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Terrorism Risk Insurance Legislation: Issue Summary and Side-by-Side

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Summary

Prior to the September 11, 2001 terrorist attacks, insurance covering terrorism losses was normally included in general insurance policies without cost to policyholders. Following the attacks, both primary insurers and reinsurers pulled back from offering terrorism coverage, citing particularly an inability to calculate the probability and loss data critical for insurance pricing. Some argued that terrorism risk would never be insurable by the private market due to the uncertainty and potentially massive losses involved. Because insurance is required for a variety of economic transactions, it was feared that a lack of insurance against terrorism loss would have wider economic impact, particularly on large-scale developments in urban areas that would be tempting targets for terrorism.

Congress responded to the disruption in the insurance market by passing the Terrorism Risk Insurance Act of 2002 (TRIA). TRIA created a temporary program, expiring at the end of 2005, to calm the insurance markets through a government backstop for terrorism losses and give the private industry time to gather the data and create the structures and capacity necessary for private insurance to cover terrorism risk. In the past three years, terrorism insurance has become widely available and largely affordable, and the insurance industry has greatly expanded its financial capacity. There has been, however, little apparent success on a longer term private solution and fears persist about wider economic consequences if insurance is not available. To a large degree, the same concerns and arguments that accompanied the initial passage of TRIA are still before Congress today.

Congress has responded to the impending expiration of TRIA with two bills that have been reported out of the committees of jurisdiction. The House bill, Representative Richard Baker's H.R. 4314, is awaiting floor consideration whereas the Senate bill, Senator Christopher Dodd's S. 467, has already been approved by the full Senate. S. 467 is entitled the Terrorism Risk Insurance Extension Act whereas H.R. 4314 is entitled the Terrorism Risk Insurance Revision Act. The titles do reflect essential differences between the two bills. S. 467 extends the current program two years and further increases the private sector's exposure to terrorism risk, as did the original act. (During the three years covered by the initial act, insurance industry deductibles and aggregate retention rose each year.) S. 467 continues to increase these and also reduces the types of insurance covered by the program and increases the size of terrorist event necessary to trigger the program. H.R. 4314 extends the program for two or possibly three years, and also substantially revises many aspects of it. Among the notable changes, it excludes some lines of coverage and includes others that were not covered before. It segments lines of insurance, introducing different deductibles for different lines. It includes the concept of resetting the deductibles and the trigger amount to lower amounts if a terrorist attack occurs in the future.

This report briefly outlines the issues involved with terrorism insurance and includes a side-by-side of the current TRIA and the legislation that is being considered to revise and extend it. It will be updated if this legislation advances.

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Prior to the September 11, 2001 terrorist attacks, insurance covering terrorism losses was normally included in general insurance policies without a specific premium being paid. Essentially most policyholders received this coverage for free. The attacks, and the more than $30 billion in insured losses that resulted from them, caused a rethinking of the possibilities of future terrorist attacks. In response to the new appreciation of the threat and the perceived inability to calculate the probability and loss data critical for pricing insurance, both primary insurers and reinsurers pulled back from offering terrorism coverage. Many argued that terrorism risk is essentially uninsurable by the private market due to the uncertainty and potentially massive losses involved. Because insurance is required for a variety of economic transactions, many feared that a lack of insurance against terrorism loss would have wider economic impact, particularly on large-scale developments in urban areas that would be tempting targets for terrorism.

Congress responded to the disruption in the insurance market by passing the Terrorism Risk Insurance Act of 2002 [1] (TRIA), which was signed by the President in November 2002. TRIA created the Terrorism Risk Insurance Program, which was enacted as a temporary program, expiring at the end of 2005, that would calm the insurance markets through a government backstop for terrorism losses and give the private industry time to gather the data and create the structures and capacity necessary for private insurance to cover terrorism risk. Terrorism insurance has become widely available under TRIA and the insurance industry has greatly expanded its financial capacity in the past three years. It appears, however, that less progress has been made on creating terrorism models that are sufficiently robust for insurers to return to offering widespread terrorism coverage without a government backstop, and that practically no progress has been made on a private pooling mechanism to cover terrorism risk. Some see the past three years as proof of the argument that the private market will never be able to offer insurance to cover terrorism risk and continue to see the possibility of wider economic consequences if terrorism insurance again is unavailable. Others, notably the U.S. Treasury Department, respond that TRIA itself is retarding the growth of this private market and should be allowed to expire, or at least be reduced from its current form.

