



# **The California Commission on Health and Safety and Workers' Compensation**

## **CHSWC Background Paper on The Impact of Terrorism and California Workers' Compensation**

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### ***Executive Summary***

In June 2004, the members of the Commission on Health and Safety and Workers' Compensation (CHSWC) voted to approve an educational forum on the relationship among terrorism risk, insurance, national security and public policy. The purpose of this background paper is to: (1) provide information on the impact of issues of terrorism on workers' compensation in Section One; and (2) outline the principal issues discussed at a CHSWC/RAND conference on terrorism and workers' compensation, the National Symposium on the Future of Terrorism Risk Insurance, held at the University of Southern California (USC) on June 20, 2005, in Section Two. Section Three will review health and safety efforts at the federal government level and the State of California level.

Some of the key questions confronting California with respect to terrorism and workers' compensation include:

- Should the Terrorism Risk Insurance Act (TRIA) be continued? If not, what is the backstop for terrorism coverage for insurer and/or excess liability?
- Can the California Self-Insurers' Security Fund (SISF) and California Insurance Guarantee Association (CIGA) function effectively without the TRIA backstop for insurers?
- Will the solvency of the State Compensation Insurance Fund (SCIF) be at risk in case of a terrorist attack without TRIA?
- Will workers' compensation insurers reduce capacity in California in the absence of federal support?
- Should California legislation allow workers' compensation insurers to exclude terrorism and chemical, biological, radiological or nuclear (CBRN) attacks?

CHSWC's recommendations for consideration regarding impact of terrorism on workers' compensation:

- Legislation to allow workers' compensation insurers to exclude terrorist attacks should be avoided. Large casualty attacks may occur while people are at work, and the workers' compensation system should provide critical assistance to the families of victims in the immediate aftermath of the attack.
- Federal support is needed to assure system integrity. Terrorist attacks pose significant risks to the stability of the California's workers' compensation system. .
- In the absence of federal support, workers' compensation insurers may raise prices or reduce capacity in high-risk areas, such as Los Angeles and San Francisco, thereby undermining the progress of the workers' compensation reforms. The state might consider a state-based solution, similar to Florida's hurricane insurance program or California's earthquake insurance program.
- California should establish a Task Force to develop a plan for how to cover workplace injuries and illnesses resulting from terrorist attacks. Possible approaches include:
  - Voluntary pool of employers for workers' compensation coverage.

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- Efforts to provide for those workers who are not covered by private group health.
  - Mandatory assessment on all employers and/or taxpayers for a terrorism insurance pool covering all Californians depending on the lines of insurance.
- A Task Force should communicate and coordinate its plans with other appropriate agencies, such as the California Governor's Office of Homeland Security, and interested stakeholders and the public.
- A Model Communications Plan is needed to coordinate the dissemination of information for state agencies and their staff on how to prepare for and respond to a terrorist attack affecting workers at the workplace. All agencies and agency staff should be made aware of the Plan, and coordination between agencies should be clear.
- Continued distribution of information and ongoing educational efforts in health and safety for disaster preparedness are essential.

Please note that since CHSWC has released a draft of this issue paper to the public, Congress has passed a two-year extension of the TRIA in December 2005.

## **SECTION ONE: BACKGROUND**

### ***Coverage under Terrorism Attacks: Terrorism Risk Insurance Act***

The experience of New York, which sustained approximately \$32.4 billion in insured losses from the September 11, 2001 terrorist attack, of which 5.8 percent or \$1.8 billion were workers' compensation,<sup>1</sup> demonstrates that insuring losses from a major terrorist attack is one of the issues that should be at the forefront of California workers' compensation issues or debate.

#### *Scope of TRIA*

In response to the September 11, 2001 attack on the World Trade Center, President Bush signed into law TRIA on November 26, 2002. The law established a temporary three-year federal Terrorism Risk Insurance Program (TRIP) or federal backstop for coverage of insured property and casualty losses that result from an act of foreign terrorism.

An act of foreign terrorism is specified in TRIA as:

"any act that is certified by the Secretary of the Treasury, in concurrence with the Secretary of State, and the Attorney General of the United States--

- (i) to be an act of terrorism;
- (ii) to be a violent act or an act that is dangerous to--
  - (I) human life;
  - (II) property; or
  - (III) infrastructure;
- (iii) to have resulted in damage within the United States, or outside the United States in the case of--
  - (I) an air carrier or vessel described; or
  - (II) the premises of a United States mission; and
- (iv) to have been committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion." <sup>2</sup>

According to the United States Department of the Treasury, TRIP's objectives are to protect consumers by addressing market disruptions and to ensure the continued widespread availability and affordability of property and casualty insurance for terrorism risk. In addition, TRIA allows for a transitional period for the private markets to stabilize, resume pricing of such

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<sup>1</sup> TRIA and Beyond: Terrorism Risk Financing in the United States. A Report Issued by the Wharton Risk Management and Decision Process Center. The Wharton School. University of Pennsylvania. August 2005. Based on Wharton Risk Center and Insurance Information Institute data. (The estimates of the costs are as of July 2004.)

<sup>2</sup> The Terrorism Risk Insurance Act of 2002.

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insurance, and build capacity to absorb any future losses, while preserving state insurance regulation and consumer protections.<sup>3</sup>

It should be noted that TRIA does not cover acts of domestic terrorism as defined as a terrorist act committed on behalf of any U.S. person or the U.S.<sup>4</sup> For workers' compensation, TRIA covers "acts of war" as well as acts of foreign terrorism.

### *Monetary Provisions under TRIA*

TRIA pays for 90 percent of losses up to \$100 billion for certified foreign terrorist acts and if property and casualty insurance losses exceed \$5 million, occurring in the event of a terrorist attack after insurance companies' deductibles. Congress is to determine the procedures for and the source of any payments above \$100 billion.<sup>5</sup> The deductible of insurance companies equates to 15 percent of the direct earned premium in 2005. This deductible is based on a percentage of direct earned premiums [from covered lines of insurance] from the previous calendar year.<sup>6</sup>

To date, no monies have been paid out by the federal government under TRIA. In order for any monies to be paid out under TRIA, the commercial, property, and casualty insurance company would have to show that it offered terrorism coverage to its policyholders.

### *Status of TRIA*

TRIA is scheduled to sunset on December 31, 2005. This means that in the event of a terrorist attack, policies incepting in June 2005, for example, will only have losses incurred in 2005 covered by TRIA. Annual policy renewals with the effective dates of January 1, 2006, or later will have to contemplate that there will be no federal backstop for any losses in 2006. For this reason, regulators expect that for covered lines other than workers' compensation, insurers and advisory organizations will file conditional exclusions for terrorism coverage and will attach them to renewal policies on a widespread basis.<sup>7</sup>

In 2004, insurers and real estate interests argued for an extension of TRIA to be enacted before the expiration to avoid market disruption. Christopher J. Dodd, D-Conn., introduced a measure ([S 467](#)) to extend the program for two years. It had 18 cosponsors, including seven Republicans. (See attachment A.) The House Financial Services Committee approved a two-year extension, but the bill did not reach the floor as a stand-alone measure, and the Senate did not act.

A Senate panel held its first hearing of 2005 on TRIA on April 14th. Testifying at the Senate Banking, Housing and Urban Affairs Committee hearing was Douglas J. Holtz-Eakin, director of the Congressional Budget Office, as well as insurance and consumer group representatives.

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<sup>3</sup> <http://www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/> and WCIRB Bulletin No. 2003-02.

<sup>4</sup> The Wasau Insurance Companies, [www.wausau.com](http://www.wausau.com).

<sup>5</sup> Terrorism Risk Insurance Act of 2002, <http://www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/pdf/hr3210.pdf>.

<sup>6</sup> Conversation with David Brumont, Legal Counsel, Terrorist Financing and Financial Crime, United States Department of the Treasury.

