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CRS Report for Congress

The Terrorism Risk Insurance Program: Current Issues 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 the three-year program was too limited 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 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. Chairman Christopher Dodd of the Senate Banking, Housing, and Urban Affairs Committee and Chairman Barney Frank of the House Financial Services Committee have both indicated that addressing terrorism insurance will be a priority this year.

This report provides an overview of the current TRIA program, how the program has changed over time, and general background on the issue. It will be updated as legislation is introduced, hearings are held, or other legislative events occur.

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[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 Terrorism Risk Insurance Act of 2002 (TRIA) and modified by 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, 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, to do to address losses exceeding $100 billion is a question that remains unanswered.

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 due to 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

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

requirements on insurers. Specifically, all insurers are required to offer coverage for 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 risk of terrorism was seen as so remote that it generally was not specifically considered in writing insurance policies. The events of September 11, 2001, however, changed this, as insurers realized the extent of possible losses. 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. Due to 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 initial act's structure was essentially that currently in place as described above. The federal government's liability in the event of a terrorist attack, however, was higher in 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 enactment, the insurance industry and others worried about a possible absence of terrorism insurance began calling for an

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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/].

extension of the program, or some other longer-term solution as they saw terrorism risk as essentially uninsurable. Responding to concerns about a continuing lack of 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 thresholds increased, but also additional lines of insurance were excluded. **Table 1** details the evolution of the various aspects of the TRIA program through the five program years to date.

The passage of TREIA exposed significant differences of approach between the House and the Senate on how to deal with terrorism risk insurance. The Senate's approach, which was backed by the President and eventually prevailed, was to keep the same TRIA structure while further scaling back federal involvement. The House approach, embodied in the 109th Congress' H.R. 4314,[6] was more varied. H.R. 4314 would have extended TRIA and also would have revised the program extensively. Changes that H.R. 4313 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.

Table 1. TRIA Program from 2002-2007

	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	

[6] H.R. 4314 was marked up by the House Financial Services Committee on November 16, 2006. The large majority of the language from H.R. 4314 was then inserted in the S. 467 before this bill was passed by the House on December 7, 2006.

Issues and Outlook for the 110th Congress

Passage of TRIEA extended the government backstop for two years, through the end of 2007. This extension, however, did relatively little to answer some of the fundamental questions surrounding terrorism insurance and federal involvement in this insurance. It seems likely that this Congress will need to address many of the same questions that have marked TRIA debates in the past. Such questions may include the following:

- Should there be a government terrorism insurance program at all?
- Should group life insurance be covered in such a program?
- How should the possibility of nuclear, biological, chemical, or radiological terrorism be treated?
- How should terrorism risk be shared between the government and private insurers?
- Should insurer reserves for future terrorism losses enjoy tax-preferred status?

Both the House and the Senate have held hearings in the 110th Congress on the future of TRIA. The Senate Banking Committee acted first with a hearing on February 28, 2007, entitled "Examining the Terrorism Risk Insurance Program," and the House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing entitled "Policy Options for Extending the Terrorism Risk Insurance Act" on April 24, 2007. At the time of this writing, no TRIA legislation had been introduced in either the House or the Senate.