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[1] P.L. 107-297, 116 Stat. 2322, 15 U.S.C. Sec. 6701 note. See CRS Report RS21444, *The Terrorism Risk Insurance Act of 2002: A Summary of Provisions* and CRS Report RS21979, *Terrorism Risk Insurance: An Overview*, both by Baird Webel.

Pending Legislation

Congress has responded to the impending expiration of TRIA with two bills that have been reported out of the committees of jurisdiction. The House bill, Representative Richard Baker's H.R. 4314, is awaiting floor consideration whereas the Senate bill, Senator Christopher Dodd's S. 467, has already been approved by the full Senate. S. 467 is entitled the Terrorism Risk Insurance Extension Act, whereas H.R. 4314 is entitled the Terrorism Risk Insurance Revision Act and the titles do reflect essential differences between the two bills.

S. 467

Senator Dodd introduced S. 467 on February 18, 2005. As introduced, it was identical to a bill, S. 2764, introduced by Senator Dodd in the 108th Congress. S. 467, as introduced, would have explicitly extended TRIA for two years, until the end of 2007, and would have added a "soft landing" year by changing the definition of an insured loss so that policies written in the second year and extending into a third year would be covered. The individual insurer deductible was to remain at 15% of earned premiums during the extension, while the insurance industry aggregate loss retention amount was to increase from the current $15 billion in 2005 to $17.5 billion for 2006 and finally $20 billion for 2007. S. 467 also would have directed the Treasury to promulgate new rules including group life insurance under TRIA.

On June 30, 2005, the Department of the Treasury released a report on TRIA accompanied by a letter from Secretary Snow indicating that TRIA had achieved its goal of stabilizing the insurance market and that the Administration would not support an extension without significant changes reducing the taxpayer exposure from the program. On November 16, 2005, the Senate Committee on Banking, Housing, and Urban Affairs marked up S. 467 and substituted an amendment by Chairman Richard Shelby for the original text. It reported the bill favorably to the full Senate by voice vote.

As amended, S. 467 would extend the current program two years and further increase the private sector's exposure to terrorism risk over the life of the act, as did the original legislation. During the three years covered by the initial act, insurance industry deductibles and aggregate retention rose each year. S. 467 would continue to increase these. It would also reduce the types of insurance covered by the program and increase the size of a terrorist event necessary to trigger the program. Specifically, it removes commercial auto, burglary and theft, surety, farm owners multiple peril, and professional liability (except for directors and officers liability), as covered lines; raises the insurer deductible to 17.5% in 2006 and 20% in 2007; decreases the federal share of insured losses from 10% to 15% for 2007; and raises the event trigger to $50 million in 2006 and $100 million in 2007.

S. 467 was brought to the Senate floor and passed by unanimous consent on November 18, 2005.

H.R. 4314

H.R. 4314 was introduced by Representative Baker on November 14, 2005, and marked up by the House Financial Services Committee on November 16. Three amendments, by Chairman Michael Oxley and Representatives Barney Frank and Debbie Wasserman Schultz, were adopted in committee by voice vote.[2] Chairman Oxley's amendment made a number of changes, including adjusting the exact deductibles for various insurance lines, reducing the program trigger amount in program years after the second year and striking language that would have preempted some state laws relating to rate and form filing. Representative Frank's amendment increased the size needed by a company or municipality to be considered an "exempt commercial purchaser" of insurance. Representative Wasserman Schultz's amendment added the requirement that life insurers not deny insurance coverage based on lawful overseas travel. The amended bill was favorably reported to the full House by a vote of 64-3. In the 108th Congress, the committee had reported favorably a straightforward extension of TRIA with relatively minor changes. H.R. 4313, however, goes well beyond the previously reported House bill or the changes recommended by Secretary Snow.

