

TERRORISM RISK INSURANCE ACT IS EXTENDED

By Ethan Lenz and Andrew Oberdeck

Congress has approved an extension to the Terrorism Risk Insurance Act of 2002, which was set to terminate on December 31, 2005. The legislation, the Terrorism Risk Insurance Extension Act of 2005 ("TRIA"), extends the original program for an additional two years to December 31, 2007, and increases both the industry retention and the size of the event required to trigger the public backstop. President Bush is expected to sign the legislation into law.

Background of TRIA

The insurance marketplace was severely disrupted following the September 11, 2001 terrorist attacks. The threat of terrorism produced uncertainty as insurance underwriters and reinsurers limited or eliminated many forms of coverage for injuries and damage arising from terrorist attacks. This impacted a wide range of businesses that were not able to obtain adequate coverage for terrorism exposures arising from their commercial activities. In response, the federal government enacted TRIA, which was intended to stabilize the market and facilitate the development of a stand-alone private market for terrorism insurance and reinsurance.

Since its enactment, TRIA has required insurers to offer terrorism coverage to their commercial policyholders and has established a governmental reinsurance backstop for 90% of losses, to a cap of \$100 billion, on events that cause total damage exceeding certain "insurer deductibles" that are based on the insurer's prior-year commercial property and casualty direct earned premium.

The Terrorism Risk Insurance Extension Act of 2005

The new legislation closely follows a Senate version favored by the Bush administration. Under the new legislation, the public backstop would be triggered by losses from any single certified act of terrorism greater than

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\$50 million in 2006, and \$100 million in 2007.¹ This is a significant increase from the current version of TRIA, under which the backstop could have been triggered at \$5 million in losses from insured events under certain circumstances. Most commercial property and liability lines of insurance, including directors and officers liability insurance, remain included under the backstop. However, commercial auto, professional liability, surety, burglary and theft, and farm owners multiple peril insurance are now specifically excluded from coverage under TRIA.²

Similar to the current TRIA program, the new legislation calls for the government to provide reinsurance for 90% of covered losses in 2006,³ to a cap of \$100 billion, after the exhaustion of insurer deductibles equal to 17.5% of an insurer's direct earned premiums during calendar year 2005.⁴ For 2007, the government will provide reinsurance for only 85% of covered losses⁵ (to a cap of \$100 billion), and the insurer deductible will rise to 20% of calendar year 2006 direct earned premium.⁶ The bill also calls for an industry-wide "aggregate retention" of \$25 billion in 2006 and \$27.5 billion in 2007.⁷ Any federal payments within this aggregate retention level would be subject to recoupment by the federal government in the form of premium surcharges.⁸

By way of example, assume a single certified act of terrorism leads to total industry-wide losses of \$75 million in 2006. If a particular insurer paid "TRIA-covered" losses of \$10 million, and that insurer's calendar year 2005 direct earned premiums were \$30 million, that insurer would recover \$4,275,000 (90% of its losses in excess of its retention of 17.5% of its direct written premium, or \$5,250,000). If this same event occurred in 2007, there would be no coverage because it would be below the \$100 million trigger for TRIA coverage. However, if the industry-wide losses did exceed \$100 million and the same facts are assumed (\$10 million in paid losses and \$30 million in 2006 direct earned premium), the insurer would recover \$3,400,000 (85% of its losses in excess of its retention of 20% of its direct earned premium, or \$6 million).

The Future of TRIA

TRIA also calls for the formation of a working group to perform an analysis regarding the long-term availability and affordability of insurance for terrorism risk, including coverage for group life and coverage for chemical, nuclear, biological, and radiological events.

¹ S. 467, 109th Cong. § 6 (as cleared for White House, Dec. 17, 2005).

² *Id.* § 3(b).

³ *Id.* § 4.

⁴ *Id.* § 3(c).

⁵ *Id.* § 4.

⁶ *Id.* § 3(c).

⁷ *Id.* § 5(a).

⁸ *Id.* § 5(b).