<sup>7</sup> [http://www.naic.org/pressroom/releases/rel04/7-20-04\\_Model\\_Bulletin\\_Final.doc](http://www.naic.org/pressroom/releases/rel04/7-20-04_Model_Bulletin_Final.doc) and TRIA.

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The Treasury Department released a report in June 2005 on the effectiveness and success of the law recommending to the U.S. Congress against the extension of TRIA in its current form.<sup>8</sup>

A General Accountability Office (GAO) report in 2004 found that although TRIA had been successful in ensuring that business was not harmed due to lack of insurance, no private-sector mechanism had emerged to replace TRIA after its expiration. The GAO study also studied six European countries, France, Italy, Spain, Germany, Switzerland and the United Kingdom, and found that France, Spain, Germany and the United Kingdom have adopted programs similar to TRIA. However, the report further noted that in contrast to the United States where "TRIA was designed as a temporary program that was expected to be discontinued when a private market for terrorism insurance could be established ..., the European programs are generally not expected to be discontinued."<sup>9</sup>

### *Update on the Status of TRIA*

Congress passed a two-year extension of the TRIA in December 2005. With the expiration of TRIA just days away, Congress acted to ensure that a federal backstop will be firmly in place while the public and private sectors continue to discuss possible long-term solutions to providing viable options for those seeking terrorism coverage. The final bill cleared by the House of Representatives and the Senate includes the following provisions:

- Extension through December 31, 2007.
- All lines covered by the original program except commercial auto, professional liability (other than Directors and Officers), surety, burglary and theft, and farm owners' multi-peril.
- "Make available" requirement remains intact.
- Event Triggers: \$50 million in 2006; \$100 million in 2007.
- Deductibles: 17.5 percent in 2006; 20 percent in 2007.
- Annual Program Cap: \$100 billion per year for insured losses.

This extension is only for two years; therefore, TRIA will continue to be of concern to the workers' compensation industry and to property and casualty insurers.<sup>10</sup>

## **Terrorism Coverage and Exclusions in Workers' Compensation and Other Property and Casualty Insurance Lines**

### *Coverage in Property and Casualty Lines*

TRIA applies to commercial lines of property and casualty insurance, including general liability, commercial property, excess insurance, workers' compensation insurance, and surety

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<sup>8</sup> Assessment: The Terrorism Risk Insurance Act 2002. Report to Congress. The United States Department of the Treasury. June 2005.

<sup>9</sup> CQ TODAY – BANKING AND FINANCIAL SERVICES, April 8, 2005, 5:57 p.m. Senate Panel to Discuss Possible Extension of Terrorism Insurance Program, by Liriel Higa, CQ Staff.

<sup>10</sup> Summary of the Risk and Insurance Management Society, Inc., (RIMS) review of the approved TRIA extension, Michael Nolan, California Workers' Compensation Institute, December 2005.



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insurance.<sup>11</sup> However, terrorism coverage varies for the different lines of property and casualty insurance. Under TRIA, owners of commercial property, such as office buildings, factories, shopping malls and apartment buildings, must be offered the opportunity to purchase terrorism coverage.<sup>12</sup> Although terrorism coverage does not have to be specifically offered for personal insurance, standard homeowners insurance policies include coverage for damage to property and personal possessions resulting from acts of terrorism.

### *Exclusions for Commercial Property and Casualty Lines*

Before the September 11, 2001 terrorist attack on the World Trade Center, terrorism coverage was not explicitly excluded in insurance policies. The general liability insurance line had exclusions on nuclear and radiological acts, but there was no explicit reference to terrorism. The commercial insurance policies included terrorism coverage effectively free of charge because it was not excluded as a cause of loss, nor priced separately.<sup>13</sup>

### *Exclusions for Workers' Compensation*

Unlike other lines of insurance, terrorism exclusions for workers' compensation only apply when they are particularly specified in the state's Labor Code precluding insurers from placing exclusions on terrorism coverage. According to the California Department of Insurance, there is no exclusion for workers' compensation losses resulting from terrorism or an act of war, and there is no exclusion for chemical, biological, radiological or nuclear (CBRN) losses as in other commercial lines. According to the National Association of Insurance Commissioners (NAIC), Pennsylvania is the only state that has any exclusion for workers' compensation policies for terrorism. As specified in its Act, Pennsylvania excludes acts of war in its policies.<sup>14</sup>

### *Exclusions by States for Terrorism - Lines Other than Workers' Compensation*

After TRIA, the majority of states adopted exclusions for terrorism for lines other than workers' compensation, which included the following limitations:

- Most states after TRIA allow carriers to exclude CBRN acts from their insurance policies if the policyholder refuses to take up terrorism coverage.
- Some states exclude domestic terrorism acts from their insurance policies.<sup>15</sup>
- Twelve of the 30 states that adopted a standard fire policy (SFP) for losses from fires allow insurers to exclude terrorist attacks in the SFP if the policyholder turns down

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<sup>11</sup> Terrorism Risk Insurance Act.2002.; Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act, Peter Chalk, Bruce Hoffman, Robert Reville, and Anna-Britt Kasupski, RAND Center for Terrorism Risk Management Policy, Santa Monica, CA, 2005.

<sup>12</sup> Insurance Information Institute

<sup>13</sup> Conversation with John Worth, Director of Microeconomic Analysis, The United States Department of the Treasury.

<sup>14</sup> Workers' Compensation Act, Section 301 (a) for Pennsylvania states ... "no compensation shall be paid if, during hostile attacks on the United States, injury or death of employees results solely from military activities of the armed forces of the United States or from military activities or enemy sabotage of a foreign power ..."

<sup>15</sup> Conversation with Larry Skelly, Senior Counsel, Insurance Services Offices and David Brumont, The United States Department of the Treasury.

terrorism coverage under TRIA.<sup>16</sup> Thus, states that would have provided coverage for a fire following a terrorist attack, started excluding this coverage from their policies after TRIA.

The potential expiration of TRIA prompted some 47 states and the District of Columbia, with the exception of Florida, Georgia and New York, to approve exclusions for property terrorism risk, conditional upon either expiration of TRIA at the end of 2005 or a renewal of TRIA with deductible, co-payment, or terrorism definition different from those in the current Program.<sup>17</sup>

## **Exposures for the Workers' Compensation Industry**

### *Exposures for Insurers*

Several experts have indicated that terrorism poses the biggest risk for workers' compensation where state laws specify benefits and allow virtually no exclusions. Terrorism cannot be excluded from workers' compensation coverage, and reinsurance for workers' compensation for terrorism insurance may be limited or costly. The risk of catastrophic losses is particularly severe for heavily concentrated workers' compensation exposures where state laws specify benefits and allow virtually no exclusions.

In addition, insurers cannot exclude CBRNs from workers' compensation policies. This particular aspect of workers' compensation has raised concern about the sunset of TRIA from workers' compensation insurers, since it is feared that in the case of a CBRN attack, even with a TRIA backstop, workers' compensation insurers have increased risk of insolvency.<sup>18</sup>

The increased risk of insolvency of insurance companies also arises from the large market share that is covered by several companies in California. According to the California Department of Insurance, only ten insurers had about 70 percent of the California workers' compensation market share in 2004, including the State Compensation Insurance Fund (SCIF) with about 50 percent of the market. In California, as in New York, where a few companies insure a large proportion of the market, these companies would bear the largest proportion of the losses. If a terrorist attack were to occur, these companies' share would greatly exceed the TRIA deductible of 15 percent of earned premium. Thus, if TRIA is not reauthorized by the federal government, these companies could become insolvent.<sup>19</sup>

Additional insurance insolvencies would also pose a bigger burden on the California Insurance Guarantee Association (CIGA) which is already paying out liabilities on over 25 workers' compensation insurance companies that have been liquidated since September 2000. CIGA's

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<sup>16</sup> Conversation with Gail Duncan, Rates and Form Analyst, Oregon Department of Insurance and Assessment: The Terrorism Risk Insurance Act 2002. Report to Congress. The United States Department of the Treasury. June 2005.

