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Terrorism Risk Insurance: A Summary of Legislative Proposals

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Summary

The insurance industry faces an estimated $40 billion to $70 billion in claims tied to terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001, and it remains exposed to significant risk from possible future terrorist acts. As a result of these events, insurance companies have become reluctant to provide insurance against losses arising from possible terrorist attacks, and are seeking exclusions for terrorism coverage in many policies, including commercial lines, and personal automobile, homeowners, and group life. This threatened lack of terrorism coverage in commercial and personal insurance policies could have a significant impact on a broad range of businesses and personal consumers.

The Bush Administration, insurance trade associations, and Members of Congress have made various proposals to establish a federal "backstop" of the private insurance (reinsurance) mechanism for the peril of terrorism. A federal backstop would involve taxpayer funds through loans or direct assistance to pay claims resulting from future terrorist attacks.

With time running out before Congress adjourns for the year, finding consensus on the design of a mechanism for insuring terrorism risks has been difficult. On November 29, 2001, the House passed H.R. 3210, largely along party lines. Action now turns to the Senate, where several Senators have introduced competing bills. Should Congress not pass legislation and state insurance regulators not allow terrorism exclusions from commercial and personal policies, insurers could face serious financial consequences.

This report discusses and compares the House bill and three competing Senate bills – S. 1743, S. 1744, and S. 1751. This report will be updated as events warrant.

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Introduction

The insurance industry faces an estimated $40 billion to $70 billion in claims tied to terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001, and it remains exposed to significant risk from possible future terrorist acts.[1] As a result of these events, insurance companies have become reluctant to provide insurance against losses arising from future terrorist attacks, and are seeking exclusions for terrorism coverage in many policies, including commercial lines, and personal automobile, homeowners, and group life. This threatened lack of terrorism coverage in commercial and personal insurance policies could have a significant impact on a broad range of businesses and personal consumers.

The Bush Administration, insurance trade associations, and Members of Congress have made various proposals to establish a federal "backstop" of the private insurance (reinsurance) mechanism for the peril of terrorism.[2] A federal backstop would involve taxpayer funds through loans or direct assistance to pay claims resulting from future terrorist attacks. With time running out before Congress adjourns for the year, however, finding consensus on the design of a mechanism for insuring terrorism risks has been difficult. On November 29, 200, the House passed H.R. 3210, largely along party lines, by a vote of 227 to 193. Action now turns to the Senate, where several Senators have introduced competing bills (S. 1743, S. 1744 and S. 1751). A major point of contention are proposal that would prohibit victims of future terrorist acts from collecting punitive damages from building or business owners.[3] Should Congress not pass legislation and state insurance regulators not allow terrorism exclusions from commercial policies, insurers could face serious financial consequences.[4]

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[1]See, *Impact of Terrorist Attacks on the U.S. Insurance Industry*, by Rawle O. King, CRS Report RS21053, Oct. 17, 2001.

[2]Several insurance trade associations have contributed to the overall industry-sponsored proposal. These groups are the American Insurance Association, the Reinsurance Association of America, the National Association of Independent Insurers, and the National Association of Mutual Insurance Companies.

[3]See, *Insurance Exclusion Clauses and Coverage of the Events of September 11*, by Christopher A. Jennings, CRS Report RL31166, October 17, 2001.

[4]Steven J. Dreyer, "Insurance Company Ratings Could Suffer in Federal-State Squeeze on Terrorism Risks," *Standard & Poors*, Nov. 12, 2001.

Insuring Future Terrorist Acts

Following the September 11, 2001 terrorist attacks on the World Trade Center and the Pentagon, major reinsurers announced that they would no longer cover acts of terrorism in their reinsurance contracts with primary insurers. Reinsurance is generally written on a one-year basis, and approximately 70% of commercial insurance policies expire on December 31, 2001. If primary insurance companies cannot obtain reinsurance for the risk of terrorism going forward, many have indicated that they intend to exclude it specifically from future policies.[5] The unavailability of terrorism risk insurance could impede the ability of lenders to finance commercial property acquisitions and new construction, and thus impair the nation's economic recovery. Insurers want the federal government to provide last resort reinsurance coverage or facilitate its provision in the private sector.

