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Terrorism Risk Insurance: An Overview

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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 enacted the Terrorism Risk Insurance Act of 2002[1] (TRIA) to create a temporary program to share future insured terrorism losses with the property-casualty insurance industry and policyholders. The act requires insurers to offer terrorism insurance to their commercial policyholders, preserves state regulation of this type of insurance, and directs the Secretary of the Treasury to administer a program for sharing terrorism losses. The three-year program that TRIA created backs up commercial property and casualty insurance, covering up to $100 billion each year after set insurer deductibles. The government pays 90% of insured losses over the deductible, with the insurer paying 10%.

Concern was expressed even before the enactment of TRIA that a three-year program would be too limited to allow the private sector to develop the capacity to insure terrorism risk. In the 109th Congress, two bills have been reported out of committee to extend and revise the program: S. 467 by Senator Christopher Dodd and H.R. 4314 by Representative Richard Baker. S. 467 passed the Senate by unanimous consent on November 18, 2005, whereas the majority of the text from H.R. 4314 was inserted into S. 467 and subsequently passed by the House on December 7, 2005. This report provides an overview of related issues, including a summary of TRIA and the TRIA extension legislation. It will be updated as significant events occur.

Prior to the September 2001 attacks on the United States, insurers generally did not exclude or separately charge for terrorism risks. The risk of terrorism was seen as so remote that it generally was not considered in writing insurance policies. The events of September 11, 2001, however, unquestionably changed this as insurers realized the extent of possible losses. Estimates of insured losses from the 9/11 attack, which ranged as high as $75 billion in the immediate aftermath, are currently around $35 billion, still the largest man-made insurance disaster on record.

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[1] P.L. 107-297, 116 Stat. 2322.

The heaviest insured losses were absorbed by foreign and domestic reinsurers — the insurers of insurance companies. Due to the lack of data on or modeling of terrorism risk, reinsurers felt unable to price for such risks and, so, 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.

Congressional Action

Congressional action to address this perceived broad economic threat began when the House Committee on Financial Services held a hearing in September 2001. Following this, its Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held another in October 2001. Chairman Michael Oxley introduced H.R. 3210 in the 107th Congress in November 2001. During the November 29 debate on the bill, the House accepted a substitute bill by a narrow vote. The bill provided for a temporary government loan to insurers in case of acts of terrorism; it also contained controversial provisions on litigation management.

The legislation subsequently stalled over tort provisions. In the Senate, Members introduced four bills in 2001, but the chamber took no action. In June 2002, Senators Dodd, Reid, Sarbanes, and Schumer introduced a compromise proposal, S. 2600, which passed the Senate in July 2002. As passed, it did not require insurers to repay all federal assistance or contain the controversial liability reform.

The reconciling November 2002 conference report retained bill number H.R. 3210 and was subsequently passed. The President signed TRIA on November 26, 2002.

TRIA's Goals and Substance[2]

TRIA's 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.

To meet the first goal, TRIA began a short-term program for the federal government to share insured commercial property-casualty losses with the private insurance market. The program extends from enactment through December 31, 2005. The role of federal loss sharing depends on the size of the insured loss. For a small loss, there is no federal sharing. For a medium-sized loss, the federal role is to spread the loss over time and over

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[2] For a more complete description of TRIA as passed, see CRS Report RS21444, *The Terrorism Risk Insurance Act of 2002: A Summary of Provisions*, by Baird Webel.

the entire insurance industry, paying claims up-front but then recouping the payments through a broad levy on insurance policies afterwards. For a large loss, the federal government ends up paying most of the losses, although recoupment is possible in these circumstances as well.

The precise criteria under TRIA are as follows: First, the federal government shares in any insurer's losses only if the industry's aggregate insured losses from an act of terrorism exceed $5 million. Second, each insurer is responsible for paying out a certain amount in claims — known as its deductible — before it can call upon federal assistance. Its deductible is directly proportionate to a particular insurer's size, rising from 7% of earned premiums in 2003, to 11% in 2004, and 15% in 2005. Once these two thresholds are passed, the federal government pays 90% of each insurer's losses above its deductible. However, if the aggregate industry loss is under $10 billion for the year 2003, $12.5 billion for 2004, or $15 billion in 2005, the amount that is paid to individual insurers is required to be recouped through a surcharge added to all commercial insurance premiums in following years. This surcharge can be a maximum of 3% of premium and will last until the federal share is repaid. If the aggregate industry loss is greater than the $10-15 billion amount, then the law imposes no mandatory recoupment surcharge, although the Treasury Secretary is given the authority to impose such a surcharge. The maximum amount that may be paid out under the program in a given year is $100 billion.

