

EXAM 6 – UNITED STATES, FALL 2015

10. (1.75 points)

a. (1 point)

Identify and briefly describe two goals of the Terrorism Risk Insurance Act (TRIA).

b. (0.5 point)

Briefly describe two justifications for homeowners insurance not being covered under TRIA.

c. (0.25 point)

Briefly describe one justification for reinsurance not being covered under TRIA.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 10	
TOTAL POINT VALUE: 1.75	LEARNING OBJECTIVE: B1
SAMPLE ANSWERS	
Part a: 1 point	
<p>Any two of the following goals, with a brief description:</p> <ul style="list-style-type: none"> • Achieve social purpose: <ul style="list-style-type: none"> ○ the intention of TRIA is to minimize or eliminate market disruption in the event of a terrorist attack ○ to minimize business interruption after a terrorist attack ○ ease the market shock after 9/11 terrorist attack ○ government provides temporary coverage to society for loss relief after 9/11 to relieve private market burden and avoid economic disruption ○ allow for large construction projects to occur, which would be at risk without terrorism coverage • Continue state regulation of insurance: <ul style="list-style-type: none"> ○ TRIA keeps regulation of rates/forms regarding terrorism insurance at the state level • Fulfill an unmet need/Promote Availability: <ul style="list-style-type: none"> ○ Insurers were unwilling or unable to provide terrorism coverage without the support of the government ○ Provide a federal backstop for losses resulting from terrorism. Insurers began to exclude coverage for losses from terrorism after 9/11 due to the risk being uninsurable. This necessitated the federal government to step in and provide coverage. ○ Federal backstop was intended to be temporary until the private market could develop solutions • Affordability: <ul style="list-style-type: none"> ○ Create a temporary federal program of public and private funding to make coverage for terrorism available and affordable. ○ Private insurers won't insure, so the federal government acts as a reinsurer of the coverage 	
Part b: 0.5 point	
<ul style="list-style-type: none"> • A terror attack would most likely target area of commerce instead of residential areas, so it is not needed as much for homeowners • Highly unlikely that terrorism would target individual homes so coverage isn't needed • Homeowners insurance had no shortage of coverage after 9/11 (insurers didn't pull out of market) • Federal disaster assistance available if needed • Homeowners were not seeking terrorism insurance and being unable to find it • The largest portion of terrorism loss is business interruption, which is not a concern for homeowners • TRIA was not aimed at personal lines coverage, it was aimed at businesses with commercial coverage 	
Part c: 0.25 point	
<ul style="list-style-type: none"> • Many reinsurers are not based in the US, so regulations would be difficult to execute 	

SAMPLE ANSWERS AND EXAMINER'S REPORT

- Reinsurers have ability to diversify and set limitations on reinsured losses. Diversification allows reinsurer to stay solvent following a destructive occurrence.
- Reinsurance is not covered under TRIA because this is essentially duplication of effort. Under TRIA, the federal government is the reinsurer to the private market, which provides primary coverage.
- If reinsurer goes insolvent, primary insurer is responsible, then would be covered by TRIA
- Difficulty of determining layers/premiums because of the complexity of reinsurance contracts
- Reinsurance could be better covered with the use of CAT bonds
- Reinsurance might be too high, and so primary will buy less than necessary reinsurance
- Much reinsurance is excess business high layer losses, only a few of these losses could bankrupt an insurer

EXAMINER'S REPORT

Part a

The paper cited many goals/rationale for why TRIA was implemented and what it was intending to accomplish. Candidates were expected to identify 2 goals of TRIA and briefly describe them (e.g. provide some context or explanation). Some candidates neglected to describe the goal they listed.

Part b

Most candidates were able to list valid arguments for why homeowners risks are not covered by TRIA. This generally required knowing a few key differences between homeowners and commercial lines. Common errors included assuming that terrorist attacks on homeowners would have a more significant impact on the economy than commercial lines (but homeowners don't have business interruption needs and the number of homes across the country would help an insurer spread the risk).

Part c

Most candidates understood that the federal government was acting as the reinsurer up to a certain limit, which was deemed generally sufficient coverage for the exposure. Some candidates recognized that this is to protect US interests first and foremost, and many reinsurers are alien so protecting reinsurer interests is less of a priority when trying to stabilize the economy. A common error was to assume that taking on even higher layers of coverage was too risky for the government (if the government wanted to increase coverage, it would be possible to do so – note the large government expenditures in other areas, such as defense).