Insurers have threatened to withdraw from writing terrorism coverage for two reasons. *First,* they want to limit their capital base from the exposure to very large future terrorism-related claims, and possible rating downgrades by rating agencies. Insurers claim they cannot afford another payout of the kind incurred on September 11th. They indicate that they did not anticipate risks related to acts of terrorism on that scale and, therefore, did not collect sufficient premiums (or establish loss reserves) to cover liabilities for terrorism specifically.[6] Mindful of their ultimate loss exposures relative to their capital strength, some insurers could invoke the "act of war" exclusions in regard to new attacks in the United States, even though the industry has so far been unanimous in not invoking that exclusion for claims stemming from the September 11th events.

Second, with some $150 billion in statutory capital backed by a global reinsurance base of about $250 billion, the problem for the U.S. commercial property and casualty industry is not one of solvency; rather, it is one of uncertainty and difficulty of the underwriting and pricing of future terrorism risks without distorting markets.[7] This uncertainty stems from insurers' inadequate understanding of the characteristics of terrorist risks for events on the scale of September 11th, and the likelihood of another occurrence, as well as the potential magnitude of possible future acts of terrorism. If insurers cannot actuarially predict losses, based on past experience, then they will have great difficulty in setting appropriate premiums. Under these circumstances, insurers are likely either not to provide coverage or to be highly selective in providing coverage.

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[5] See, *Terrorism Insurance in the Post September 11 Marketplace*, by S. Roy Woodall, Jr., CRS Report RS21075, Nov. 26, 2001.

[6] Calmetta Coleman, "Buffett Say Insurers Made Mistakes on Terrorism As Berkshire Post Loss," *The Wall Street Journal,* Nov. 12, 2001, p. B3.

[7] Standard & Poor's Insurance Commentary, *Maintenance of Insurance Ratings Depends on Mitigating Terrorism Risks*, New York, Oct. 19, 2001.

Legislative Proposals

To address potential reinsurance capacity shortage, particularly in commercial property insurance, congressional committees are considering several proposals for a federal backstop to maintain a market for terrorism risk insurance. Table 1 provides a comparison of terrorism risk insurance legislative proposals. There is not yet a consensus proposal.

Terrorism Risk Protection Act (H.R. 3210)

On November 29, 2001, the House of Representatives passed H.R. 3210, the Terrorism Risk Protection Act (TARPA). H.R. 3210 provides for the establishment of a temporary risk-sharing government loan program to cover 90% (after $5 million deductible) of terrorism-related insured losses of commercial insurers above $1 billion for the entire industry (or lesser amounts if individual insurers are particularly affected as specified by the bill – i.e., losses from terrorism exceed 10% of the capital surplus and 10% of the net premium for an individual commercial insurer). Federal financial assistance to commercial property and casualty insurers would be in the form of a repayable loan, rather than direct terrorist disaster assistance. The program would be administered by the Secretary of the Treasury.

Claims paid by Treasury would be repaid through charges assessed on insurers and purchasers (surcharges) of commercial property and casualty insurance. Specifically, if covered losses were to exceed $20 billion, insurers could recoup part of their costs through a premium surcharge of up to 3% on commercial policyholders. Under H.R. 3210 there would be a "deductible" in 2002, which could be as low as $100 million.

The bill also includes liability modifications provisions that would preclude punitive damage awards from being levied on defendants who were not involved in terrorist acts and limit defendants' liability for non-economic damages to their portion of responsibility. The program would end December 31, 2002, but could be extended to 2004.

National Terrorism Reinsurance Fund Act (S. 1743)

S. 1743 would create a temporary (three year) reinsurance fund administered by the Secretary of Commerce through which participating commercial insurers would pay assessments and receive federal reinsurance protection against losses related to acts of terrorism. The fund and its assessment mechanisms would provide the first $50 billion of protection for the insurance industry. All terrorism-related events that result in losses beyond $50 billion would qualify for a direct federal grant program.

On an individual company basis, a trigger of 10% of premiums would apply, after which an insurer could apply for assistance from the fund and the federal government. In the first year, the fund would cover up to 90% of an insurer's losses. For the second and third years, the fund would cover up to 80% of that insurers' losses. The maximum insured losses covered by the fund would be $100 billion. The bill does not include a liability modification provision.