The act covers only U.S. commercial property-casualty insured losses due to acts of international terrorism certified by the Treasury Secretary. It does not cover losses due to acts of war declared by Congress, except workers' compensation losses. Congress also "carved out" certain lines, disallowing their coverage under TRIA. The carved-out lines are: federal crop insurance, private crop or livestock insurance, private mortgage insurance, title insurance, financial guaranty insurance of single-line guaranty insurers, medical malpractice, flood insurance, reinsurance, and all life insurance products.

TRIA addressed the second goal, to protect consumers, by nullifying all commercial terrorism exclusions in force on TRIA's date of enactment. TRIA required property-casualty insurers, as a condition of receiving federal assistance, to make terrorism insurance available prospectively to their commercial policyholders by February 23, 2003. The coverage may not differ materially from coverage for other types of losses. Each offer must reveal both the premium charged for terrorism insurance and the federal share of compensation. TRIA in effect gave policyholders coverage for terrorism risk immediately, without charge, until the policyholder accepted or declined the coverage TRIA required insurers to offer. The policyholder was not, and is not, however, required to purchase coverage. If the policyholder declines, its insurer may exclude terrorism losses. TRIA does not limit what insurers could charge for terrorism risk insurance, though it does give state regulators the authority to modify excessive, inadequate, or unfairly discriminatory rates. The legislation makes this "make available" provision effective until the end of 2004, with the Treasury Secretary having the option to continue it until the end of 2005.

TRIA's third goal was to preserve state regulation of insurance. Section 106 does so expressly, with some exceptions. One exception is the definition of an "act of terrorism": TRIA's definition applies despite any other definition in state law. A second exception is TRIA's limited preemption of state rate and form filing requirements. TRIA preempts all prior approvals through December 31, 2003, though it does allow any state to invalidate an excessive or discriminatory rate and any state with prior approval authority to review policy forms after their use. Thus, states retain considerable authority over rates and terms for terrorism coverage. A third exception is TRIA's requirement that workers' compensation coverage include not only coverage for terrorism risk but also for war risk. Finally, TRIA directs the Treasury Secretary to consult with the state regulators' group, the National Association of Insurance Commissioners, on several application issues.

In addition to the determination on the "make available" provisions, Congress directed the Treasury Secretary to conduct an expedited study of whether the TRIA program should be extended to group life insurance and allowed the Secretary to extend TRIA to group life if the study determined that it should be. TRIA also directed the Secretary to "study the potential effects of acts of terrorism on the availability of life insurance and other lines of insurance coverage, including personal lines," by August 2003. The report on this study has yet to be delivered to Congress. Finally, the Secretary required a report to Congress by June 30, 2005, on the effectiveness of the program, the ability of the property-casualty industry to offer terrorism insurance after the program ends, and on "availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit."

Post-Enactment Activity

Executive Branch and Private Market

The Treasury has issued guidelines and rules for carrying out TRIA and has carried out most of the studies and made determinations as directed by Congress.[3] Three actions have drawn the most congressional attention and controversy. In August 2003, the results of its study on group life insurance were announced and the determination was made that group life not be covered under TRIA because such insurance was still readily available from primary insurers in the private market. This determination would essentially be overturned by both bills that have been introduced in the 109th Congress to extend TRIA. In June 2004, Treasury made the determination that the "make available" provisions should be extended through the end of the program in 2005, a determination that is consistent with the introduced legislation.

On June 30, 2005, the Treasury issued its report on TRIA with Treasury Secretary Snow's accompanying letter recommending against continuation of TRIA "in its present form."[4] The Secretary stressed two factors: the economy has become more robust since 9/11, and extension of TRIA would hinder the development of private insurance solutions by crowding out innovation and capacity building. In order to gain support from the Administration, the letter specifies that any TRIA extension should include an increase of the event threshold from $5 million to $500 million, increases in deductibles and co-payments and a reduction in the types of insurance covered by TRIA. These requirements differ substantially from previously introduced legislation on the topic, particularly the increase to $500 million and the reduction in the types of insurance.

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[3] See [http://www.treasury.gov/trip] for the latest details.

[4] See:[http://www.ustreas.gov/press/releases/js2618.htm].

