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The Terrorism Risk Insurance Program: Current Issues, Legislation, and Background

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Summary

After September 11, 2001, many businesses were no longer able to purchase insurance protecting against property losses that might occur in future terrorist attacks. Addressing this problem, Congress passed the Terrorism Risk Insurance Act of 2002[1] (TRIA), creating a temporary three-year program to share future insured terrorism losses with the property-casualty insurance industry and commercial policyholders. The act required insurers to offer terrorism insurance to their commercial policyholders, preserved state regulation of this type of insurance, and directed the Secretary of the Treasury to administer a program for sharing terrorism losses. Once certain conditions were met, the initial program covered 90% of insurer losses up to $100 billion each year. Responding to concerns that three years was insufficient time to allow the private sector to develop the capacity to insure terrorism risk, the 109th Congress passed the Terrorism Risk Insurance Extension Act of 2005[2] (TRIEA) to extend the program two additional years. TREIA left the program essentially intact while increasing the private sector's exposure to terrorism risk through a higher trigger, higher deductibles, greater industry loss sharing and exclusion of certain lines of insurance.

With less than one year left in the extended program, concerns are again being expressed that the private market will be unable to provide terrorism insurance without a government backstop. The House passed TRIA extension legislation (H.R. 2761) by a vote of 312-110 on September 19, 2007. Similar legislation has yet to be introduced in the Senate. This report provides an overview of the current TRIA program, general background on the issue, and a summary of current legislation. It will be updated as legislation is introduced, hearings are held, or other legislative events occur.

[1] P.L. 107-297, 116 Stat. 2322. See CRS Report RS21444, *The Terrorism Risk Insurance Act of 2002: A Summary of Provisions*, by Baird Webel.

[2] P.L. 109-144, 119 Stat. 2660. See CRS Report RL33177, *Terrorism Risk Insurance Legislation in 2005: Issue Summary and Side-by-Side*, by Baird Webel.

Current Terrorism Risk Insurance Program

The current Terrorism Risk Insurance Program, as created by the Terrorism Risk Insurance Act of 2002 (TRIA) and modified by the Terrorism Risk Insurance Extension Act of 2005 (TRIEA), "provides for a transparent system of shared public and private compensation for insured losses resulting from acts of terrorism."[3] The TRIA program is often described as a reinsurance backstop. It does not offer policies directly to insurance consumers, but operates by sharing losses due to a terrorist attack with the insurance companies which have sold policies to businesses. After certain thresholds are reached, it steps in and pays insurers for a portion of covered losses due to a terrorist act. Depending on the total size of the losses, the federal payments made to individual insurers may or may not be recouped through assessments on all those covered by TRIA in the years following the attack. TRIA is limited to covering $100 billion in insured losses and relieves insurers of liability for losses over this amount. What, if anything, that could be done in the event of losses exceeding $100 billion is a question left to a future Congress.

TRIA Thresholds

- TRIA applies only to an act of foreign terrorism (as certified by the Secretary of Treasury in concurrence with the Secretary of State and the Attorney General).
- TRIA applies only to commercial property/casualty insurance, excluding federal crop insurance, private mortgage insurance, title insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, reinsurance, commercial automobile insurance, burglary and theft insurance, surety insurance, professional liability insurance (except for directors and officers liability), and farm owners multiple peril insurance.
- Aggregate industry insured losses in a given year must exceed $100 million (the "Program Trigger").
- Before payments are made to an individual insurer, that entity's losses must exceed 20% of the value of its direct earned premiums from the previous year (the "Insurer Deductible").

Once these thresholds are met, TRIA covers 85% of the insured losses caused by a terrorist attack. If the total insured losses are under $27.5 billion (the "Aggregate Retention Amount"), then all of the insurers covered by TRIA would be assessed a recoupment fee, not to exceed 3% of premium, until the federal share of the losses has been repaid. The Secretary of the Treasury has the authority to set the exact recoupment percentage, as well as the authority to extend the recoupment fee and require payment to the government beyond the $27.5 billion amount required by law.

Unlike private reinsurance, the TRIA program charges no premiums for the reinsurance coverage provided by the program. The law, however, does place requirements on insurers. Specifically, all insurers are required to offer coverage for

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[3] U.S. Treasury Department, Treasury Terrorism Risk Insurance Program, *Overview*, available at [http://www.ustreas.gov/offices/domestic-finance/financial-institution/terrorism-insurance].

terrorism risk "that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism."[4] The policyholders, however, are not required to purchase this offered terrorism coverage.

