UNITED STATES DEPARTMENT OF THE TREASURY
FEDERAL ADVISORY COMMITTEE ON INSURANCE
SUMMARY OF PUBLIC MEETING

September 18, 2013

The Federal Advisory Committee on Insurance was convened for its sixth meeting at 1:30 P.M. on September 18, 2013, in the Cash Room at the U.S. Department of the Treasury, 1500 Pennsylvania Avenue, NW, Washington, D.C., with Brian Duperreault, Chair, presiding.

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

Committee Members present:

BRIAN DUPERREAULT, Chair
DAVID BIRNBAUM, Member
JACQUELINE CUNNINGHAM, Member
BENJAMIN LAWSKY, Member
LORETTA FULLER, Member
SCOTT KIPPER, Member*
PAUL MATTERA (representing CHRISTOPHER MANSFIELD, Member)
SEAN McGOVERN, Member
WILLIAM WHITE, Member

Others present:

MICHAEL T. MCRAITH, Director, Federal Insurance Office
JAMES P. BROWN, Designated Federal Officer
AARON BUELER, Marsh & McLennan Companies
CHRISTOPHER FLATT, Marsh & McLennan Companies
CHRISTOPHER LEWIS, Hartford Financial Services Group
JOSEPH GUNSET, Lloyd's of London

*Participating via teleconference

Chairman Duperreault called the meeting of the Federal Advisory Committee on Insurance (Committee) to order at 1:33 PM. After calling attendance of those in person and those participating by phone, the Chairman noted that Member Birnbaum would leave early due to his appearance before a Senate Sub-Committee regarding the National Flood Insurance Program. Member Birnbaum was asked to provide the Committee a preview of his testimony.

Member Birnbaum's Testimony on the National Flood Insurance Program (NFIP)

Member Birnbaum stated that the hearing was likely to focus on the impacts of changes to the NFIP under the Biggert-Waters Act, including large rate increases for some 20 percent of currently subsidized policyholders and new consumers being required to purchase flood insurance with new flood maps. Member Birnbaum explained his testimony would focus on force-placed flood insurance, force-placed flood placements, and increased enforcement by servicers. He also indicated that he would offer some ideas about how to address the problems faced by consumers.

Approval of Previous Minutes

Chairman Duperreault asked for approval of the Minutes from the June meeting of the Committee. The approval of the Minutes were moved, seconded and unanimously approved.

Renewed Charter

Chairman Duperreault called on Director McRaith to speak about the recently renewed Charter for the Committee. Director McRaith explained that the original Charter for the Committee had been renewed prior to its expiration in August 2013, and provided an explanation of changes in the renewed charter. In response to a question from Member Cunningham, Director McRaith explained that there will be representation from the state regulatory community and possibly representatives of regulatory agencies, in addition to consumer participation.

Terrorism Risk Insurance Program

Chairman Duperreault introduced the topic of Terrorism Risk Insurance Program (TRIP) by providing background concerning the Terrorism Risk Insurance Act (TRIA) and the Federal Insurance Office's role regarding TRIP. He also explained that the President's Working Group on Financial Markets (PWG) is preparing a report on TRIA and the terrorism insurance market and that that effort is being led by the Federal Insurance Office.

Director McRaith then provided a more extensive overview of TRIP, explaining that TRIA created a program of shared public and private compensation for privately-insured commercial property and casualty losses resulting from certified acts of terrorism and providing an explanation of the details of the program.

Presentation of Chris Flatt and Aaron Bueler on Terrorism Risk Insurance

Chairman Duperreault then called on the first two presenters on the issue of TRIP: Chris Flatt, representing the Marsh & McLennan Company, and Aaron Bueler, representing Guy Carpenter. Mr. Flatt thanked the Committee for the opportunity to present. He began by providing context for TRIA by explaining the market conditions following the terrorist attacks of 9/11, with a special emphasis on the impact on workers' compensation insurance, which effectively dried up to almost nothing. Mr. Flatt then opined that the passage of TRIA in 2002 and its renewals provided the intended stability in the market, as well as the development of some private market solutions. Mr. Flatt then traced the evolution of TRIA through its extensions noting that each time there was a reduction of the government's potential exposure. He then explained the importance of reauthorization past the end of 2014, noting that there is a lot of uncertainty in the market now, resulting in reduced market capacity and increased prices. In response to a question by Director McRaith, Mr. Flatt provided further information on the impact of market uncertainty on worker's compensation markets. Mr. Flatt explained that the timing of Congressional action was important because many annual policies begun in 2014 would extend beyond the expiration of the law on December 31, 2014.