Terrorism Insurance Act (S. 1744)

S. 1744 would create a temporary (two year) industry risk-sharing commercial terrorism insurance program under the auspices of the Secretary of Commerce. Commercial insurers would submit to either the Commerce Secretary or National Association of Insurance Commissioners (NAIC) information on the aggregate premium amount of terrorism coverage written. Should the Commerce Secretary determine that a commercial insurer's annual insured losses for covered lines resulting from acts of terrorism occurring in 2002 and 2003 exceeded the greater of $10 million or 5% of gross written premiums, the government would pay 80% of those losses, up to an aggregate industry limit of $100 billion. Insurers would repay the first $50 billion in insured losses through terrorism loss repayment surcharges, which would be limited to 6% of policyholder's annual premium. The surcharge would be imposed on all covered lines, which could be broad enough to apply even to insurers who excluded terrorism from coverage. The bill includes a prohibition on punitive damages arising from an act of terrorism, except for the terrorists who perpetrated the act.

Terrorism Risk Insurance Act (S. 1751)

S. 1751 would create a temporary public/private federal reinsurance program under the auspices the Secretary of Treasury, who would be authorized to develop regulations to implement the program, as well as to investigate and audit all claims. In the first two years, the industry would pay the first $10 billion of insured losses related to acts of terrorism, and then 10% of losses above $10 billion; the government would pay the remaining 90%. Should the program be extended for a third year, then 90% of insurers' losses in excess of the first $20 billion would be paid by the Treasury. The aggregate insured losses would be $100 billion. The program would be terminated on December 31, 2003, unless the Secretary of Treasury were to extend it one year to December 31, 2004.

Table 1. Comparison of Terrorism Risk Insurance Legislative Proposals (As of December 5, 2001)

Provision	S. 1751	H.R. 3210	S. 1743	S. 1744
Sponsor	Sen. Gramm, Enzi, Bennett, Bunning, Allard	Reps. Armey/Oxley/Baker	Sen. Hollings, Boxer, Wyden	Sen. McCain
Program Name	Terrorism Risk Insurance Act	Terrorism Risk Protection Act	National Terrorism Reinsurance Fund Act	Terrorism Insurance Act
Purpose	Provide a temporary public/private program for losses resulting from terrorism	Provide a temporary loan program	Provide additional reinsurance capacity to participating insurers for losses due to acts of terrorism	Provide federal assistance and create a temporary industry risk sharing program
Type of Entity	Terrorism Insured Loss Sharing Compensation Program	Federal Risk Sharing Loan Program	National Terrorism Reinsurance Program	Temporary Industry Risk Sharing Program
Form of Governance	Secretary of Treasury	Secretary of Treasury would provide oversight	Secretary of Commerce with advice and counsel from newly established 10-member Advisory Committee	Secretary of Commerce
National Terrorism Reinsurance Fund (NTRP)	None	None	Yes. Makes payments under reinsurance contracts under the Act and pays expenses of the NTRP and interest payments on funds borrowed from the Treasury. Administrative expenses could not exceed $5 million for fiscal years 2002, 2003 and 2004.	None
Underwriting Standards	None	None	Yes. Minimum underwriting standards for participating insurers	None
Monitoring of Terrorism Insurance Rates	No	No	Yes. Establishes special committee on rates.	No

Provision	S. 1751	H.R. 3210	S. 1743	S. 1744
Submission of Premium Data	No. But Treasury Secretary has access to books and records.	Yes. Insurers must submit to Treasury Secretary or to the NAIC data on net premiums written under each line of commercial property and casualty insurance in previous year.	No. Reinsurance premiums established by Commerce Secretary.	Yes. Insurers must submit to Treasury Secretary or NAIC information on premiums on each commercial line.
Funding of NTRP	NA	NA	Treasury provides a $2 billion start-up loan. Repayment of loan comes from premium assessments on participating insurers. In addition, insurers would pay into the fund an annual reinsurance contract premium up to 3% of gross direct written premiums. Insurers allowed to recover contract premium and annual assessment from surcharge (calculated as a uniform percentage of premiums charged) on covered lines from policyholders. Total amount of Treasury borrowing is $50 billion.	NA
Who Determines Occurrences?	Treasury Secretary in concurrence with the Secretary of State and the Attorney General	Treasury Secretary in consultation with Attorney General and Secretary of State decides if acts are acts that fall within the definition of terrorism or war and whether acts occurred during covered period.	Commerce Secretary determines if loss is attributable to terrorism. Determination subject to judicial review.	Secretary of Commerce
Length of Program	2 years, may be extended to a 3rd year	1 year, may be extended 2 additional years.	3 years, but fund could continue until dissolved by Commerce Secretary.	2 years