H.R. 4314 as reported limits the types of insurance covered by removing commercial auto insurance. However, it expands the program to cover domestic terrorist events; increases the covered types of insurance to include group life and specific coverage for nuclear, biological, chemical, and radiological (NBCR) events. It raises the event trigger to $50 million in 2006 and an additional $50 million for every future year the program is in effect. It also changes the insurer deductible but does so differently for different lines of insurance, raising it to as high as 25% for casualty insurance but lowering it to 7.5% for NCBR events. H.R. 4314 lowers the federal share of insured losses to 80% for events under $10 billion but raises it gradually to 95% for events over $40 billion. In the case of a terrorist act, the deductibles and event triggers are to reset to lower levels, with deductibles possibly as low as 5% in the event of a large attack. It removes the cap on the mandatory recoupment provision so that all money expended under TRIA would be recouped by the federal government through a surcharge on insurers in the years after the attack. H.R. 4314 also creates "TRIA Capital Reserve Funds (CRF)," which would allow insurers to set aside untaxed reserves to tap in the case of a terrorist event.

H.R. 4314 was not considered on the House floor prior to the recess that began on November 18, 2005.

Administration Reaction

The Executive Office of the President issued a Statement of Administration Policy supporting S. 467 on November 17, 2005. It also indicated that the Administration will strongly oppose "any efforts to add lines of coverage, including group life insurance, or further expand the program," which is one component of H.R. 4313 as reported.

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[2] Amendment texts can be found at [http://financialservices.house.gov/legis.asp?formmode=item&number=430].

Table 1. Side-by Side: Current Terrorism Risk Insurance Act, S. 437 and H.R. 4314

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Title	Terrorism Risk Insurance Act of 2002	Terrorism Risk Insurance Extension Act of 2005	Terrorism Risk Insurance Revision Act of 2005
Expiration Date	December 31, 2005 (Sec. 108(a))	December 31, 2007 (Sec. 2)	December 31, 2008, or December 31, 2007 if the Secretary of the Treasury determines that the "Commission on Terrorism Risk Insurance" established by the bill does not fulfill the bill's requirement to submit a report. (Sec 108(a))
"Act of Terrorism" Definition	For an act of terrorism to be covered under TRIA, it must be a violent act committed on behalf of a foreign person or interest as part of an effort to coerce the U.S. civilian population or influence U.S. government policy. It must have resulted in damage within the United States or to a U.S. airliner or mission abroad. Terrorist act is to be certified by the Secretary of the Treasury in concurrence with the Attorney General and Secretary of State. (Sec. 102(1)(A))	No Change	Removes requirement that a terrorist act must have been committed on behalf of a foreign person or interest. (Sec. 102(1)(A))

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Affiliated Insurer Definition	An affiliate is an entity, that controls, is controlled by, or under common control with an insurer. Control is defined as the power to vote 25% of an entity's shares or to appoint a majority of the board of directors. Alternately, the Secretary is given the authority to determine that one entity controls another. (Sec. 102 (2-3))	No Change	Removes the definition of "control" and redefines an affiliate as an insurer that owns, is owned by, or under common ownership with another insurer. Defines "ownership" as owning 25% or more of an insurer's voting securities. (Sec. 102(2) and 102(14))
Limitation on Act of Terrorism Certification in case of War	Terrorist act would not be covered in the event of a war, except for workers compensation insurance. (Sec. 102(1)(B)(I))	No Change	Adds group life insurance to workers compensation as covered lines in case of war. (Sec. 102(1)(B))
Aggregate Industry Loss Requirement/Program Trigger	Terrorist act must cause more than $5 million in losses to be covered. (Sec. 102(1)(B)(ii))	Raises this amount to $50,000,000 for 2006 and $100,000,000 for 2007. (Sec. 3)	Creates a "Program Trigger" that would prevent coverage under the program unless aggregate industry losses exceed $50,000,000 in 2006 and raises this limit by $50,000,000 in each successive program year. If there is a terrorist attack, the subsequent trigger amount is reduced by $10,000,000 for each $1,000,000,000 in insured losses with a lower limit of $50,000,000 (Sec 103(e)(1)(B))