In response to a question from Member Fuller, Mr. Flatt then explained about disclosures of terrorism coverage in policies. Mr. Flatt then discussed take-up rates for terrorism coverage, noting that coverage is being purchased across many industries and geographic areas, with the Northeast having the highest take-up rates particularly in large cities. Noting the take up rates for the construction and real estate industries, Director McRaithasked whether there are data on self-insurance versus commercial coverage. Mr. Flatt said he would check if those data are available and, if so, would provide them to the Committee.

Mr. Bueler then addressed the Committee to further discuss worker's compensation coverage, which is compulsory coverage without a policy limit in terrorism risk insurance. Terrorism coverage presents unique challenges for workers' compensation after January 1, 2014 because a non-renewal of, or substantial change to, TRIA will probably drive many of those policyholders into the individual residual market facilities that are set up individually by state and have varying degrees of backstops that they pursue through private and public means.

Mr. Bueler then led discussion of the effective size of the held surplus for the various sizes of companies, and what percentage of their capital is applied towards the deductible of TRIA. In response to a question by Director McRaith about state-based RBC formulas, Mr. Bueler noted that A. M. Best had stated that they were requiring companies that are very reliant on TRIA to come up with independent detailed plans of action in the event that TRIA is non-renewed or significantly changed. Mr. Bueler then discussed the global reinsurance market in general and its interaction with terrorism risk. Mr. Bueler emphasized the view that, absent TRIA, there is going to be an increase in cost, a reduction in capacity, with the result that some policyholders will go without terrorism insurance protection.

Director McRaith asked Mr. Bueler to elaborate on the impact on the workers' compensation market. Mr. Bueler explained that while it is mandatory for policyholders/employers to obtain the coverage, it is not mandatory for carriers to offer it, and the expiration of TRIA could result in carriers withdrawing from the workers' compensation market. This potentially could leave employers relying on state-specific residual market. Director McRaith noted that forcing employers to seek options through the state fund mechanisms will reduce private market competition and could also have an impact on pricing as well, and Mr. Mattera offered some real world examples of that phenomenon. Chairman Duperreault asked Mr. Bueler if similar market reactions occurred in the years when TRIA came up for renewal. Mr. Bueler responded that there seems to be more attention paid this time. Mr. Flatt added that insurance carriers over time have done a much better job of understanding their exposures. They really know where they have their aggregations and sort of the data quality, and the ability to model out expected losses is much better now than it was in the past.

Mr. Bueler then led a discussion of changes that could be considered in any reauthorization of TRIA. Member Fuller expressed concern that consumers may not be as informed as they should be on cost of coverage, and Director McRaith suggested that he and Member Fuller have a discussion on how to better inform the public of the program.

Chairman Duperreault thanked them for their presentation and asked them to be available for the discussion that would follow the presentations.

Presentation of Chris Lewis on Terrorism Risk Insurance

Chairman Duperreault then called on Chris Lewis, former Chief Insurance Risk Officer at The Hartford. Mr. Lewis shared observations based on his experience in dealing with terrorism risk, from a catastrophe risk management perspective, from a buyer of reinsurance, and interfacing with the capital markets. He opined that he believed that TRIA has worked. Director McRaith and Mr. Lewis then discussed affordability for small businesses.

Mr. Lewis then discussed differences between conventional and unconventional terrorist attacks. He explained that insurers have made tremendous progress in their ability to manage conventional terror, but private insurance mechanisms are not sufficient for pooling the risk of loss from unconventional attacks because of their potential magnitude. Mr. Lewis then discussed the interaction between terrorism and "insurable peril," suggesting that terrorism risk, in and of itself, doesn't meet the terms of an insurable peril. However, he explained that TRIA is a balanced public/private partnership that effectively privatizes as much of the risk as you can between conventional terror, but provides a mechanism to finance after event those truly cataclysmic losses that you would see from an unconventional attack.

Director McRaith asked Mr. Lewis elaborate on how companies are reducing their aggregate exposure and what that means for the market. Mr. Lewis explained that carriers have created a better spread of risk for the company overall, so that they can offer terrorism coverage, workers' compensation, and property coverage to policyholders more broadly. Further, TRIA provided carriers with the space to rebalance risk. As a result, those who want coverage can get it. Mr. Lewis further explained that if TRIA is not renewed, the ability to get coverage will be impacted. Mr. Lewis further explained that the amount of terrorism reinsurance that is available is very limited and is restricted to conventional events. In response to a question from Mr. Mattera, Mr. Lewis then explained why capital markets do not participate in terrorism risk. There was then a discussion of ways in which insurance carriers consider different types of terrorist attack risks.