<sup>17</sup> Assessment: The Terrorism Risk Insurance Act 2002. Report to Congress. The United States Department of the Treasury. June 2005.

<sup>18</sup> Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act, Peter Chalk, Bruce Hoffman, Robert Reville, and Anna-Britt Kasupski, RAND Center for Terrorism Risk Management Policy, Santa Monica, CA, 2005.

<sup>19</sup> TRIA and Beyond: Terrorism Risk Financing in the United States. A Report Issued by the Wharton Risk Management and Decision Process Center. The Wharton School. University of Pennsylvania. August 2005.

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annual liabilities require a payout exceeding \$900 million per year to 40,000 injured workers, more than any private carrier (other than SCIF) or self-insured employer in California. CIGA's monthly cash drain during the 12-month period ending December 31, 2003, averaged \$84.1 million each month, of which \$74 million represented workers' compensation payments.<sup>20</sup>

### *Exposure for Self-Insured Employers*

Private self-insured employers buy excess coverage from insurers. Currently, workers' compensation excess coverage is covered by TRIA. However, if the TRIA backstop is not reauthorized, the workers' compensation excess insurers may start excluding terrorism from their coverage. In addition, if the excess insurer still agrees to write policies and goes insolvent as a result of a terrorist attack, the liability not covered by CIGA will fall to the California Self Insurers' Security Fund (SISF) but only if the self-insured becomes insolvent.<sup>21</sup> SISF currently receives monies from an assessment on self-insured employers at a rate of \$60 million annually and has liability of about \$30 million.<sup>22</sup>

### *Terrorism Exposures: Gaps in TRIA*

Although TRIA provides certain coverage for terrorist acts, the law does not fully address some crucial areas of exposure or potential exposure. The World Trade Center disaster illustrated how an extreme event could simultaneously result in large losses for many lines of insurance, thereby threatening the financial solidity of insurers practicing account underwriting across multiple lines. That reminder of the risk of concentration of exposure across an account, as well as geographically, has caused insurers to reassess their underwriting and reinsurance strategies. Any changes resulting from such reassessment could also affect insurers' ratemaking and pricing and marketing strategies.

While TRIA provides reinsurance for certified acts of foreign terrorism, insurers are also providing coverage for other terrorism risk in response to policyholder demand. This could require separate treatment in policy language and ratemaking, because TRIA does not cover such additional terrorism risk, such as domestic terrorism. RAND identifies four trends that are likely to become manifest and which have relevance for evolving domestic terrorist threat contingencies in the United States: a continuing interest in attacking hard targets, but an increasing focus on soft, civilian-centric venues; an ongoing emphasis on economic attacks; a continued reliance on suicide strikes; and a desire to use CBRN weapons but little ability to execute large-scale unconventional attacks<sup>23</sup>.

Moreover, TRIA specifies different limits of insurer retention for calendar years 2003, 2004, and 2005. Since the vast majority of policy terms are not concurrent with a calendar year, policy premiums, like insurer retentions, could vary depending on the portion of the policy in each calendar year.

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<sup>20</sup> California Insurance Guarantee Association Executive Summary February 5, 2004

<sup>21</sup> CIGA will cover the claims for an excess coverage insurer that provided coverage to the self-insured employer up to \$500,000.

<sup>22</sup> Jeff Pettegrew, Executive Director, Self-Insured Security Fund.

<sup>23</sup> Terrorism Insurance and the Evolving Terrorist Threat, Research Brief, RAND Center for Terrorism Risk Management Policy, Santa Monica, CA, 2005.

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An insurer's retention under TRIA will grow as its premium volume increases for TRIA-covered lines. That growth could occur even if the new insureds elect not to purchase terrorism insurance, because the law bases an insurer's retentions on the company's total premium for affected lines.

TRIA caps covered industry losses at \$100 billion, and Congress would have to decide on how to handle losses above \$100 billion. The government has so far not explained how insurers or the Treasury would manage losses exceeding the cap. Even if insurers are not liable for losses over \$100 billion, increasing retentions and coinsurance provisions could still leave insurers with substantial losses from a major act of terrorism.

If the involuntary market grows for workers' compensation or property lines, the insurers writing those lines voluntarily could face growing subsidies for terrorism (and other) losses arising from the involuntary market. The only way an insurer can limit that exposure is to stop writing the lines in one or more particular states. Guaranty fund assessments for insurers becoming insolvent because of large terrorism (and other) losses could further increase liabilities for solvent insurers.

In summary, insurers could still have substantial terrorism exposure even if TRIA is extended because of:

- Growing insurer retentions.
- Ten percent coinsurance provisions.
- Responsibility for all loss adjustment expenses.
- Premium growth in TRIA-covered lines for policies not covering terrorism risk.
- Uncertain treatment of losses above \$100 billion.
- Subsidizing of the involuntary market.
- Terrorism event not certified as a foreign terrorism event by the Secretary of the Treasury.

### *Alternative Coverage Arrangements – Proposed Alternative Arrangements to TRIA*

According to a 2004 Workers' Compensation Terrorism Reinsurance Pool Feasibility Study by Towers Perrin, a voluntary workers' compensation industry reinsurance pool could help insure or address terrorism losses by diversifying risk and "thereby increasing the efficiency with which existing capital is deployed."<sup>24</sup>

In addition, the General Accounting Office (GAO) has found that some insurers and reinsurers benefit from catastrophe bonds because the bonds diversity their funding base for catastrophic risk. These bonds are not used widely, as many insurers view the costs associated with issuing them as significantly exceeding traditional reinsurance. European countries, such as Italy, France, and Germany, authorize the establishment of tax-deductible reserves for potential catastrophic events. Some analysts believe that authorizing US insurance companies to establish these reserves would increase private-sector capacity and lower premiums. However, some industry analysts have pointed out that authorizing U.S. insurance companies to establish

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<sup>24</sup> Workers' Compensation Terrorism Reinsurance Pool Feasibility Study, Towers Perrin, April 2004.

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these reserves could lower federal tax receipts and not create a meaningful increase in capacity as insurers may substitute the reserves for other types of capacity.<sup>25</sup>

According to a RAND analysis, there are two key implications for the trends in evolving domestic terrorist threat contingencies mentioned above: that TRIA does not provide adequate financial protection, particularly in the face of economically motivated attacks; and that TRIA has significant gaps and is not robust enough to an evolving threat. RAND therefore recommends that instead of allowing TRIA to sunset, Congress might prefer to consider policy measures that increase the take-up of terrorism insurance and lower its price. In addition, the United States must address CBRN attacks and attacks by domestic groups. CBRN coverage may be appropriately covered through a direct government program. Finally, RAND recommends that an oversight board of national governors should be established to review the performance of TRIA or its successor and ensure that it is robust to changes in the underlying risk.<sup>26</sup>

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<sup>25</sup> "Catastrophe Risk: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks," Report 05-199 to the Chairman, Committee on Financial Services, House of Representatives, General Accounting Office, February 2005.

<sup>26</sup> Terrorism Insurance and the Evolving Terrorist Threat, Research Brief, RAND Center for Terrorism Risk Management Policy, Santa Monica, CA, 2005.

## **SECTION TWO: CHSWC/RAND CONFERENCE ON THE FUTURE OF TERRORISM RISK INSURANCE**

A planning committee consisting of CHSWC staff, RAND, and the Communications Institute put together a list of invitees and an agenda and topics for a forum, the "National Symposium on the Future of Terrorism Risk Insurance," which was held at University of Southern California on June 20, 2005. The forum included participants from RAND, the Wharton School, University of Pennsylvania, and the Center for Risk and Economic Analysis of Terrorism Events (CREATE) at University of Southern California. (See Attachment B for Conference Agenda and Attachment C for RAND' paper Trends in Terrorism: Threats to the United States and the Future of the Terrorism Risk Insurance Act.)

The forum brought together many of the nation's leading experts from the public and private sectors to discuss the relationship between terrorism risks, insurance, national security and public policy. These top researchers, corporate leaders and policymakers framed and analyzed the ongoing policy debates related to the Terrorism Risk Insurance Act (TRIA), terrorism risk management and insurance.

