pooled their assets and formed a mutual insurance company. Today GNY is a regional company operating in 15 states, and in 2016 they wrote $343 million in direct written premium, with $183 million written in New York state, and 85% of that number written in downstate New York (including the five boroughs). GNY is the sixth largest writer of commercial multi-premium in New York, the seventh largest in New Jersey, and the largest writer of condominium and co-op buildings in New York City. At the end of 2016, GNY had a statutory surplus of $473 million, and held over $1 billion in assets. GNY has been rated A+ by A.M. Best for many consecutive years.

GNY targets a high retention rate (over 90%) and has had some of its policyholders for longer than 20 years, and others for longer than 50 years. Focusing on a customer service model, GNY was unwilling to abandon the New York market after 9/11. Ms. Hecht stated that the terrorism backstop helped GNY remain in the New York marketplace. She stated that after 9/11 (prior to the creation of the terrorism backstop), primary carriers were not renewing their business or they reduced their limits in order to manage aggregation. These issues were compounded in New York State, because state law prohibits insurers from excluding coverage. As a result, the only alternative for a company was to reduce its limit or leave the market. The few companies that were willing to provide coverage increased their premiums, but were still limited in capacity. This had a significant effect on the marketplace, and construction and projects stopped in New York City because the business community was not able to get adequate coverage and the pricing was expensive.

Ms. Hecht stated that the passage of TRIA ended the fear that a worst-case scenario could render a company insolvent, allowed the market to stabilize, and enabled insurers to stay in the New York market. She added that GNY did not just rely on TRIA, but for the first time it also adjusted its underwriting guidelines, pared down aggregations, and adjusted its risk accumulations. GNY also cut back on writing workers' compensation by limiting the number of workers it would insure in a single location and considering occupancy and shift times when writing coverage. Workers' compensation went from being a leading line for GNY to under 5% of written premium, and terrorism risk played a large role in this change.

Ms. Hecht stated that since 9/11, the terrorism backstop has allowed the primary insurance market to stabilize. Primary coverage is available and affordable, limited reinsurance is available, and take-up rates are near 100% for GNY's New York City client base. She said without the backstop, the industry would again face the same issues with coverage being unavailable.

Ms. Hecht emphasized that the Program Trigger is important to small and mid-size insurers as well as the marketplace. She stated that GNY is able to work within the parameters of TRIP by managing aggregation and purchasing standalone reinsurance. GNY purchases reinsurance with a limit to cover the Program Trigger, because due to the nature of terrorism, one specific insurance company could have a disproportionate share of the loss. As a result, increasing the Program Trigger would be like having no backstop at all, because an individual insurer needs to manage to ensure it can handle the loss. Ms. Hecht stated this is important because carriers are not interchangeable, and many specialize in certain areas (which injects competition into the market), and without a backstop these companies would have to leave the market. She emphasized that these companies are critical to the market – in 2016, only 132 of insurers in the industry had a policyholder surplus of over $1 billion. Eliminating insurers with a lower surplus could have a potentially negative impact on the industry.

Ms. Hecht provided an overview of her personal experience buying reinsurance for GNY since 9/11. She stated that a problem has been an inability for the reinsurance industry to spread risk to enough insures with varying degrees of terrorism exposure. The availability of reinsurance has increased since 9/11, but it is still very limited in high-risk regions. In addition, the price has dropped but is still relatively high compared to what insurers can charge to policyholders. Ms. Hecht stated that this increased availability and decreased pricing is a result of TRIA. The primary insurance market does not operate in a free market, and states regulate rates. The cost of reinsurance is not an acceptable justification for filing a request for a rate increase, and the state is cognizant of additional costs to the consumer and will not necessarily accept any request for a rate increase.

Ms. Hecht stated that immediately after 9/11, GNY sought out reinsurance but was not able to find markets that were interested in selling terrorism reinsurance. In the first year after 9/11, GNY paid a high premium for a small limit. She stated that the limit was so small it was almost not meaningful, but GNY wanted to partner with reinsurers to build capacity and make pricing more manageable over time. However, even with this reinsurance, capacity is still limited where GNY needs reinsurance the most. GNY attempted to buy reinsurance for larger buildings within the past year that included some catastrophic and terror risks. Ms. Hecht says she found very few markets that were willing to accept the risk because of the concentration.