Presentation of Joe Gunset on Terrorism Risk Insurance

Chairman Duperreault called on Joe Gunset to speak for Lloyds. Member McGovern noted that Lloyd's has something of a reputation for being a market for insuring and reinsuring the world's most difficult risks, and that it had suffered the single biggest loss following 9/11. He explained that while Lloyds was a supporter of free markets and philosophically opposed to government intervention as a rule, the decision on TRIA renewal should be driven by hard-headed pragmatism about the world as it exists and what would happen if TRIA was not renewed. He then asked Mr. Gunset to offer his remarks.

Mr. Gunset gave a brief overview of Lloyds' history of insuring risks in the U.S. market. He then emphasized the importance of TRIA. Mr. Gunset then cited a speech to the NAIC by Michael Angelina of the American Academy of Actuaries which outlined some of the issues inherent in terrorism risk insurance. Mr. Gunset explained that insurers, including the Lloyd's market, have become more capable of measuring terrorism risk in respect to aggregate exposure to terrorism events through deterministic modeling, such as blast modeling and plume analysis, and this kind of modeling which has allowed the growth of the so-called standalone market for terrorism. However, Mr. Gunset explained that the standalone market cannot substitute for the important backstop provided by TRIA. He added that state regulators reported at the recent NAIC summer meeting that they are already seeing policies with contingent terrorism exclusions, as insurers prepare for the possibility of TRIA expiring. He also suggested that a sudden and complete removal of the program would have a negative impact on the cost, terms, conditions under which insurers are able to renew their insurance programs. Mr. Gunset concluded by noting that taxpayers have not paid one cent for TRIA thus far. Chairman Duperreault thanked Mr. Gunset and member McGovern for their insights.

Chairman Duperreault then led a discussion of Committee members about TRIA. Member Lawsky offered his opinion that without TRIA the rebuilding that is still going on in lower Manhattan will grind to a halt, and asked why the program was not being extended permanently. Member White agreed, suggesting that as a long term platform, bifurcated coverage might be the most workable approach. Mr. Lewis suggested that there is little sentiment in Washington to make the program permanent in the near term. Mr. Materra stated his belief that terrorism still uninsurable, and the goal should be to make the risk manageable. The goal ought to be to make the risk manageable. Chairman Duperreault added that although modeling has improved it is not foolproof. Director McRaith then posed a series of questions to the Committee and the presenters regarding the data points that need to be studied to properly evaluate the impact of continuing or discontinuing TRIP. A lengthy discussion ensued which brought out many points regarding the economic harm that would flow from major terror attacks without the benefit of a program like TRIP. Director McRaith thanked all of the participants for their thoughts on TRIP.

Captive Insurers

Chairman Duperreault called on Member White to update the Committee on the efforts of the NAIC regarding captives. Member White reported on the work of the Base-Reserving Executive Committee and a report by Rector & Associates. He recommended that everyone read the Joint Forum Report on Longevity Risk Transfer.

International Developments

Chairman Duperreault then called on Director McRaith to give a report on international developments. Director McRaith reported on issues relating to the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS), including a directive from the FSB to the IAIS to develop a straightforward capital backstop for those firms that were identified as globally systemically important, and to develop a comprehensive group wide supervisor framework with a quantitative capital standard for internationally-active insurance groups. Member McGovern asked if the FSB's goals for the IAIS were achievable. Director McRaith noted that the IAIS has difficult tasks, but the FSB has been very clear in their directives, and the IAIS is aggressively focused on producing meaningful solutions consistent with those directives. Member McGovern then asked where the G-20 came out on these issues, and Director McRaith explained that the G-20 publicly supported all elements of the FSB direction to the IAIS, including the development of the Comprehensive Supervisory Framework.

Director McRaith indicated that he would be sending questions regarding TRIP to the subcommittees for their consideration and response at the next meeting. Chairman Duperreault asked if there was any additional business to come before the Committee. Seeing that there wasn't any, he closed the meeting at 4:00PM.

I hereby certify these minutes from the September 18, 2013 public meeting of the Federal Advisory Committee on Insurance are true and correct to the best of my knowledge.

James P. Brown

James P. Brown
Designated Federal Officer