Topics for the forum included:

- The terrorism threat: insuring for the future.
- The economics of terrorism insurance.
- Trends in terrorism and the architecture of TRIA.
- Can insurance cover weapons of mass destruction?
- Industry response: how we will prepare for the threat.
- Insurance and the catastrophic loss of human life: workers' compensation, life insurance, and victim compensation.
- Perspectives.
- The future of terrorism insurance.

Some of the key observations voiced at the forum include:

- TRIA does not provide adequate financial protection, particularly in the face of economically motivated attacks, as take-up rates (approximately 50 percent currently) for terrorism insurance may be too low. TRIA also has significant gaps and is not robust to an evolving threat.
- Insurers cannot exclude acts of terrorism or CBRNs from workers' compensation policies, and reinsurance for workers compensation is limited.
- There is an ongoing need to provide financial protection of the kind that TRIA was intended to encourage. State government could potentially supplement the private marketplace to provide insurance coverage.
- TRIA's sunset can slow recovery after future attacks and magnify economic consequences of attacks.
- If TRIA sunsets, workers' compensation carriers may withdraw from the market and a bigger share may fall to SCIF. A major terrorist attack could potentially bankrupt SCIF.

### **SECTION THREE: DISASTER RESPONSE AND PREPAREDNESS AT THE FEDERAL AND STATE LEVEL**

#### **Response to September 11, 2001 Terrorist Attack**

##### *Government Response to Victims of the September 11, 2001 Terrorist Attack*

According to RAND, payments to victims of the September 11, 2001 terrorist attack, both individuals killed or seriously injured and individuals and businesses affected, were \$38.1 billion, with insurance companies and the federal government providing more than 90 percent of the payments. Civilians killed or seriously injured received a total of \$8.7 billion dollars, averaging about \$3.1 million per recipient. Government payments included payments from local, state and federal governments, plus payments from the September 11 Victim Compensation Fund of 2001, which was created within weeks of the terrorist event. Additional payments were from insurance companies, employers and charities.<sup>27</sup>

The federal Office of Victims of Crime (OVC) provided states with approximately \$65.2 million in emergency and supplemental grant funds to assist victims, emergency responders, and their families. State Victims of Crime Act (VOCA) administrator agencies were awarded grants to administer the funds.<sup>28</sup>

The OVC determined that grantees discovered that "existing systems for emergency management or terrorism planning were based primarily on a public safety model of disaster response that focused on saving lives and ensuring citizens' immediate safety. For the most part, these models were not developed to take into account the human impact of mass criminal incidents and did not recognize the social, psychological, and economic toll that might manifest itself in physical or emotional symptoms." The OVC also determined that "a lack of coordinated resources impeded smooth delivery of services to victims."<sup>29</sup>

Recommendations by the OVC, incorporating perspectives from VOCA administrator agencies, include: ensuring smooth coordination of services among federal, state, and local agencies and organizations; formalizing collaborate relationships at the institutional level to define realistic policies, procedures, and protocols; addressing geographical and territorial issues inherent to assisting large populations of victims; and creating centralized databases to track compensation and dissemination of services to avoid duplication of efforts.<sup>30</sup>

##### *New York's Response to September 11, 2001 Terrorist Attack*

New York has passed new legislation to protect workers' compensation benefits for World Trade Center victims and families. "Under the new legislation insurance companies cannot terminate the workers' compensation benefits being paid to victims and their families if they seek compensation from the federal Victim Compensation Act." New York has had 6,706 claims

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<sup>27</sup> Rand Report Details 9-11 Victims Compensation, <http://usgovinfo.about.com/od/defenseandsecurity/a/randon911.htm>.

<sup>28</sup> Responding to September 11 Victims: Lessons Learned From the States, Office for Victims of Crime, Office of Justice Programs, U.S. Department of Justice, p. iii.

<sup>29</sup> Ibid., p.x.

<sup>30</sup> Ibid., p.19.

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reported as of September 12, 2002, as a result of September 11<sup>th</sup> terrorist attacks. The types of claims reported include death/missing, lost time, medical only and other.<sup>31</sup>

Key challenges for New York after September 11, 2001, included responding to inquiries, issuing of orders/resolutions, outreach to constituents, coordination with other agencies/entities, claims processing, development of an Adjudication Plan to provide optimum services for World Trade Center claims, reviewing and resolving legal issues, and ongoing monitoring of claims.

### *The Legal Backdrop in New York*

Prior to September 11, 2001, under New York law, injuries from a terrorist attack were not considered to "arise from the employment"; such cause was an outside actor unrelated to the employer and the employment. This fell under the risk category of "neutral" risks or risks unconnected with either the employment or the worker and, therefore, the employer "contends it should not have to bear the expense."

In New York State and other jurisdictions, three main doctrines have been developed following September 11, 2001, under which a work connection may be found for neutral risks: Increased Risk, Actual Risk and Positional Risk. An additional doctrine, Street Risk, has also been developed.

- Increased Risk Doctrine: "an injury is considered to have a work connection if the work placed the employee at a greater risk of the particular neutral cause than is experienced by members of the public generally."
- Actual Risk Doctrine: "goes beyond the Increased Risk Doctrine in that it is sufficient if the employment subjected the claimant to the actual risk that caused the injury."
- Positional Risk Doctrine: "goes even further in that the injury will be compensable if the employment placed the employee in the particular place at the particular time when he or she was injured by some neutral force."
- Street Risk Doctrine, "that is, street or highway injuries to workers ... whose duties increase their exposure to the hazards of the street, are considered to arise out of the employment."<sup>32</sup>

### *Other Legal Issues*

Additional legal issues important to New York's post-September 11<sup>th</sup> experience include:

- Stress Cases (post traumatic stress or mental or emotional injury) -- decisions were based on whether the injury arose "in the course of employment."
- Course of Employment –The "going and coming" rule – decisions were based on the rule that "ordinarily an employee is not considered to be within the scope of his or her employment while traveling to and from work." New York case law determined that "an exception could be made where the employee drew physically nearer to the workplace until

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<sup>31</sup> Summary of New York State workers' Compensation Claims Associated with the September 11, 2001 World Trade Center Attacks.

<sup>32</sup> Workers' Compensation and Terrorist Attacks by Lex K. Larson and Thomas A. Robinson, Workers' Compensation Policy Review & WCIRB Study, 2005.



he or she could be said to have entered a 'gray area' where the risks of travel and the risks from work might be said to merge."

- Definition of Employee – whether the claimant is an employee or an independent contractor.
- Which Parties Should Share Death Benefits -- there is no exclusion in workers' compensation law for "parents who fail to provide for their child or children" ... to inherit from "a child who dies intestate and from receiving the proceeds of an action for the wrongful death of the child." The courts could not deny a claim without "a clear intention from the Legislature."
- Employers Excused from Late Payment – "The New York courts have shown flexibility in excusing statutory penalties imposed on an employer or carrier for delays in paying benefits where the delays were the result of the September 11 attacks." The Appellate Division ruled that the Board had the authority to excuse the carrier from this penalty and remitted back to the Board for a consideration of whether the carrier's late payment should be excused under the circumstances.<sup>33</sup>

## **Disaster Response and Preparedness at the Federal Level: the Role of the National Institute for Occupational Safety and Health**

### *Disaster Response*

The National Institute for Occupational Safety and Health (NIOSH) is the federal agency responsible for conducting research and making recommendations for the prevention of work-related disease and injury. Its efforts to ensure worker health and safety in relation to terrorism focus on both short-term and long-term prevention and recovery.<sup>34</sup> In addition, bioterrorism is a key focus for NIOSH and includes disease (for example, anthrax), chemical hazards, and blood-borne infectious disease.