Mr. Ryan asked Ms. Hecht to comment on take-up rates in GNY's portfolio. Ms. Hecht stated that in urban areas, take-up rates are in the mid-90% range, and outside of urban areas take-up rates are in the 70% range. Mr. Ryan then asked Mr. Hecht about whether premium costs were covering the cost of purchasing reinsurance. Ms. Hecht stated that after 9/11, GNY was subsidizing the entire amount they paid for reinsurance, but was still unable to purchase as much as they needed, so they pared down aggregations instead.

Mr. Sapnar asked how GNY charges for terrorism premium. Ms. Hecht stated that GNY currently uses ISO's pricing model, but before this pricing model was developed they charged for terrorism coverage as a percentage of the overall premium. With respect to underwriting, she added that GNY manages its proximity to high-risk buildings, it manages its aggregations within 500 feet, and it manages aggregation in single locations. She stated one of the challenges in properly underwriting terrorism is that individual measures are not as meaningful as protections from terrorism ultimately come at a federal and state level. Terrorism risk is also unlike a natural catastrophe risk wherein you can examine data, use sub-limits and deductibles, and take action to protect the underlying policy. She added that an additional challenge with terrorism risk is that a single carrier can face a disproportionate share of loss due to the concentration of the risk.

Mr. Sapnar noted that even though the risk may be concentrated in specific geographic areas, the benefits of the Program reach beyond these areas, and therefore maybe it is an issue that policyholders residing in areas with a lower concentration of risk would pay very little (if anything) for terrorism insurance. He cited New York City as an example, which has many people visiting the city who do not live there. Ms. Hecht added that the benefit is national because mitigation involves addressing the national problem of terrorism, and that having nationwide participation is what makes the program affordable and benefits everyone.

American Insurance Association Presentation

Chairwoman Peters introduced Stef Zielezienski, Senior Vice President and General Counsel for the American Insurance Association.

Mr. Zielezienski stated that AIA represents approximately 320 insurers, which are mainly mid-to-large size carriers writing in TRIP-eligible lines. Mr. Zielezienski stated that even with improvements in modeling since 9/11, AIA still largely views terrorism as an uninsurable risk because of the risk's reliance on human behavior, the intentional nature of the act, and the reduced incentives to mitigate behavior (as a terrorist can shift targets to overcome mitigation efforts). Terrorism is not a localized problem; it is a national problem that is bound up in the essential role of the government in providing national defense. Therefore, there is an asymmetry in which the government will always have more information at hand about a potential terrorist attack than the private sector. Mr. Zielezienski stated that the most effective loss mitigation is intercepting a terrorist before the act occurs, but the private sector is not capable of doing this. AIA membership takes the view that the government will always play an economic role in helping address terrorism risk. In addition, they believe that the basic structure of TRIA is the right one, but improvements could be made to make the environment more meaningful for insurers to write risk.

Due to the catastrophic risk of terrorism, there are scenarios that exceed the capacity of the insurance marketplace to respond and test the financial solvency of individual insurers, and AIA believes it is important to keep this in mind when examining the potential for improving the current program.

Mr. Zielezienski repeated his belief that improving the current program is the best option. He then summarized other options that have been considered in lieu of TRIP. After 9/11, AIA's membership approached the Bush Administration proposed a variation on the United Kingdom's Pool Re program. There were a variety of reasons that this idea was rejected, but one of the primary concerns regarded placing the government in a permanent reinsurance role and the idea that the government would collect premiums upfront. In comparison to the U.S. system, which is a backstop that provides support following a catastrophic event ($35+ million), Pool Re provides lower-level support and is therefore more compatible with a pre-funded structure.

Another idea was to create a reinsurance mechanism for lower-level events where the private market could be expanded. Upon exploration, AIA found there was a lack of demand as well as political structural obstacles, and the idea was rejected.

Mr. Zielezienski stated a third proposal was for risk securitization, drawing upon the influx of capital in the natural catastrophe space; however it did not seem that it was possible to reach a sufficient level with insurance-linked securities because of the strong correlation between terrorism events and other investment vehicles. The viability of using insurance-linked securities may ultimately come down to the nature of the risk and its insurability characteristics.

