

EXAM 6 – UNITED STATES, FALL 2016

6. (3 points)

a. (0.75 point)

Briefly describe three reasons why terrorism may be considered an uninsurable risk.

b. (0.75 point)

Identify the three goals of the Terrorism Risk Insurance Act (TRIA) of 2002.

c. (1.5 points)

Discuss whether the Terrorism Risk Insurance Act (TRIA) of 2002 and its successor(s) have met each of the goals identified in part b. above.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 6	
TOTAL POINT VALUE: 3	LEARNING OBJECTIVES: B1, B2, B3
SAMPLE ANSWERS	
Part a: 0.75 point	
<p><u>Sample Responses for A Sufficiently Large Number of Insureds to Make Losses Reasonably Predictable</u></p> <ul style="list-style-type: none">• There are not a large number of insureds that have historically been exposed to terror attacks• There are not enough insured to pool to predict the risk reasonably• The risk pool is non-uniform, there may not be enough insureds to disperse the costs over• Number of insureds must be great enough that losses are reasonably predictable --- terrorism is rare so this fails• There is not a large number of insureds so losses are not very spread out and it is difficult to determine actuarially sound rate• Small number of risks• Not a large number of independent insureds• There are not a large number of insureds to enable risk to be predictable• A large number of insureds is needed to be reasonably predictable and this is not available for terrorism• There is not enough insureds or loss history to make losses reasonably predictable so pricing is difficult• There are not enough insureds to determine reasonable expected losses for an individual insured• Terrorism is not frequent so that there is not enough insureds or loss/coverage information to have predictable expected losses• There must be a large number of insureds to make risk reasonably predictable – not many insureds need terrorism risk• Not a large number of insureds are affected by terrorism activity which also reduces price determinations• There are not a large number of risks making it hard to estimate expected losses and price• It does not have a large amount of insureds• Requires large number of insureds to make the losses predictable which is not the case with terrorism• Does not affect a large number of insureds• Sufficiently large number of reasonably similar risks to make losses reasonably predictable – terrorism fails (doesn't exist for terrorism coverage) not predictable <p><u>Sample Responses for Losses Must be Fortuitous or Accidental</u></p> <ul style="list-style-type: none">• Attacks are planned and not random in the way a hurricane is• Intentional, not accidental• Insurable risks should be fortuitous; terrorism is an intentional act• Terrorism is the act of humans and therefore is not fortuitous. Insurable losses should be	

SAMPLE ANSWERS AND EXAMINER'S REPORT

fortuitous

- Terrorist attacks are not fortuitous or accidental
- Not accidental
- It is an intentional act (not fortuitous)
- Not fortuitous → terrorist did damage on purpose
- Losses aren't fortuitous. Terrorism isn't an accident, it involves people actively trying to cause harm
- Acts must be accidental → terrorism is an intentional act
- Losses are not fortuitous. Since terrorism attacks are human acts, they are not "random" in the way a car crash is.

Sample Responses for Losses Must Not be Catastrophic

- Losses are not independent. It is likely that a terrorist attack is catastrophic and affects multiple policies simultaneously.
- It is usually catastrophic if it happens
- Losses affect a large group of insureds in a certain region making exposure to risk really regionally dependent
- Losses are catastrophic
- Catastrophic element
- It is catastrophic in nature
- Might be considered catastrophic for small insurers or those who are not diversified geographically
- Events are infrequent and too volatile to price accurately

Sample Responses for Lack of Public Data about Both the Frequency and Severity of Terrorist Acts

- The frequency & severity of terrorism is very difficult to gauge so an actuarially sound price may not be available
- No credible data to predict the future losses
- Large number of loss needed but not many terrorism events occurred.
- Lack of data to rate the premium
- It does not have sufficient data
- Very few occurrences, so little data
- Does not have enough data to derive accurate price
- Low frequency, high severity nature of losses

Sample Responses for Company Should Not Insure an Event that Could Bankrupt the Firm

- Losses are catastrophic: A loss event could lead to insolvencies without TRIA, one loss can cost billions of dollars
- Availability of reinsurance. A lot of reinsurers exclude terrorism losses (after insolvencies resulting from 9/11). Without reinsurance the potential huge losses are uninsurable as they would lead to insolvencies
- The losses can be astronomically high which could cause a swift insolvency issue

Part b: 0.75 point

SAMPLE ANSWERS AND EXAMINER'S REPORT

Sample Responses for Goal 1 - Create a temporary federal program of shared public and private compensation for insured terrorism losses to allow the private market to stabilize.