NIOSH responded to health and safety needs following the September 11, 2001 terrorist attacks. The agency sent dozens of staff to Ground Zero and took the following actions:

- Assessed individual jobs and work locations to identify potential hazards, including risk of eye injuries from blowing debris and potential exposure to silica dust, asbestos, and other hazardous materials.
- Helped site managers select appropriate equipment for sampling, use it properly, and institute procedures for analyzing samples quickly.
- Helped managers and workers select appropriate personal protective equipment (PPE) and coordinated deployment respirators to rescue and recovery workers.
- Developed cost-effective procedures for cleaning and sanitizing respirators on-site.
- Worked with medical assistance teams to ensure that they were prepared to meet specific emergencies on-site, as well as to help them develop procedures for follow-up evaluations of worker injuries.

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<sup>33</sup> Ibid.

<sup>34</sup> [www.cdc.gov/niosh](http://www.cdc.gov/niosh)

### *Disaster Preparedness*

NIOSH has also helped build safety and health capacity by assessing individual jobs and work locations to identify potential hazards, identifying appropriate personal protective equipment (PPE) and providing training in its use, and developing written guidelines to help supervisors integrate worker safety and health into site operations. It has also distributed written documents that workers and supervisor were most likely to need on-site to address specific concerns, including information on exposure to dusts and gases, eye safety procedures and equipment; traumatic incident stress for emergency response workers. In addition, NIOSH maintains health and safety information on its website as a resource to workers, supervisors and others in the event of future emergencies.<sup>35</sup>

### **Disaster Preparedness and Response at the California State Level**

#### *Risk of Terrorism in California*

Several agencies in California have analyzed the risk of terrorism and potential costs California would face in the event of a terrorist attack.

#### *Potential Costs to Workers' Compensation in California from Terrorist Attacks*

The University of Southern California (USC) Homeland Security Center has a national focus on assessing the threat of terrorism and the losses that would occur.<sup>36</sup> It has also studied the risk and potential costs of terrorist attacks in California.

USC studies incorporate a methodology involving threat assessment which projects risk analysis (terrorism threat and vulnerability assessment) with game theoretic concepts and other methods to address the problem of the unknown probability of a specific terrorism attack. In addition to risk analysis, consequence assessment, emergency response, and economic analysis of the impact on the economy are analyzed. Studies also incorporate economic modeling of major disasters and cost-benefit analysis of major risk-reduction decisions, as well as the impact of environmental changes on the behavior of economic agents. The USC methodology also uses risk-based methods to improve the allocation of funds to fight terrorism.

USC studies have examined three specific types of threats: an explosive attack that is capable of damaging a structure; a cyber-attack; and an attack that disrupts commercial air traffic. According to a hypothetical case study by USC's Center for Homeland Security, the closure of the Long Beach and Los Angeles ports due to a terrorist strike by a dirty bomb or attack on a liquefied natural gas (LNG) tanker in 2003 would have massive economic costs in terms of both immediate effect and long-term impacts in the sum of approximately \$1 billion per day.<sup>37</sup>

To estimate the economic impact of a terrorist attack on the twin ports of Los Angeles and Long Beach, USC used the Southern California Planning Model (SCPM) to estimate "spatially disaggregated economic impacts of projects, policies and plans." This model is both a regional

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<sup>35</sup> [www.cdc.gov/niosh](http://www.cdc.gov/niosh)

<sup>36</sup> [www.usc.edu](http://www.usc.edu)

<sup>37</sup> University of Southern California Center for Homeland Security, [www.usc.edu/dept/create/research](http://www.usc.edu/dept/create/research).

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model and a transport network model that looks at structure loss, business interruption loss, network loss (travel cost, including personal travel and freight costs), and infrastructure repair, e.g., bridge repair, cost. The model looks at local impact, or the job (in person-years of employment) and output losses, and the regional and national impact (in person-years of employment) and output losses.

The USC research models only economic impacts – business interruption and impaired transport network performance. Other costs, such as mortality and illness, prevention and mitigation, are not yet estimated. Using the model, which indicates the level of economic impact costs, can suggest the level of justification of resource expenditures on prevention. Currently, out-of-region impacts are estimated only in the aggregate. USC is working on an integrated regional-national model that specifies out-of-region impacts, state-by-state.

According to a Workers' Compensation Terrorism Reinsurance Pool Feasibility Study, plausible catastrophic terrorism events could "generate workers' compensation losses of \$90 billion or more, roughly three times the \$30 billion in capital backing the workers' compensation line of business." The study argues that a voluntary reinsurance pool could be of value to some individual insurers but would have limits as "a meaningful industry solution, particularly absent some form of ongoing federal backstop protection."<sup>38</sup>

The study also argues that a major terrorist event could exceed the entire base of capital that is supporting the workers' compensation insurance market. Since employers are required by law in virtually all states to provide workers' compensation insurance, the entire country could be affected if the workers' compensation insurance market is not functional.

Moreover, workers' compensation statutes require coverage for injuries that "arise out of and in the course of employment." The probability of injuries from acts of war and terrorism has historically been very low. Therefore, most state workers' compensation statutes do not exclude acts of war and terrorism. Only in one state, Pennsylvania, does the statute contain exclusions for injuries to employees resulting from acts of war or terrorism.<sup>39</sup>

The industry sponsors of the study agreed that industry reinsurance pools would not be able to meaningfully help absorb losses from major terrorism events without a more permanent federal backstop. The sponsors also agreed that "the best way to measure terrorism risk exposure is via a census of employee headcount by geographic location, rather than by workers' compensation premium or payroll."

In California, the Workers' Compensation Insurance Rating Bureau (WCIRB) has sought to estimate the California workers' compensation terrorism losses subject to TRIA that would be retained by insurers. The WCIRB engaged a nationally recognized catastrophe model firm, EQECAT, to estimate potential terrorism losses using statistical methods similar to those used to model losses from natural catastrophes such as earthquakes.

EQECAT has provided an estimate of California workers' compensation losses arising from terrorism for expected policy-year 2003, and the WCIRB has used this information to estimate

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<sup>38</sup> Workers' Compensation Terrorism Reinsurance Pool Feasibility Study, Towers Perrin, April 2004.

<sup>39</sup> Gregory Heidrich, "The Illusion of Protection: Terrorism, War and Workers' Compensation," April 15, 2002, <http://www.insurancejournal.com/magazines/southcentral/2002/04/15/features/21799.htm>

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the losses subject to TRIA that would be retained by insurers. The estimated losses per \$100 of payroll retained by insurers range from \$0.005 to 0.04.<sup>40</sup>

### *Role of California State Government in Disaster Preparedness and Disaster Response*

Several state agencies in California are involved in disaster preparedness and response, including the Office of Emergency Services -- the Office of Homeland Security,<sup>41</sup> the Division of Workers' Compensation (DWC), the Department of Industrial Relations (DIR) and Cal/OSHA. The Office of Emergency Services coordinates the State's disaster preparedness, response, recovery, and mitigation activities, assisted by state agencies. The role of state agencies is to carry out assigned activities related to mitigating the effects of an emergency or disaster in full cooperation with each other.

The efforts to build health and safety systems for disaster preparedness and response in California could include written guidelines to help supervisors integrate worker safety and health into site operations, revision of Injury and Illness Preparation Plans to include preparation for terrorism, use of proper Personal Protective equipment, and development of a system for coordinating deployment of rescue and recovery work.

The role of DIR in disaster preparedness, response and recovery is to use the Standardized Emergency Management system (SEMS) during emergency and disaster operations. The focus is on continuity of government and continuity of business, as well as preparedness and response.

Grants to local governments and appropriate state agencies are provided by the federal Office of Homeland Security. Under the Federal Homeland Security Grant Strategy, the state receives bioterrorism grants for distribution to local public health officers and to emergency medical response personnel.

Federal Homeland Security Grants from 2000-2004 focused on the following authorized activities to ensure the health and safety of workers in the event of a terrorist attack:

- Purchasing personal protective equipment (PPE) and conducting exercises for first responders.
- Planning, training, and purchasing PPE for first-responder agencies.
- Planning, training, purchasing PPE and paying for overtime costs during periods of elevated threat levels for large urban areas.
- Planning, training, and purchasing PPE and medical supplies for public health agencies.
- Planning, training, and purchasing PPE and medical supplies for the emergency-medical services system, hospitals, poison control centers, and health centers.