Mr. Zielezienski commented on ways that TRIA could be altered to improve the program. AIA has concluded that the Program currently covers the proper lines of insurance. Workers' compensation should continue be included because not having a government backstop would cause a spillover effect in workers' compensation carriers endeavoring to maintain financial solvency examining their risks and affecting other types of coverage they insure. He added that in many high-risk terrorism markets there is also a statutory mandate because states have statutory fire polices that come into play in terms of covering fires following terrorist events (such as a nuclear attack).

Mr. Zielezienski stated that commercial liability within the Program is a bit of "an unknown." Iterations of the Program have scaled back on included lines, but unlike property damage and workers' compensation exposure after 9/11, there are not liability examples to draw from other than the 9/11 Victims' Compensation Fund. In the absence of a victims' fund, Mr. Zielezienski stated you could expect liability lawsuits which would involve covered losses.

Mr. Zielezienski also indicated there are certain sectors (i.e. transportation, communication, and energy) which significantly rely on a federal backstop to help manage economic recovery following a loss.

Mr. Zielezienski stated that with respect to the TRIA program itself, the Committee should examine insurer retentions under the Program, because there is a disconnect between the deductibles, co-share, and premiums collected for terrorism risk. This results in risk being managed from the perspective of insurer solvency, rather than exposure. Accordingly, although TRIA is working, insurers view the Program as the last resort before insolvency. As a result insurers may not even being writing coverage to the levels where TRIA would apply, but rather they are managing exposure to a modeled event. TRIA could be modified by examining where insurers are managing their exposure, and adjusting the Program Trigger to that metric. AIA has not reached closure on this as a Program structure, but does recommend that it be examined as a potential option.

Mr. Wolfe asked whether the AIA intends to create a consensus on elements of the Program that the membership agrees upon. Mr. Zielezienski confirmed that the AIA would be extensively examining options and intended to come to a consensus. Mr. Wolfe acknowledged that it was the Committee's responsibility to make a recommendation, but due to the size of AIA's membership, it would be helpful to get additional feedback from the AIA throughout the recommendation/report process.

Mr. McGovern stated that each of the three presentations discussed some of the challenges with the Program's operation, and noted that engaging with state regulators to understand the impact of state regulations is important to understanding how to improve the Program because insurance is a state-regulated business. He asked whether AIA has engaged with the NAIC on this topic. Mr. Zielezienski confirmed that AIA has had conversations with the NAIC, but they needed to increase. He noted that data collection in connection with the Program is an immediate issue, however all stakeholders (state, federal, policyholders) need to have a discussion about the long-term changes that need to be made for the market to function the best it can.

Mr. Driscoll stated that he believes the fact that there is not a premium charge for the catastrophic protection provided by the government has impeded development of the market, and state involvement is part of that process. The insurance-linked securities market has not engaged because there is not a substantive premium basis, and the reinsurance markets limit capacity because they won't receive a large enough payment to reinsure terrorism risk. He added that vendor models, insurers, and reinsurers have not invested enough in understanding the peril because of the existence of subsidized reinsurance protection. He asked Mr. Zielezienski on what AIA's opinion was on having an associated reinsurance cost to make TRIP function more like a traditional insurance risk-transfer mechanism. Mr. Zielezienski responded that to introduce a pre-event premium in the context of a post-funded mechanism draws capital away on the front-end which would otherwise be deployed to provide insurance. However, if Congress shifted away from a post-event structure to a pre-event structure, then a set premium would make sense. That said, Mr. Zielezienski stated he does not see the political will for the government to act as a more permanent/official reinsurer.

Mr. Seo proposed that the whole idea of insurance is that pre-event funding is better than post-event funding, and to ask policyholders after a traumatic event to repay what they have just been paid is less optimal than having them fund it along the way. Mr. Seo stated that he understands the presenters to be saying that piecemeal changes to TRIA could be potential harmful, and he agrees, and therefore the Committee would be looking at AIA and other stakeholders to provide input on ways to make changes that are not piecemeal and can make the Program more effective. He also stated that he believes the United States is wealthy enough that it should be able to afford a pre-funding mechanism, and post-funding mechanisms are generally reserved for countries that are less wealthy and cannot budget for a pre-funding mechanism.

