

# **Terrorism Insurance Series: GAO Study of NBCR Availability**

Jason Schupp

January 5, 2009

# Overview

---

As part of the 2007 extension of TRIA, Congress requested GAO to investigate the availability of insurance coverage against terrorist attacks through the use of nuclear, biological, chemical and radiological (NBCR) weapons:

**Make Available Requirement:** TRIA presently requires insurers to make available a policy of insurance that covers loss from terrorism in the same manner the policy covers a loss not resulting from terrorism. In practical terms, “make available” requires insurers to first offer a policy that does not contain a terrorism specific exclusion. However, any exclusion (such as a nuclear, pollution or contamination exclusion) that would apply to a non-terrorism event equally applies to a terrorism event. While nuclear and pollution exclusions are common in property and liability insurance policies, workers compensation policies generally have no exclusions or limitations.

**Property and Liability:** GAO found little available NBCR insurance for property or liability risks. GAO found insurers reluctant to assume the NBCR exposure because of the unpredictability of frequency and potential for extreme and even ruinous loss. While there is a modest market in stand-alone NBCR terrorism coverage, pricing is generally unattractive to property owners. Because of this limited availability, lenders generally do not require borrowers to maintain coverage against NBCR terrorism on property securing a commercial loan. GAO found evidence that some property owners have created or expanded captives (which if domiciled in the U.S. have direct access to the Federal back-stop) to cover NBCR exposures.

**Workers Compensation:** Because workers compensation insurance does not contain exclusions or limitations, workers compensation insurers are highly exposed to NBCR terrorism – especially in urban business centers where large accumulations of workers exist. The only tool available to private insurers to manage the workers compensation NBCR risk is to avoid writing too many exposures in a given geographic area. Because NBCR events can impact a wide geographic area, such accumulation management techniques can be challenging to execute. GAO observes that even accumulation management is unavailable to the workers compensation residual markets that provide insurance to employers unable to obtain coverage in the private market . In addition, GAO noted that highly rate-regulated workers compensation insurers charge an average of only 1 cent per \$100 of payroll against the terrorism exposure (including both conventional and NBCR events).

**Reinsurance:** GAO found little available private reinsurance for NBCR terrorism. GAO found evidence that at least some of the available reinsurance contain significant restrictions on coverage (e.g., coverage only for immediate consequences of an attack, but not for long-term disease or contamination).

# Options to Increase NBCR Availability

---

GAO reviewed several proposals intended to increase the availability of NBCR terrorism insurance:

**2007 House Bill:** The House passed a Bill in 2007 that would have expanded the “make available” requirement to include an offer of a policy with an exception to the nuclear and pollution exclusions that would permit coverage of NBCR terrorism losses. In addition to offering this exception, the insurer could offer a complete terrorism exclusion (except for workers compensation insurance). In exchange for this expanded offer, the 20% back-stop deductible would be reduced to 3.5% for NBCR losses. In addition, the insurer’s co-share above the back-stop would decrease from 15% to 5% as the size of the loss increased.

**NBCR Pool:** GAO reports that some have proposed a reinsurance pooling concept by which insurers would purchase 95% quota share reinsurance against up to \$40 billion of industry losses backed by the pool’s assets. To the extent that losses exceeded available assets, the pool would borrow to pay losses (presumably from the Federal government who would be paid back through future premium collections). Above \$40 billion of industry losses, the Federal government would assume all NBCR losses to an aggregate of \$100 billion in industry losses and Federal losses.

**Tax-Deductible Pre-Event Reserving:** GAO noted that some have proposed allowing insurers to set-aside a tax-deductible reserve to pay for future NBCR losses, although it is unclear such a proposal alone would generate substantial additional capacity for NBCR coverage.

**Federal Assumption of Risk:** GAO also described a concept by which the Federal government would assume all NBCR terrorism exposure through 100% reinsurance of private insurers (loosely based on the National Flood Insurance Program model). GAO recited concerns that private insurers would not have the staffing and expertise to respond to a large-scale, complex NBCR terrorism event. Further, such a program could create a substantial risk to taxpayers.

The GAO report makes clear that while TRIA has been effective in achieving widespread availability of conventional terrorism insurance, the tools for restoration following an NBCR terrorism event remain significantly limited. The report offers little to support the future emergence of a robust market for NBCR terrorism insurance absent a program that recognizes the limited tools available to private insurers to manage the exposure, the potential for extreme loss and the unique administrative challenges of an NBCR terrorism event.



**ZURICH**