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<sup>40</sup> The ranges of estimates indicate insurers' liability depending on the assumed countrywide number of events per year and what portion of losses over the limit are paid by the insurer. Worker's Compensation Insurance Rating Bureau, WCIRB Summary of EQECAT California Terrorism Study, 2003.

<sup>41</sup> LAO Findings and Recommendations to Improve Homeland Security, see Homeland Security -- Legislative Analyst's Office, Presented to: Assembly Budget Subcommittee No. 1, Hon. Hector De La Torre, Chair.

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The California Homeland Security Strategy approach focuses on three key areas: prevention, response, and recovery.<sup>42</sup>

- Prevention:
  - Cooperation and information-sharing at local, regional, and national levels through the Joint Center – State Terrorism Threat Assessment Center (STTAC).
  - Four Regional Terrorist Treat Assessment Centers (RTTACs).
  - Criminal intelligence and interdiction.
  - Local community vulnerability and threat assessment on a regular basis.
  - Conduit for “requests for federal assistance when the threat exceeds the capabilities of local jurisdictions and private entities within those jurisdictions.”
  - A California-specific version of the federal Homeland Security Advisory System to disseminate information regarding the risk of terrorist acts, providing “warnings in the form of a set of graduated threat conditions that increase as the risk of the threat increases.”
- Response:
  - Sharing of information and intelligence in a timely and useful manner.
  - Rigorous training and exercise programs to adequately prepare first responders for times of crisis.
  - Information and training for the general public as to “how they can aid the response effort in the event of an emergency.”
    - Standardized Emergency Management system (SEMS).
    - Emergency Medical Services Authority (EMSA).
    - Department of Health Services (DHS).
  - Grant funds from the federal Centers for Disease Control (CDC), Health Resources and Services Administration (HRSA) and Office of Domestic Preparedness.
- Recovery:
  - California Office of Emergency Services (OES) is the lead agency:
    - Grantee for federally funded disaster-assistance programs.
    - Grantor for the California Disaster Assistance Act (CDAA) program.
      - The Legislature amended California’s Government code, Section 8680.3, at OES’ request, to include “terrorism” in the definition of a disaster. As such, response and recovery assistance and funds available under the CDAA would be available for an act of terrorism with the same regulatory requirements as any natural disaster.

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<sup>42</sup> California Homeland Security Strategy, February 2005 Draft, Governor’s Office of Homeland Security.

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- Provides educational programs for grant recipients, disaster victims, local and state agencies, and private non-profit organizations.
- Coordinates recovery assistance for individuals, businesses and the agricultural community.

Another key California state agency, Cal/OSHA, is focused on prevention and response to recovery. Efforts by Cal/OSHA to ensure worker health and safety include:

- Ensuring that Title VIII requirements are being followed.
- Being part of the California Office of Emergency Services (OES).

Every emergency response in California is structured along an Incident Command System (ICS), which includes officers for Information, Public Relations, Operations, Logistics, Finance, and Planning Intelligence. In addition, Cal/OSHA teams of designated specialists, including industrial hygienists and safety engineers, in both northern and southern California are presenting training.

Cal/OSHA is also involved in the Standardized Emergency Management System (SEMS) and the Incident Command System (ICS), as well as in a number of levels of emergency response: state (SOC), regional (REOC), operational area (EOC), local government (EOC), and field level (incident command). Cal/OSHA's role during the emergency response phase would include providing technical safety assistance and advisories at the coordination levels and integrating into established incident commands at the field level as technical specialists in Planning/Intelligence.

The agency's role as a staff of technical specialists includes: providing technical expertise, advising the safety officer, assisting units in other sections as needed, participating as needed in safety briefings, and developing the safety plan.

At the SOC level, Cal/OSHA provides state agency representation and technical services safety advisory for state and local response. At the REOC level, Cal/OSHA provides OSHA regional representation and technical services safety advisories for state and local response; it also coordinates with OSHA technical specialists at incident sites.

At the field level, OSHA response personnel are integrated into existing incident organization; they act as technical specialists, assist the Safety officer, provide input into safety plans, and assist with compensation and claims.

During the Recovery phase, Cal/OSHA supports clean-up or clearance activity and oversight of private contractor(s) and public works operations. The agency also fulfills its mandates (Government Code 6300, 6307, 6309) to provide supervision of work-site safety, enforcement of standards and investigation.

## SECTION FOUR: CHSWC RECOMMENDATIONS

Based on the research discussed in this paper and on the CHSWC/RAND Conference, CHSWC recommends giving consideration to the following:

- Legislation to allow workers' compensation insurers to exclude terrorist attacks should be avoided. Large casualty attacks may occur while people are at work, and the workers' compensation system should provide critical assistance to the families of victims in the immediate aftermath of the attack.
- Federal support is needed to assure system integrity. Terrorist attacks pose significant risks to the stability of the California's workers' compensation system.
- In the absence of federal support, workers' compensation insurers may raise prices or reduce capacity in high-risk areas, such as Los Angeles and San Francisco, thereby undermining the progress of the workers' compensation reforms. The state might consider a state-based solution, similar to Florida's hurricane insurance program or California's earthquake insurance program.
- California should establish a Task Force to develop a plan for how to cover workplace injuries and illnesses resulting from terrorist attacks. Possible approaches include:
  - Voluntary pool of employers for workers' compensation coverage.
  - Efforts to provide for those workers who are not covered by private group health.
  - Mandatory assessment on all employers and/or taxpayers for a terrorism insurance pool covering all Californians depending on the lines of insurance.
- A Task Force should communicate and coordinate its plans with other appropriate agencies, such as the California Governor's Office of Homeland Security, and interested stakeholders and the public.
- A Model Communications Plan should coordinate the dissemination of information for state agencies and their staff on how to prepare for and respond to a terrorist attack affecting workers at the workplace. All agencies and agency staff should be made aware of the Plan, and coordination between agencies should be clear.
- Continued distribution of information and ongoing educational efforts in health and safety for disaster preparedness are essential.

ATTACHMENT A

**Terrorism Risk Insurance Extension Act of 2005. (Introduced in Senate)**

S 467 IS

109th CONGRESS  
1st Session  
**S. 467**

To extend the applicability of the Terrorism Risk Insurance Act of 2002.

**IN THE SENATE OF THE UNITED STATES**

*February 18, 2005*

Mr. DODD (for himself, Mr. BENNETT, Mr. SCHUMER, Mr. HAGEL, Mr. CORZINE, Mr. BUNNING, Mr. REED, Mr. LUGAR, Mrs. CLINTON, Mr. NELSON of Nebraska, Mr. CARPER, Mrs. DOLE, Mr. CHAMBLISS, and Mr. LAUTENBERG) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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**A BILL**

To extend the applicability of the Terrorism Risk Insurance Act of 2002.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the 'Terrorism Risk Insurance Extension Act of 2005.'

**SEC. 2. EXTENSION OF TERRORISM RISK INSURANCE PROGRAM.**

(a) Extension of Program Years- Section 108(a) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2336) is amended by striking '2005' and inserting '2007'.

(b) Continuing Authority of the Secretary- Section 108(b) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2336) is amended by striking 'arising out of' and all that follows through 'this title'.

**SEC. 3. CONFORMING AMENDMENTS.**

(a) Definitions-

(1) PROGRAM YEARS- Section 102(11) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2326) is amended by adding at the end the following:

    '(E) PROGRAM YEAR 4- The term 'Program Year 4' means the period beginning on January 1, 2006 and ending on December 31, 2006.

    '(F) PROGRAM YEAR 5- The term 'Program Year 5' means the period beginning on January 1, 2007 and ending on December 31, 2007.