Background on Terrorism Insurance and TRIA

Prior to the September 2001 attacks on the United States, insurers generally did not exclude or separately charge for terrorism risks. The events of September 11, 2001, however, changed this, as insurers realized the extent of possible losses from terrorism. Estimates of insured losses from the 9/11 attacks are around $35 billion in current dollars, the largest man-made insurance disaster on record.[5]

The heaviest insured losses were absorbed by foreign and domestic reinsurers — the insurers of insurance companies. Because of the lack of data on or modeling of terrorism risk, reinsurers felt unable to price for such risks, and they largely withdrew from the market for terrorism risk insurance. Once reinsurers stopped offering coverage for terrorism risk, primary insurers, who also suffered from a lack of data and models, also withdrew or tried to withdraw from the market. In most states, state regulators must approve policy form changes, and state regulators generally agreed to insurer requests to exclude terrorism risks from their commercial policies, just as they had long excluded war risks. Terrorism risk insurance was soon unavailable or extremely expensive, and many businesses were no longer able to purchase insurance that would protect them in future terrorist attacks. Although most data were anecdotal, this problem was widely thought to pose a threat of serious harm to the real estate, transportation, construction, energy, and utility sectors, in turn threatening the broader economy.

Responding to the perceived problem, Congress passed TRIA in November 2002. TRIA's stated goals were to (1) create a temporary federal program of shared public and private compensation for insured losses to allow the private market to stabilize; (2) protect consumers by ensuring the availability and affordability of insurance for terrorism risks; and (3) preserve state regulation of insurance. The act's initial structure is essentially still in place. The federal government's liability in the event of a terrorist attack, however, was higher at the beginning of the program, and it has decreased through the life of the program. This decrease in the federal liability, and resulting increase in private liability, was intentional; it was hoped that this would spur the private market to develop the financial capacity and other infrastructure necessary to begin insuring terrorism risk without a government program.

The development of a private market for terrorism risk did not proceed with the speed hoped for when TRIA was passed. Soon after TRIA's enactment, the insurance industry and others, worried about a possible absence of terrorism insurance and viewing terrorism risk as essentially uninsurable, began calling for an extension of the program, or some other longer-term solution. Responding to concerns about a continuing lack of

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[4] 15 U.S.C. § 103(c).

[5] See "Terrorism Risk and Insurance," Insurance Information Institute website, available at [http://www.iii.org/media/hottopics/insurance/terrorism/].

private market in terrorism risk insurance, Congress passed a two-year extension bill, TRIEA, near the end of 2005. This act continued the first act's trend of decreasing the federal government's liability in the case of a terrorist attack. Not only were the monetary thresholds increased, but additional lines of insurance were also excluded. **Table 1** details the evolution of the various aspects of the TRIA program through the five program years to date.

Table 1. TRIA Program from 2002 to 2007

	2003	2004	2005	2006	2007
Program Trigger	$5 million	$5 million	$5 million	$50 million	$100 million
Insurer Deductible	7%	10%	15%	17.5%	20%
Industry Retention	$10 billion	$12.5 billion	$15 billion	$25 billion	$27.5 billion
Federal Share	90%	90%	90%	90%	85%
Excluded Insurance Lines	federal crop insurance, private mortgage insurance, title insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, reinsurance			As before plus: commercial automobile insurance, burglary and theft insurance, surety insurance, professional liability insurance (except for directors and officers liability), and farm owners multiple peril insurance	

The passage of TRIEA exposed significant policy differences between the House and the Senate on how to deal with terrorism risk insurance. The Senate bill (S. 467, 109th Congress), which was backed by the President and eventually enacted,[6] kept the same TRIA structure while further scaling back federal involvement. The House bill (H.R. 4314, 109th Congress) was more varied. H.R. 4314 would have extended TRIA and also would have revised the program extensively. Changes that H.R. 4314 would have implemented included expanding the program to cover domestic terrorist events; increasing the types of insurance covered to include group life and specific coverage for nuclear, biological, chemical, and radiological (NBCR) events; implementing a different insurer deductible for different lines of insurance; and creating TRIA Capital Reserve Funds (CRF), which would allow insurers to set aside untaxed reserves to tap in the case of a terrorist event.

[6] S. 467 was first passed by the Senate on November 18, 2005. The House replaced the text of S. 467 with the large majority of the language from H.R. 4314 before passing S. 467 on December 7, 2005. The Senate then responded by replacing the House text with S.Amdt. 2689, a slightly modified version of S. 467 as the Senate had previously passed the bill. This version of S. 467 passed the Senate on December 16, 2005 and the House on December 17, 2005.