Early reports on TRIA's required offers of coverage suggested that terrorism coverage was considered too expensive for many policyholders to purchase, as high as 30% of an overall insurance policy's cost,[5] and take-up rates were as low as the 10% range.[6] Premiums have dropped significantly though 2003 and 2004. Marsh Inc. reports that the median cost for terrorism coverage was 10.8% of the overall policy cost in early 2003, but had dropped to 4.3% at the end of 2003 and then climbed slightly to 4.7% at the end of 2004.[7] This percentage rise, however, was due to a drop in the other policy costs, not because of an actual rise in the cost of terrorism coverage Unsurprisingly, take-up rates have climbed as prices are dropping, reaching 49% at the end of 2004.[8]

Congress

Oversight and Hearings. Congressional oversight continued after enactment, with hearings in both the House and the Senate in April and May 2004. The principal points of concern expressed in these hearings were the Treasury's prior decision to exclude group life insurance from coverage under TRIA, the then upcoming Treasury decision on the "make available" provisions, and the possibility of a general extension of the act past its scheduled sunset date. Support for some sort of extension of the program was expressed both at the spring hearings and in a June 4, 2004 letter to Secretary Snow signed by 190 Members of the House. Some concerns about TRIA extension were also raised at the hearings and whether all who expressed support for TRIA extension agree on the exact form of this extension was unclear as well. Officials at the Treasury Department in had previously repeatedly indicated that they expect the program to expire as the law provides. When pressed for the Administration's current position on TRIA extension at the hearings, the Treasury witnesses generally indicated no strong position, preferring instead to wait for the results of the then ongoing study (issued on June 30, 2005, and discussed above).

Through the early part of the 109th Congress, many Members and interest groups seemed largely to be waiting for the Treasury report that was expected to provide the Administration's position on possible TRIA extension. The Senate Banking, Housing, and Urban Affairs Committee did hold a general oversight hearing on TRIA on April 14, 2005. Shortly after the release of the Treasury study, both the House (July 13, 2005) and the Senate (July 14, 2005) held hearings featuring Secretary Snow explaining further the Administration's position on TRIA extension that he outlined in his June 30, 2005 letter. The House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises went further, hearing from regulators, insurers and other interested parties on "The Future of Terrorism Insurance" on July 27, 2005.

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[5] But this 30% was still lower than the cost at the end of 2002. See Gary Mogel, "Moody's 'snapshot': Terror premiums lower," *National Underwriter (Property and Casualty Edition)*, vol. 107, May 5, 2003, p. 18.

[6] "Brokers, Insurers Struggle with Rollout of Terror Coverage," *BestWire*, Apr. 8, 2003.

[7] *Marketwatch: Property Terrorism Insurance 2004*,Marsh, Inc., Apr. 2004, p. 21 and *Marketwatch: Property Terrorism Insurance 2005*,Marsh, Inc., Apr. 2005, p. 9.

[8] *Marketwatch: Property Terrorism Insurance 2005*, p. 6.

TRIA Extension Legislation. Two bills, S. 467 and H.R. 4313, have been reported out of committee to extend and revise TRIA. Different versions of S. 467 have passed both the Senate and the House.[9]

S. 467 was introduced in the 109th Congress by Senator Dodd on February 18, 2005, prior to the Treasury report. It was marked up in the Senate Banking, Housing, and Urban Affairs Committee on November 16, 2005. The Committee amended the bill substantially before reporting the bill favorably. S. 467, as reported, extends the program by two years and leaves the framework largely intact while further limiting federal government exposure, as suggested by Treasury Secretary Snow. Specifically, it removes a number of types of insurance (commercial auto, burglary and theft, surety, farm owners multiple peril, and professional liability, except for directors and officers liability); raises the insurer deductible to 17.5% in 2006 and 20% in 2007; increases the insurer co-payment from 10% to 15% for 2007; and raises the event trigger to $50 million in 2006 and $100 million in 2007. After the markup, the bill was brought to the Senate floor and passed by unanimous consent on November 18.

H.R. 4314 was introduced by Representative Richard Baker on November 14, 2005, and marked up by the House Financial Services Committee on November 16. Relatively minor amendments were made in committee, including language prohibiting life insurers from denying coverage due to lawful travel undertaken by individuals. H.R. 4314, as reported, extends TRIA and revises the program extensively. It limits the types of insurance covered by removing commercial auto, but it expands the program to cover domestic terrorist events. Also, it increases the types of insurance covered 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 the deductible to as much as 25% for casualty insurance but lowering it to 7.5% for NCBR events. H.R. 4314 would raise the insurer co-payment to 20% for events under $10 billion while raising it gradually to 5% for events over $40 billion. In the event of a terrorist event, the deductibles and event triggers would 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. The majority of the text of H.R. 4314 was inserted into S. 467, and the House passed this bill on December 7, 2005.

The Executive Office of the President issued a Statement of Administration Policy supporting S. 467 on November 17, 2005. This was followed on December 7, 2005, by a statement opposing the House-passed version of the bill as inconsistent with the objectives of reducing taxpayer exposure and promoting private market solutions.

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[9] For additional information, see CRS Report RL33177, *Terrorism Risk Insurance Legislation: Issue Summary and Side-by-Side*, by Baird Webel.