- `(G) OTHER PROGRAM YEARS- Except when used as provided in subparagraphs (B) through (F), the term 'Program Year' means, as the context requires, any of Program Year 1, Program Year 2, Program Year 3, Program Year 4, or Program Year 5.'
- (2) INSURED LOSSES- Section 102(5) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2324) is amended--
- (A) by inserting 'on or before December 31, 2007, as required by this title,' before 'if such loss';
  - (B) by striking '(A) occurs within' and inserting the following:  
'(A) occurs on or before the earlier of the expiration date of the insurance policy or December 31, 2008; and  
'(B) occurs--
    - '(i) within'; and
  - (C) by striking 'occurs to an air carrier' and inserting the following:  
'(ii) to an air carrier'.
- (3) CONFORMING AMENDMENTS- Section 102 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2323) is amended--
- (A) in paragraph (1)(A)(iii)(I), by striking '(5)(B)' and inserting '(5)(B)(ii)'; and
  - (B) in paragraph (4), by striking 'subparagraphs (A) and (B)' and inserting 'subparagraph (B)'.
- (b) Applicable Insurer Deductibles- Section 102(7) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2325) is amended--
- (1) in subparagraph (D)--
    - (A) by inserting 'and each Program Year thereafter' before ', the value'; and
    - (B) by striking 'preceding Program Year 3' and inserting 'preceding that Program Year'; and
  - (2) in subparagraph (E), by striking 'for the Transition' and all that follows through 'Program Year 3' and inserting the following: 'for the Transition Period or any Program Year'.
- (c) Continuation of Mandatory Availability- Section 103(c)(1) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2327) is amended--
- (1) by striking 'last day of Program Year 2' and inserting 'termination date established under section 108(a)'; and
  - (2) by striking the paragraph heading and inserting 'IN GENERAL- '.
- (d) Duration of Policies- Section 103(c) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2327) is amended--
- (1) by redesignating paragraph (2) as paragraph (3); and
  - (2) by inserting after paragraph (1) the following:  
'(2) MANDATORY DURATION- Coverage for insured losses required by paragraph (1) under a policy issued at any time during Program Year 5 shall remain in effect for not less than 1 year following the date of issuance of the policy, except that no loss occurring after the earlier of the expiration date of the subject insurance policy or December 31, 2008, shall be considered to be an insured loss for purposes of this title.'

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(e) Insured Loss Shared Compensation- Section 103(e) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2328) is amended--

(1) in paragraph (2)(A), by striking 'ending on' and all that follows through 'Program Year 3' and inserting 'ending on the termination date established under section 108(a)'; and

(2) in paragraph (3), by striking 'ending on' and all that follows through 'Program Year 3' and inserting 'ending on the termination date established under section 108(a)'.

(f) Aggregate Retention Amount- Section 103(e)(6) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2328) is amended--

(1) in subparagraph (B), by striking 'and' at the end;

(2) in subparagraph (C), by striking the period at the end and inserting a semicolon; and

(3) by adding at the end the following:

    '(D) for Program Year 4, the lesser of--

        '(i) \$17,500,000,000; and

        '(ii) the aggregate amount, for all insurers, of insured losses during such Program Year; and

    '(E) for Program Year 5, the lesser of--

        '(i) \$20,000,000,000; and

        '(ii) the aggregate amount, for all insurers, of insured losses during such Program Year.'

### **SEC. 4. COVERAGE OF GROUP LIFE INSURANCE.**

Section 103 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2327) is amended by striking subsection (h) and inserting the following:

    '(h) Applicability to Group Life Insurance-

        '(1) IN GENERAL- The Secretary shall, by rule, apply the provisions of this title to providers of group life insurance, in the manner determined appropriate by the Secretary, consistent with the purposes of this title.

        '(2) CONSISTENT APPLICATION- The rules of the Secretary under this subsection shall, to the extent practicable, apply the provisions of this title to providers of group life insurance in a similar manner as those provisions apply to an insurer otherwise under this title.

        '(3) CONSIDERATIONS- In determining the applicability of this title to providers of group life insurance, and the manner of such application, the Secretary shall consider the overall group life insurance market size, and shall consider the establishment of separate retention amounts for such providers.

        '(4) RULEMAKING REQUIRED- Not later than 90 days after the date of enactment of the Terrorism Risk Insurance Extension Act of 2005, the Secretary shall issue final regulations to carry out this subsection.

        '(5) RULE OF CONSTRUCTION- Nothing in this subsection may be construed to affect or otherwise alter the applicability of this title to any insurer, as defined in section 102.

        '(6) DEFINITION- As used in this subsection, the term 'group life insurance' means an insurance contract that provides term life insurance coverage, accidental death coverage, or a combination thereof, for a number of persons under a single contract, on the basis of a group selection of risks.'

**SEC. 5. RECOMMENDATIONS FOR LONG-TERM SOLUTIONS.**

Section 108 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note, 116 Stat. 2328) is amended by adding at the end the following:

`(e) Recommendations for Long-Term Solutions- The Presidential Working Group on Financial Markets shall, in consultation with the NAIC, representatives of the insurance industry, and representatives of policy holders, not later than June 30, 2006, submit a report to Congress containing recommendations for legislation to address the long-term availability and affordability of insurance for terrorism risk.'

**ATTACHMENT B**

**National Symposium on the Future of Terrorism Risk Insurance**

*Agenda*

- 8:00 a.m.      **Continental breakfast/Registration**
- 8:30            **Introduction/Welcoming Remarks**  
                  **John E. Cox, Jr.**, President, The Communications Institute  
                  **Randolph Hall, Ph.D.**, Principal Investigator & Co-Director, CREATE;  
                  Senior Associate Dean for Research, Viterbi School of Engineering, USC  
                  **Michael Wermuth**, Director, Homeland Security, RAND
- 8:45            **The Terrorism Threat: Insuring for the Future**  
                  **Admiral James Plehal**  
                  Director of Infrastructure Analysis and Information Assurance  
                  United States Department of Homeland Security
- 9:00            **The Economics of Terrorism Insurance**  
                  **Neil A. Doherty, Ph.D.**, Chair, Insurance and Risk Management,  
                  The Wharton School, University of Pennsylvania
- 9:30            **Trends in Terrorism and the Architecture of TRIA**  
                  **Robert T. Reville, Ph.D.**, Co-Director, Center for Risk Management  
                  Policy, RAND Corporation  
                  **Peter Chalk, Ph.D.**, Associate Political Scientist, RAND Corporation
- 10:00          **Break**
- 10:15          **Can Insurance Cover Weapons of Mass Destruction?**
  - **Bio-Terrorism**  
                  **Terry O'Sullivan, Ph.D.**, Postdoctoral Researcher, CREATE, USC
  - **Nuclear Weapons**  
                  **Greg Jones**, Senior Researcher, RAND
  - **Radiological Weapons**  
                  **Detlof von Winterfeldt, Ph.D.**, Co-Director, CREATE,  
                  Professor of Public Policy and Management, USC
  - **Covering WMD**  
                  **David Torregrosa**, Economist, Congressional Budget Office
- 11:15          **Industry Response: How We Will Prepare for the Threat**
  - **Hemant H. Shah**, President & CEO, Risk Management Solutions, Inc.  
                  (RMS)

## **CHSWC Background Paper on Terrorism and Workers' Compensation**

- **Peter S. Lowy**, CEO, Westfield Corporation, Inc.
- **Debra Ballen**, Executive Vice President, American Insurance Association, (AIA)
- **Jacques E. Dubois**, Chairman, Swiss Re America Holding Corporation

12:15 p.m.     **Luncheon – Special Address**

**Introduction: Randolph Hall, Ph.D.**

**Presentation:**

**Mark Warshawsky, Ph.D.**

Assistant Secretary for Economic Policy  
United States Department of the Treasury

1:30     **Insurance and the Catastrophic Loss of Human Life:  
Workers' Compensation, Life Insurance, and Victim Compensation**

- **Lloyd Dixon, Ph.D.**, Senior Economist, RAND Corporation
- **Scott Harrington, Ph.D.**, Professor of Health Care Systems, The Wharton School, University of Pennsylvania
- **Peter Ulrich**, Managing Director, Enterprise Risk Management, RMS

2:30     **Stakeholder Discussion**

- **David Bellusci**, Chief Actuary, California Workers' Compensation Insurance Ratings Bureau
- **Julie Butcher**, General Manager, Services Employee International Union (SIEU), Los Angeles
- **Brian Melas**, Senior Vice President, Commercial Markets, Liberty Mutual Insurance Company
- **Greg Serio**, Managing Partner, Park Strategies; Former Insurance Commissioner, New York State

3:15     **Closing Remarks: The Future of Terrorism Insurance**

3:30     **Adjournment**

# Trends in Terrorism

## Threats to the United States and the Future of the Terrorism Risk Insurance Act

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Peter Chalk, Bruce Hoffman,  
Robert Reville, Anna-Britt Kasupski



CENTER FOR TERRORISM  
RISK MANAGEMENT POLICY



## CHSWC Background Paper on Terrorism and Workers' Compensation

The research described in this report was conducted by the RAND Center for Terrorism Risk Management Policy.