Mr. Zielezienski stated that even if a pre-funding mechanism is used, the government still needs to be involved at a catastrophic level where the private market can't operate. He also noted that there must be political will at the state level, as this is where pre-event funding will work most effectively. If this happens, Mr. Zielezienski added there is needs to be a determination of at what level the government will become involved and address catastrophic losses, and an understanding of what types of risks the government would become involved with (i.e. cyber, NBCR), particularly because the current Program has a $100 billion cap, and there are many unconventional risk scenarios that could cause losses above this threshold.

Mr. Sapnar agreed that he $100 billion cap could be too low for certain types of catastrophic losses. Mr. Zielezienski responded that there has not been a conversation about increasing the Program Cap. Although this could be discussed, the more immediate concern should be about how to make the lower layer work better, because the current Program structure involves retention based on a catastrophic level of loss versus trying to get the private market to work at the lowest layer.

Mr. Sapnar asked Mr. Zielezienski if the AIA had an opinion on how effective the claims administration process would be under the Program. Mr. Zielezienski responded that there is a process in place, but it has not been tested and it would make sense to do a beta test on the system before an event happens. AIA would be willing to participate in such an event.

Real Estate Roundtable Presentation

Mr. Wolfe introduced Ed Walter, a Professor with the McDonough School of Business Georgetown University and a Representative speaking on behalf of the Real Estate Roundtable. The Real Estate Roundtable brings together leaders in the real estate industry to discuss key policy issues affecting the industry and economy as a whole. Mr. Walter has spent over 20 years in the real estate industry, most recently as President & CEO of Host Hotels.

Mr. Walter began by acknowledging the attendance of Chip Rodgers, the Senior Vice President of Real Estate Roundtable, who would also be available to answer technical questions.

Mr. Walter stated that maintaining an effective terrorism insurance program is critical to overall economic security and the health of the real estate industry. With reference to 9/11, Host Hotels had a unique perspective on the event because the company owned the World Trade Center Marriott, which was demolished as a result of the attack. He added that the impacts of 9/11 on the travel industry were devastating. Airports were closed, but meetings across the country for the next four months were also cancelled. Business in September typically runs at 80% occupancy, and Host Hotels modelled that they would end up with 40% occupancy (which Mr. Walter estimated was likely an optimistic model). Profits dropped roughly 35-40% in 2002, and ultimately the impact of the attacks lingered for 18 months. Host Hotels suffered over $300 million in insured losses. After the market downturn, the company's equity condensed significantly, but Mr. Walter believes impact would have been even worse if Host's losses had not been covered under their insurance policy. He added that although insurance covered physical loss and business interruption in the vicinity of the World Trade Center, business interruption that happened through the remainder of the company's portfolio was not covered. This serves as evidence that the impact of terrorism events is broader than the physical location where they occur.

In the aftermath of 9/11, it was difficult for Host to procure terrorism insurance. Most of Host's properties reside in major gateway markets, and lenders were focused on ensuring when Host's renewals came up that they were purchasing terrorism insurance. Whereas a pre-9/11 policy had a billion dollar limit, the new policy had a limit of only $300 million (a 70% decline in coverage), and cost about 40-45% more in premium. The limits did not provide enough coverage for the full value of some of Host's larger hotels. $15 billion in construction in 17 different states was stalled, and a Moody's downgrade resulted in lost value.

Mr. Walter stated that Congress addressed these problems by passing TRIA. The original idea was that TRIA would serve as a bridge to the future, where the private market would deal with terrorism risk. Mr. Walter stated that as a policyholder, his sense is that the market has improved but it has not grown to the level required to provide comprehensive coverage. This has resulted in three reauthorizations of the Act, but Mr. Walter noted that the reauthorizations have been difficult and there is a fear that a 2020 reauthorization may not occur.

Mr. Walter also noted that there have been terrorism incidents on an ongoing basis, even though none of them have risen to the level of 9/11 to date. Lenders and investors therefore view terrorism as a continuing risk, and if anything they are more focused on it now than they were previously.

Mr. Walter stated that the 12-day lapse that occurred prior to the 2015 renewal caused harm to the industry. Some property owners in the Real Estate Roundtable's gateway markets were forced to renew their insurance during this gap and paid five times their 2014 premium in order to maintain coverage. Similarly, properties on the West Coast saw their premiums more than double. He stated that it was a surprise that reauthorization did not occur immediately and the liquidity of the market likely reflected this, however at the same time there were a limited number of policyholders trying to tap the market for insurance capacity. As a result, if the entire market was trying to tap the market without TRIA, the fear is that there would not be sufficient capacity, particularly in Eastern markets with aggregation issues.