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Insurer Deductible	7% of earned premium for 2003, 10% of earned premium for 2004, 15% of earned premium for 2005 (Sec. 102(7))	Raises this to 17.5% for 2006 and 20% for 2007. (Sec. 3)	Implements different deductibles for different lines of insurance, raises deductibles over time, except in the year following a terrorist attack, in which deductibles would be reduced. For 2006, deductibles would be: 16% for workers compensation, 21.5% for group life, 20% for property, and 25% for casualty insurance, unless the loss was caused by NCBR terrorism, in which case the deductible would be 7.5% for all lines. In program years after 2006, the deductibles would increase 2.0% per year for workers' compensation, 2.5% per year for group life and property, 5% per year for casualty, and 0.75% in the case of a loss in any line due to NCBR terrorism. In the case of a terrorist attack, all deductibles would be reduced in the year following by 0.1% for every $1,000,000,000 in insured loss, to a minimum of 5%. After this reduction, the annual increases would again take effect. (Sec 102(12))

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Covered lines of Insurance	Commercial property casualty insurance including excess insurance, workers' compensation, and surety but excluding crop insurance, private mortgage insurance, title insurance, financial guaranty insurance, medical malpractice insurance, health or life insurance, flood insurance, or reinsurance. (Sec. 102(12))	Adds commercial auto, burglary and theft, professional liability (except for directors and officers liability), and farm owners multiple peril to lines that are excluded from coverage. (Sec. 3)	Adds commercial auto as a line that is excluded from coverage. Adds group life insurance as a line that is included in coverage, but specifically excludes group life insurance that is either "Corporate Owned Life Insurance" or "Business Owned Life Insurance" as defined by the IRS. (Sec. 102(4), 102(8), and 102(19))
Mandatory Availability	Every insurer must make terrorism coverage that does not differ materially from coverage applicable to losses other than terrorism. (Sec 103(c))	No Change	Adds that every insurer must make coverage for NCBR terrorist events available; however, this coverage may differ materially from the coverage applicable to other losses. (Sec 103(c)(2))
Life Insurance and Travel	No Similar Provision	No Similar Provision	Adds requirement that life insurers may not deny coverage due to lawful past or future travel of an individual but may charge an actuarially based premium for this coverage. (Sec. 103(c)(2))

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Insured Shared Loss Compensation	Federal share of losses will be 90% for insured losses that exceed the applicable insurer deductible. (Sec. 103(e))	Reduces federal share of losses to 85% for 2007. (Sec. 4)	Creates a sliding scale for the federal share of losses that exceed the applicable insurer deductible. Federal share will be: 80% for years when the aggregate industry loss is less than $10,000,000; 85% for years when loss is between $10,000,000 and $20,000,000; 90% for years when loss is between $20,000,000 and $40,000,000; and 95% for years when the loss is above $40,000,000 (Sec. 103 (e)(1)(A)).
Aggregate Retention Amount Maximum	$10,000,000,000 for 2002-3, $12,500,000,000 for 2004, $15,000,000,000 for 2005 (Sec. 103(6))	Raises amount to $17,500,000,000 for 2006 and $20,000,000,000 for 2007. (Sec. 5)	No similar provision
Mandatory Recoupment of Federal Share	If insurer losses are under the aggregate retention amount, a mandatory recoupment of the federal share of the loss will be imposed. If insurer losses are over the aggregate retention amount, such recoupment is at the discretion of the Secretary of the Treasury. (Sec. 103(7))	No Change	Requires the Secretary to collect full recoupment of federal financial assistance. (Sec 103(e)(8))