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## Summary

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### Introduction

The Terrorism Risk Insurance Act of 2002 (TRIA) was crafted in the aftermath of the 9/11 attacks after the insurance industry, stung by \$32 billion in damage claims (by current estimates) and fearing another attack of equal magnitude, began to exclude terrorism coverage from policies. The legislation requires insurance companies to make terrorism insurance available to customers and, in return, provides federal reinsurance (a “backstop”) for losses from terrorist attacks. It is intended to give insurers time to assess their exposure to terrorism risk and to consider how to price and underwrite the risk. TRIA is set to expire at the end of December 2005.

TRIA embodies federal policy that a private insurance market will provide the foundation of the financial recovery from future terrorist attacks. It also recognizes that since the risk is unfamiliar to the industry, federal government assistance should, at least in the short run, be made available to support this market.

In this book, we examine whether this policy and, in particular, the architecture of TRIA provide robust protection against the threat of losses from future attacks. By robust, we ask specifically whether the structure of TRIA is in line with the fundamental qualities of the risk of terrorism and with likely evolving trends in this threat. The focus of the analysis is on developments that have relevance for terrorist attacks taking place within the borders of the continental United States and the extent to which they are addressed (or not) by the TRIA framework.

## **What Is The Evolving Threat?**

Al Qaeda clearly represents the principal focus of current U.S. concern about transnational terrorism. The network has not only explicitly defined its ideological and operational agenda as one directed against American citizens and property, it has also demonstrated a proven capability to effectively employ land, air, and sea modalities against target venues that have ranged from hotels to state-of-the-art warships. Nothing suggests that the group's hardcore leadership has changed its views since December 2003, when bin Laden vowed to pursue Americans "in their own backyard."

That said, it is evident that the character of al Qaeda today differs markedly from what it was when it organized and executed the suicide attacks of September 11, 2001. The loss of its safe haven in Afghanistan, combined with the capture and/or elimination of many of its critical field commanders and functionaries, has forced the group to reconfigure its operational agenda—away from centrally controlled strategic assaults executed by an inner core of jihadist activists and toward tactically oriented strikes undertaken by affiliated cells (and sometimes individuals) as and when opportunities arise. In many ways, the largely monolithic structure that emerged out of Afghanistan in the late 1990s now better correlates to an amorphous "movement of movements" that is more nebulous, segmented, and polycentric in character.

Based on these developments, one can postulate four trends that are likely to become manifest, all of which have relevance for threat contingencies in the United States:

- A continuing interest in attacking hard targets, but an increased focus on soft, civilian-centric venues.
- An ongoing emphasis on economic attacks.
- Continued reliance on suicide strikes.
- A desire to use chemical, biological, radiological, and nuclear (CBRN) weapons but little ability to execute large-scale unconventional attacks.

In addition to the terrorist threats posed by al Qaeda and both associated and independent radical jihadists, a growing groundswell of domestically inspired radicalism has emerged that appears to be based on the spreading phenomenon of anti-globalization (AG). The AG movement has had an impact on at least three homegrown entities—all of which have demonstrated, in varying degrees, an explicit penchant for violence and civilian-directed action:

- Anarchists, who resonate with the claim that international trade and commerce are, in fact, a mask designed to hide and covertly advance U.S. global economic, cultural, and political power.
- Far-right extremists, who reject the loss of individual identity associated with international movements of people, commodities, and money; who oppose the concentration of power that globalization entails; and who argue that globalization is an American-led conspiracy conducted by and for the benefit of Jewish capitalists.
- Radical environmentalists, who now routinely denigrate corporate power and capitalism (and the unrestrained discretionary spending that they entail) as posing the single greatest threat to the planet and its life.

A notable common thread in many of the trends is an increased risk for the private sector. This increase arises from the changes in the operational environment because of the Global War on Terror; the hardening of government facilities, which is shifting risk to softer targets; the rise of extremists motivated by AG and therefore hostile to corporate power; and the increased focus by al Qaeda on attacks that yield magnified economic consequences. These changes raise the stakes for ensuring a properly functioning insurance system that protects against these risks.

## Does TRIA Provide Robust Protection Against These Threats?

The results of our comparison of these trends in the underlying risk to the architecture of TRIA and the insurance market shaped by it has led to two primary conclusions:

- *TRIA does not provide adequate financial protection, particularly in the face of economically motivated attacks.* Specifically, take-up rates for terrorism insurance may be too low, thus escalating the risk of disruption after future attacks and undermining resilience. As al Qaeda increasingly advertises its interest in attacks with magnified economic consequences, and as the private sector becomes more the concerted focus of terrorist attacks, a growing necessity has emerged to fortify the institutions that buffer the economic consequences of such an attack. Insurance provides funds to compensate injured victims and the families of the deceased, sustain business operations during disruption, and rebuild damaged and destroyed assets and infrastructure. However, take-up rates at current low levels (approximately 50 percent) are likely to lead to widespread uninsured losses, which would slow recovery and magnify the economic consequences.
- *TRIA has significant gaps and is not robust to an evolving threat.* Given contemporary trends in terrorism and the current architecture of TRIA, there remains a real possibility of large uninsured losses accruing in the near-to-medium term, which will significantly impede the recovery from some future attacks. The most profound risk occurs in the area of CBRN attacks, for which insurers are not required to offer coverage (except under workers' compensation). As a result, such attacks are typically excluded from most insurance policies. Another significant gap is the exclusion of domestic attacks; while such attacks are less of a risk than imported threats, they remain real and increasingly appear to be focusing on private-sector targets. The exclusion of domestic attacks is also problematic given the increased "fran-

chising” of terrorist attacks by al Qaeda to local affiliates and the added difficulty of attributing attacks to a particular group.

## Policy Recommendations

Given these conclusions, this book emphasizes the following two suggestions:

- *Instead of allowing TRIA to sunset, particularly in the face of economically motivated terrorist attacks, Congress might prefer to consider policy measures that increase the take-up of terrorism insurance and lower its price.* These measures might include offering subsidies for the purchase of terrorism insurance or providing more risk sharing within the insurance industry in the form of lower TRIA “deductibles” for insurance companies. With lower individual company deductibles, if the entire industry’s backstop remains the same (the industry “retention” of \$15 billion), the price of terrorism insurance is likely to fall without increasing costs to taxpayers.
- *A long-term solution to providing terrorism insurance in the United States must address CBRN attacks and attacks by domestic groups.* While the extension of TRIA to domestic attacks is straightforward, extension to cover CBRN attacks poses significant challenges for insurance and may be appropriately covered through a direct government program.

Other suggestions include

- considering mandatory requirements for companies that own or operate systems vital to the functioning of U.S. critical infrastructure to carry adequate levels of insurance
- conducting further research on the ability of insurance to prompt increased security in the private sector

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- establishing an oversight board to review TRIA or its successor's performance and ensure that it is robust to changes in the underlying risk.