Mr. Walter stated that terrorism attacks are not specific to a location or type of property, and while the government and the industry will do what they can to mitigate risks, terrorism attacks cannot be prevented. A primary goal of terrorism (after shock and fear) is economic dislocation, and TRIP provides a federal backstop that provides certainty and a path to recovery. Mr. Walter stated that the best thing that can happen for a company following an event is having stability and an understanding of your potential recovery. If TRIA does not exist, the government would still likely be involved as a major event would bring calls for the government to step in and provide relief. But this involvement would not likely happen expeditiously or fairly, which creates uncertainty that makes it more difficult for affected businesses to recover.

Mr. Walter stated that real estate and hospital are both major users of terrorism insurance. While the average take-up rate around the country is approximately 60 percent, the average rates for real estate and lodging are higher (71 percent and 74 percent, respectively). He stated this is done because the industry considers it important in terms of its investments in property, but also because investors and lenders are looking for longer-term safe returns.

Lending markets are a major player in the real estate world, with nearly $4 trillion in debt capacity tied to real estate. In 2014, S&P noted a private market would lead to higher costs, which would result in lower return on investment and valuations. Mr. Walter stated that lower coverage ratios could result in technical defaults on loans, which leads to downgrades in debt rating, and the continuing risk of capacity shortfalls after an event. Ultimately, any lack of coverage, whether from a delay in extending the Program or difficulties arranging coverage in a private market, will reduce new construction activity and impair recovery efforts.

Mr. Walter noted that terrorism risk tends to be discussed primarily in the context of gateway and major markets, but in actuality terrorism is a problem that extends across the country. This is one more reason it is important to have a Program in place.

Mr. Walter concluded by stating that terrorism is an ongoing long-term threat, and insurance provides a solution to mitigate the economic impact of the event, thereby reducing overall impact and arguably contributing towards deterrence. The Real Estate Roundtable also believes that having a program in place reduces costs to taxpayers, as compared to having a government payout in the absence of an established program. As a result of these factors, The Real Estate

Roundtable advocates for the creation of a permanent program. Real estate companies are buying, building, and financing assets for the long term, which is at odds with TRIA renewal. When financing, companies spend a lot of time talking about what will happen if TRIA is not renewed and identifying the costs of purchasing coverage in the absence of TRIA (which is always multiple times higher than current costs). These discussions slow economic growth, and the closer the reauthorization date comes, the more protracted these discussions become.

Given the delay in the 2015 reauthorization, the real estate community has a fear about what may happen when the Program needs to be renewed in 2020. He noted that if one of the trade-offs in creating a permanent program would be the use of up-front funding, the Real Estate Roundtable would be willing to seriously consider it as an option, even though it would likely increase costs, because the Roundtable views long-term benefits of having permanent insurance as worthwhile.

Mr. Walter expressed the Real Estate Roundtable's willingness to be involved in the Committee's process going forward and would be happy to continue to provide policyholder opinions on the subject of terrorism risk insurance.

Mr. Sapnar asked how captive insurers could be used by the real estate and hospitality industry to help ensure full coverage. Mr. Walter responded that captives have been used to fill holes in existing coverage, and that Host's captive was also used to cover all NBCR risks. Host's captive was also responsible for covering the first deductible layer under TRIP.

Mr. Sapnar then asked if policyholders interact with Homeland Security to facilitate risk prevention. Mr. Walter said there is, but the level of involvement varies. He stated that they would be contacted by government security agencies if there was a heightened level of activity near one of their major properties, and in turn Host hotels would heighten security. Mr. Rodgers added that the Roundtable has a Homeland Security Taskforce that is comprised of senior security officers from members, investors, and other real estate trade associations. Staff work with law enforcement on a daily basis to declassify potential threat information. The Roundtable also has a real estate information sharing and analysis center that continuously reports to security officers on terrorism, cyber, and natural catastrophe issues affecting the industry. Mr. Rodgers emphasized that information sharing is critical to risk mitigation, and these efforts are taken on top of physical security efforts in almost every building. Mr. Sapnar followed-up by asking how this information is used at a local level, because from his personal experience in New York it appears that the security measures at different locations are disparate. Mr. Rodgers confirmed that they do work on a local level with many different stakeholders (both commercial and governmental), and building trusted partnerships has been the best way to develop mitigation strategies. He also noted that many security measures happen behind the scenes.