TRIA Extension Legislation in the 110th Congress

Both the House and the Senate held hearings early in the 110th Congress on the future of TRIA. The Senate Banking, Housing, and Urban Affairs Committee acted first with a hearing on February 28, 2007, entitled "Examining the Terrorism Risk Insurance Program," while the House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held two hearings. The first "The Need to Extend the Terrorism Risk Insurance Act" was a field hearing held in New York City on March 5, 2007, and the second "Policy Options for Extending the Terrorism Risk Insurance Act" occurred on April 24, 2007.

Terrorism Risk Insurance Revision and Extension Act of 2007 (TRIREA). Representative Michael Capuano, along with 23 cosponsors, introduced H.R. 2761 on June 18, 2007. Referred to the Financial Services Committee, the bill was the subject of a hearing in that committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises on June 21, 2007. It was marked up by the subcommittee on July 24, 2007, and by the full committee on August 1, 2007, where it was ordered to be favorably reported to the full House by a vote of 49-20. The committee report (H.Rept. 110-318), including the required cost estimate from the Congressional Budget Office (CBO), was filed on September 6, 2007. The House considered the bill under a special rule (H.Res. 660) on September 19, 2007, and ultimately passed it by a vote of 312-110. The following summary focuses on action on the bill after committee consideration. For more complete information see CRS Report RL34025, *Terrorism Risk Insurance: Issue Analysis and Legislation*, by Baird Webel.

As reported by the Financial Services Committee, H.R. 2761 included the following changes to the existing TRIA program:

- Extended the TRIA program for 15 years, until the end of 2022.
- Added coverage for domestic terrorist acts to the program.
- Added the Secretary of Homeland Security to the certification process.
- Added group life insurance to the program with a separate set of retentions and deductibles.
- Returned farmowners multiple peril as a covered line.
- Reduced of the general trigger to $50 million.
- Required that insurers cover nuclear, biological, chemical, and radiological (NCBR) terrorist attacks starting in 2009.
- Lowered the individual insurer deductible for NCBR attacks to 7.5%.
- Temporarily preempted state laws on rate and form filing for NCBR coverages.
- Provided possibility of relief from NBCR requirement to smaller insurers.
- Reset individual insurer deductibles to 5% and the program trigger to $5 million in the aftermath of a future terrorist attack (or series of attacks) that causes more than $1 billion in damage. Deductible reset is only for insurers who suffer losses.
- Increased the post-reset insurer deductibles by 0.5% per year.
- Established a "Terrorism Buy-Down Fund" that would essentially allow insurers to put aside reserves that would grow tax-free to cover future

losses that are not reimbursed by TRIA. The fund would also be available to the Secretary of the Treasury to cover the federal share of TRIA losses.

- Indexed the dollar amounts in the program to an unspecified measure of inflation.
- Restricted life insurers' use of foreign travel as an underwriting tool.

Prior to floor consideration of H.R. 2761, CBO issued a cost estimate which found that the bill would increase the deficit or reduce the surplus by $8.4 billion from 2008 to 2017. This meant that the bill as reported would run afoul of the PAYGO rule passed by the House at the beginning of the 110th Congress.[7] In response, the special rule (H.Res. 660) under which TRIREA was considered on the House floor included a self-executing amendment that inserted language into H.R. 2761 requiring the subsequent passage by Congress of a joint resolution before any funds could be expended. This requirement for future congressional action introduces uncertainty to the TRIA program that did not exist before. It is unclear exactly how the insurance market might react to this uncertainty, should this language become law.

H.Res. 660 made in order two amendments and a motion to recommit with instructions for subsequent consideration on the House floor. The manager's amendment (H.Amdt. 801) by Chairman Barney Frank changed the bill to include the NBCR deductible in the reset provisions, modified the certification process for an NCBR attack, indexed the dollar amounts in the bill to inflation as measured by the Consumer Price Index, and made a variety of technical an conforming changes. It passed by a vote of 426-1. The other amendment (H.Amdt. 802) was offered by Representative Steve Pearce. It would have increased the rise in the deductible under the post-attack reset provisions from 0.5% per year to 1% per year. This amendment failed by a vote of 194-230. The motion to recommit with instructions was offered by Representative David Drier and failed by a vote of 196-228. On final passage, the bill was approved by a vote of 312-110.

[7] See CRS Report RL33850, *The House's "Pay-As-You-Go" (PAYGO) Rule in the 110th Congress: A Brief Overview*, by Robert Keith, for more information on PAYGO. The CBO score of H.R. 2671 was similar to the scores issued for the prior TRIA laws. The current House PAYGO provisions, however, were not in effect at the time of passage of these laws.