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Recoupment Surcharge	Surcharge is limited to 3% of property-casualty insurance premium and may be adjusted by the Secretary to take into account the economic impact of the surcharge on urban commercial centers, the differential risk factors related to rural areas and smaller commercial centers, and the various exposures to terrorism risk across lines of insurance. (Sec. 103(8))	No Change	No Change
Preservation and Preemption of Existing State Law	Preserves all existing regulatory authority and jurisdiction of the states except that exclusions for terrorism existing at the time of the act's enactment are annulled, but can be reinstated by the insurer with the agreement of the insured (Sec. 105), the definition for "Act of Terrorism" in the act shall preempt any state definitions for purposes of the act, partial preemption of state rate and form filing requirements until the end of 2003, and insurers are required to provide books and records relevant to the program at the request of the Secretary notwithstanding any state laws to the contrary. (Sec. 106(a))	No Change	Preserves all existing state authority and jurisdiction except that: the definition for "Act of Terrorism" in the act shall preempt any state definitions for purposes of the act, some state laws relating to surplus lines placements are preempted to streamline such placements, and states are required to streamline their rate and filing system. (Sec 106)

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Litigation Management	Litigation arising out of a certified terrorist attack must be filed in federal court and state jurisdiction is preempted. Any punitive damages awarded in such an action shall not be included in any insured damages payable under TRIA. (Sec. 107)	Adds a section codifying existing Treasury regulations. (Sec. 6)	No Change.
Studies and Reports	Calls for a study of the need to include group life insurance under TRIA (Sec. 103 (h)), a study and report of the potential impact of terrorism on life insurance and other lines of insurance (Sec 103 (g)), and a study assessing the effectiveness of the program, the likelihood of the private industry insuring against terrorism after the program expiration, and the availability and affordability of such insurance. (Sec. 108(d)).	Calls for an analysis and report, not later than September 30, 2006, from the President's Working Group on Financial Markets, in consultation with various stakeholders, on the longer term availability and affordability of terrorism risk insurance including particularly group life coverage and coverage against chemical, nuclear, biological, and radiological events. (Sec. 7)	Calls for studies and reports to be completed by September 1, 2006 by the Comptroller General on (1) the exposure of personal lines of insurance to terrorism risk, (2) the risks from NBCR terrorist events, and (3) the need for a federal natural disaster catastrophe program. (Sec. 103 (h-j)) Requires report from the Commission on Terrorism Risk Insurance (see below) with specific recommendations for a possible future replacement of the program to be completed by December 31, 2006. (Sec. 105)

Provision	15 U.S.C. 6701 note	S. 437 (as passed)	H.R. 4314 (as reported)
Capital Reserve Funds	No Similar Provision	No Similar Provision	Allows the establishment of TRIA capital reserve funds (CRF) from premiums paid for terrorism coverage. These funds are to be held by the insurer on behalf of the Secretary of the Treasury. The CRF are to be used first by the Secretary toward the federal share of future terrorism losses. Funds used by the Secretary would be replenished by the mandatory recoupment surcharge. Any remaining funds not used by the Secretary may be used by the insurers toward their terrorism losses. If the program expires, 90% of the unused funds would be returned to the insurer and 10% would be remitted to the Treasury. (Sec 103(e)(2) and 103(e)(9)(F))
Commission on Terrorism Risk Insurance	No Similar Provision	No Similar Provision	Establishes an 11-member commission with a wide range of stakeholders, primarily from the insurance industry. In addition to a report on the need for, and possible future replacement of the program, the commission is to make recommendations regarding possible actions to encourage private insurance coverage of terrorism risk and specifically evaluate the TRIA Capital Reserve Funds. (Sec 105)

Note: H.R. 4314 would strike all of 15 U.S.C. 6701 note (which sets out sections 101-108 of P.L. 107-297) except for Sec. 107 and replaces it with a similar structure, including in some cases, identical language. The section numbers for H.R. 4314 cited in this side-by-side are, therefore, those that would appear in the Code if the bill were enacted. In contrast, S. 467 would simply amend 15 U.S.C. 6701 note. The section numbers for S. 467 cited in this side-by-side are those of that bill itself