Chairwoman Peters asked whether the Real Estate Roundtable is seeing any pushback from lenders with respect to current construction projects with completion dates beyond the expiration of TRIA. Mr. Walter stated that he suspects construction lenders are most concerned about whether construction will finish, and whether there is a take-out lender in place. With respect to underwriting, these lenders are likely asking how much more the owner can pay for insurance in the future if TRIA is not renewed.

Mr. Driscoll asked Mr. Walter about the price of insurance in the current market. Mr. Walter said that Host Hotels' coverage has gone back up to $1 million, under an all-risk policy (excluding earthquake and wind), but he does not recall how much they are paying currently. He said it is a better ratio than it was a 9/11. Mr. Walter said that with TRIA in effect, most participants in the Real Estate Roundtable are finding that they can purchase adequate insurance, but others have a more concentrated risk in gateway markets and have some challenges in obtaining supplemental coverage. This applies to conventional terrorism risks, but there are more questions about the insurability of unconventional (i.e., NBCR) risks. He stated that NBCR risks are just as critical and the psychological damage would be even greater than that of a conventional attack, which is another reason it is important to have a workable government program in place.

Direct Insurance Subcommittee Next Steps

Mr. Wolfe stated that the Direct Insurer Subcommittee met prior to the meeting to discuss the importance of examining key metrics in considering the impact of changes to TRIP. Mr. Ryan proposed a structure for the Committee's approval on three topics that the Subcommittee intends to use going forward as a construct for its work. First, the brokers on the Committee intend to meet and assemble metrics that are currently available, and decide how to get to the next stage of making a more robust assessment of the market. The Subcommittee's second area of focus will be to determine how to best assess the potential impact of changes to the Program. Third, the Subcommittee will focus on the specific components of TRIP and assess which may be integral and which may not be necessary for a federal backstop going forward. Ms. Peters stated that the Subcommittee also discussed whether they would use third-party data resources, and Mr. Ryan added that the Subcommittee also anticipates using data received from the Federal Insurance Office (FIO).

Update on Terrorism Risk Insurance Program Activities

Mr. Ifft announced that final and interim rules addressing changes in the 2015 TRIA Reauthorization Act were issued in December 2016. Immediately following, Treasury issued proposed templates to be used for the 2017 data collection process (based on 2016 data), including separate forms for large insurers, small insurers, captive insurers, and alien surplus lines. Data collection for 2017 is mandatory as required by the 2015 Reauthorization Act.

Mr. Ifft noted that the data collection portal was open for registration and that insurers would receive their forms for completion from Treasury's data aggregator upon approval of the templates by OMB. (*Note: as of the date of these minutes, the data collection period for 2017 has closed*).

New Business

The Subcommittees were finalized to include the following members:

Direct Insurers: Keith Wolfe (Chair), Jake Clark, Greg Hendrick (added by Sean McGovern), Wendy Peters, Ed Ryan

Reinsurance: Kean Driscoll (Chair), Greg Hendrick, Ed Ryan, Mike Sapnar, John Seo, Keith Wolfe

Capital Markets: John Seo (Chair), Jake Clark, Greg Hendrick

Exploration of Terrorism and Catastrophic Risk Approaches in Other Countries: Mike Sapnar (Chair), Jake Clark, Wendy Peters, John Seo

Consumer Interests: Jake Clark (Chair), Wendy Peters

Chairwoman Peters confirmed that the next meeting would be held in early June and would focus on exploration of terrorism risk in other countries and catastrophic risks.

Deputy Director Seitz announced that the ACRSM website is live (https://www.treasury.gov/initiatives/fio/acrsm/Pages/default.aspx).

At 12:39 p.m., Chairwoman Peters concluded the meeting.

I hereby certify these minutes of the March 31, 2017 Advisory Committee on Risk Sharing Mechanisms public meeting are true and correct to the best of my knowledge.

Wendy Peters

Wendy Peters, ACRSM Chair