- Provide temporary coverage in wake of 9/11. Provide government backstop for terrorism losses.
- Share the cost of terrorism with society for a period of time before industry get back capacity.
- Provide temporary solution by reinsuring terrorist acts while the private market stabilized after 9/11.
- Increase insurer's ability to write terrorism insurance by providing reinsurance.
- Create a temporary federal program of shared public and private compensation for insured terrorism losses to allow the private market to stabilize.

Sample Responses for Goal 2 - Protect consumers by ensuring the availability and affordability of insurance for terrorism risk.

- Protect consumers by making sure terrorism coverage is available and affordable.
- Provide affordable and available terrorism coverage
- Ensure coverage is available and affordable to all commercial purchasers who desire it.
- Fill the unmet need after 9/11 for terrorism insurance

Sample Responses for Goal 3 - Preserve state regulation of insurance

- Retain state based system of regulation of rates.
- Protect state regulation of insurance

Part c: 1.5 points

Sample Responses for Goal 1

- Not met, so far this system has been renewed 2 already and it seems like, it's no longer a temporary program.
- They provide coverage of 85% of losses over a 20% deductible and act as reinsurer for the primary market allowing them to offer this coverage.

Sample Responses for Goal 2

- Yes, government mandates that the insurer has to provide affordable terrorism coverage in a CGL policy, unless insured does not want to purchase.
- Yes TRIA increased availability of terrorism coverage significantly post 9/11. It provides a strong reinsurance backstop so that private insurers are willing to write the insurance.
- Affordable – Goal not met. As evidenced by a low take-up rate in commercial insurance, terrorism coverage may be prohibitively expensive to potential consumers.

Sample Responses for Goal 3

- The act expressly provides that nothing in the act shall affect the regulatory authority of the individual states.
- law has not interfered with regulation but hasn't been tested yet since there has not been a covered loss
- The state regulates rates.

EXAMINER'S REPORT

The candidates were expected to demonstrate knowledge of TRIA and evaluate the Act.

SAMPLE ANSWERS AND EXAMINER'S REPORT

Candidates generally did well in discussing why terrorism was not insurable. Candidates struggled with providing detail on whether or not the Act was successful in meeting its goals.

Part a

The candidates were expected to list three reasons terrorism is not considered insurable.

A common error was not providing complete thoughts. Some examples include:

- It is Not Measurable; the candidate needed to explain why it was not measurable
- It is Unaffordable; the candidate needed to explain why it was unaffordable
- It is Not Independent; the candidate needed to explain why that would not be insurable
- It is Hard to Define; the candidate needs to describe why it is hard to define and why that is not insurable
- Companies are Unwilling to Write; the candidate needs to describe why companies do not want to write coverage
- Similar answers that needed some explanation are – difficult to price, adverse selection and location

Part b

The candidates were expected to list three goals of TRIA.

Common mistakes included:

- TRIA covered 9/11 losses
- TRIA provided insurance
- Prevent business/economic disruption
- Prevent insurance company insolvencies

Part c

The candidates were expected to fully describe why or why not each of the three goals is met by TRIA.

A common mistake was not providing enough detail on one or more goals. Some examples include:

- Goal 1 – Government acts as reinsurer
- Goal 2 – Government will subsidize loss
- Goal 2 – Availability has increased
- Goal 2 - Insurers are offering coverage
- Goal 3 - States continue to regulate