Provision	**S. 1751**	**H.R. 3210**	**S. 1743**	**S. 1744**
Trigger	Industry-wide losses exceed $10 billion in years 2002, 2003, then $20 billion if program extended to 2004.	Industry-wide losses exceed $1 billion; individual insurer trigger exceeds $100 million and some portion of such losses for any single commercial insurer exceed 10% of capital surplus and 10% of net premiums written in force at time the insured losses occurr.	Individual Insurer: Losses in excess of 10% of average gross direct written premium and policyholders' surplus for covered lines.	Individual Insurer: If losses exceed the greater of $10 million or 5% of gross premiums on covered lines
Retention Level	Over trigger, financial assistance at 90/10 of insured losses	Upon a triggering event, financial assistance shall be made available as follows: individual insurer deductible of $5 million then financial assistance at 90/10 of insured losses	Over trigger, insurer is reimbursed at 90% in 2002: 90%in 2003 if assessment of 4% is paid: 80% if assessment of 3% is paid, and 70% if assessment of 2% is paid, up to $50 billion total fund reimbursement for all participating insurers.	Over trigger, financial assistance at 80/10 of covered losses
Aggregate Limitation on Federal Assistance	$100 billion, then notice to Congress	$100 billion; losses exceeding this amount would necessitate action by Congress	Over $50 billion, 90% in 2002, 80% in 2003 or 2004, but not in excess of $100 million	$100 billion
Mandatory Lines	Commercial/ Personal	Commercial	Commercial/Personal (optional)	Commercial
Mandatory Coverage	Yes	No	Yes	No

Provision	**S. 1751**	**H.R. 3210**	**S. 1743**	**S. 1744**
Assessment	None	Treasury Secretary would impose levy assessment up to 3% of premium against all commercial insurers, based on percentage of aggregate written premiums for calendar year preceding the assessment. Secretary first determines aggregate assessment which shall be the lesser of $20 billion and total amount of financial assistance. Failure to pay assessment could result in civil monetary penalty or interest payment.	Yes. See above for percentages and years	None
Policyholder Premium Surcharge	None	If aggregate industry-wide losses exceed $20 billion, Secretary of Treasury shall establish and impose a policyholder premium surcharge (3% or premium) on commercial insurers for purposes of repaying the balance of the financial assistance provided. Commercial insurers are to charge, collect, and remit surcharge to the Treasury Secretary.	None	Yes. To repay the first $50 billion in 2002 and in 2003, but limited to 6% of policyholder's annual premium. Also imposed on all covered lines (this could be broad enough to apply even if insurer excluded terrorism from coverage).
Considers economic impact and risk factors of premium assessment and policyholder surcharge on commercial centers in urban and rural areas	No	Yes	No	No
When Is Repayment Made?	No repayment	In year following the triggering determination. Treasury Secretary could defer the payment or part or all of the assessment by an individual commercial insurer to avoid the likely insolvency of the insurer.	In year following triggering determination	Timing is up to Secretary of Commerce

Provision	**S. 1751**	**H.R. 3210**	**S. 1743**	**S. 1744**
Civil Monetary Penalties	NA	$1 million for failing to pay assessment or surcharge or providing Treasury erroneous information regarding premium or loss amounts.	NA	NA
Regulation	Treasury Secretary may prescribe reasonable procedures	Treasury Secretary may issue any regulations to carry out the Act.	Participating insurers must report terrorism coverage to state insurance regulators and obtain a certification from regulator. State regulator sends copy of certification to Commerce Secretary.	Secretary of Commerce
Credit for Reinsurance	No	No	Yes	No
Coverage for self-insurance arrangements for municipalities, port authorities, offshore and non-admitted insurers and reinsurers	No. Would not meet definition of “participating insurance company.”	Yes. By Treasury Secretary consults with NAIC.	Includes risk retention group or other authorized residual market mechanism.	Yes. By Commerce Secretary in consultation with NAIC
Deductibility of loss reserves for future acts of terrorism	No	Treasury shall conduct a study of issues surrounding amending IRC of 1986 to establish tax-favored loss reserves for future acts of terrorism. Submit study to Congress 120 days after enactment of bill.	No	No
Definition of Terrorism	Yes. But must be in excess of $5 million, and have concurrence of Treasury Secretary, Secretary of State, and Attorney General.	Sense of Congress that the NAIC, in consultation with the Treasury Secretary, should develop definitions for acts of terrorism and standards for making determinations concerning terrorist acts, which should be adopted by all states and by the Administrator.	Made by Secretary of Commerce	Yes. Determination by Secretary of Commerce based on requirements in Act plus any additional further specified after consultation with NAIC
Disclosure of Pricing of Terrorism Coverage	No disclosure required, would fall to states.	Sense of Congress that states should require separate disclosure of price of terrorism coverage, assessments or surcharges.	Must file premium with state and identify terrorism portion.	Sense of Congress that states should require separate disclosure, including surcharges.

Provision	S. 1751	H.R. 3210	S. 1743	S. 1744
Consultation with State Insurance Regulators and NAIC	No, except with respect to life insurance study	Yes, with respect to financial assistance, assessments, surcharges, and investigating and auditing claims.	Implied since NAIC is member of advisory committee	Yes
Requirement for consistent state guidelines for coverage and maintenance of reserves	No, except that federal definition of "Terrorism" preempts for purposes of compensation for insured losses.	Yes. States required to adopt uniform definitions and underwriting standards for acts of terrorism developed by the NAIC, in consultation with the Treasury Secretary.	No, for state laws as to coverage and financial requirements not applicable to contracts entered into by the fund.	Yes, NAIC, in consultation with Secretary of Commerce, and each state should adopt as to coverage standards.
Sovereign Immunity Protections	Federal cause of action in district assigned by the Judicial Panel on Multidistrict Litigation	Exclusive remedy for claims connecting to acts of terrorism that resulted in insured losses will be a federal right of action. Judicial Panel on Multidistrict Litigation will designate one or more district courts that will have exclusive jurisdiction.	None	None
Punitive Damages	Prohibited	Prohibited. With respect to pain and suffering and other non-economic damages, each defendant shall only be liable for the share of damages for which that defendant is responsible. U.S. shall have a right of subrogation with respect to any claim paid by the U.S. Attorneys fees limited to 20% of damages or 20% of any court-approved settlement. Plaintiff's recovery reduced by amount of collateral source compensation. Also, U.S. may seek protective orders to prevent disclosure of classified information.	No provision, thus would be allowed as in any other court action, federal or state.	Prohibited except against a defendant who committed the act of terrorism.
Life Insurance Industry Study	Yes	Seven-member commission established. Report due in 120 days of enactment.	No	No
Railroad and Trucking Insurance Study	No	Yes	No	No

Provision	**S. 1751**	**H.R. 3210**	**S. 1743**	**S. 1744**
Reports from Insurers	None required, except as to claims	None required	Yes. Quarterly reports submitted to Commerce Secretary, FTC, and GAO	Yes. To the extent such information is not otherwise available. Aggregate premium of each commercial line per request of Secretary of Commerce.
Study of Reinsurance Pool System for Future Acts of Terrorism	No	Yes	No	No
State Preemption	Yes, as to definition of "terrorism," prior approval rating statutes, and grant to Treasury Secretary for access to books/records	State "prior approval" rate regulation laws with respect to increasing premium rates to recover any assessments (imposed by the Treasury Secretary) are preempted. Requirements for filing and subsequent review are not preempted.	Does not supersede or preempt state law that prohibits unfair methods of competition in commerce, unfair or deceptive acts or practices in commerce, or unfair insurance claims practices.	Yes. As to regulation of insurance for acts of terrorism, including initial rates, but not subsequent review of rates by states.

Source: Congressional Research Service