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Terrorism Risk Insurance: An Overview

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Abstract. The three-year program that TRIA created backed up commercial property and casualty insurance, covering up to $100 billion each year after set insurer deductibles. The government would have paid 90% of insured losses over the deductible, with the insurer paying 10%. 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 (TRIEA) to extend the program two years, leaving it essentially intact while increasing the private sector's exposure to terrorism risk. With less than one year left in the extended TRIA, concerns are again being expressed that the private market will be unable to provide terrorism insurance without a government backstop. Both Chairman Chris Dodd of the Senate Banking, Housing, and Urban Affairs Committee and Chairman Barney Frank of the House Financial Services Committee have indicated that addressing terrorism insurance will be a priority this year. This report provides an overview of related issues, including a summary of the original TRIA and the TRIA extension legislation.

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CRS Report for Congress

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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 program to share future insured terrorism losses with the property-casualty insurance industry and 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. The three-year program that TRIA created backed up commercial property and casualty insurance, covering up to $100 billion each year after set insurer deductibles. The government would have paid 90% of insured losses over the deductible, with the insurer paying 10%.

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 (TRIEA)[2] to extend the program two years, leaving it essentially intact while increasing the private sector's exposure to terrorism risk. With less than one year left in the extended TRIA, concerns are again being expressed that the private market will be unable to provide terrorism insurance without a government backstop. Both Chairman Chris Dodd of the Senate Banking, Housing, and Urban Affairs Committee and Chairman Barney Frank of the House Financial Services Committee have indicated that addressing terrorism insurance will be a priority this year. This report provides an overview of related issues, including a summary of the original TRIA and the TRIA extension legislation. It will be updated as significant 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.

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, changed this as insurers realized the extent of possible losses. Current estimates of insured losses from the 9/11 attack, are around $32 billion, still the largest man-made insurance disaster on record.[3]

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. Responding to the problem, Congress passed the Terrorism Risk Insurance Act in November 2002.

TRIA's Goals and Substance

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 extended from enactment through December 31, 2005. The role of federal loss sharing depended on the size of the insured loss. For a small loss, there was no federal sharing. For a medium-sized loss, the federal role was to spread the loss over time and over 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 was to pay most of the losses, although recoupment was possible in these circumstances as well.

The precise criteria under TRIA were as follows: First, the federal government would have shared in any insurer's losses only if the industry's aggregate insured losses from an act of terrorism exceeded $5 million. Second, each insurer would have been responsible for paying out a certain amount in claims — known as its deductible — before it could call upon federal assistance. Its deductible was directly proportionate to a particular insurer's size, rising from 7% of earned premiums in 2003 to 11% in 2004,

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

and 15% in 2005. Once these two thresholds are passed, the federal government would have paid 90% of each insurer's losses above its deductible. However, if the aggregate industry loss was under $10 billion for Program Year 1 (2003), $12.5 billion for Year 2 (2004), or $15 billion for Year 3 (2005), the amount that would have been paid to individual insurers was required to be recouped through a surcharge added to all commercial insurance premiums in following years. This surcharge could be a maximum of 3% of premium and would last until the federal share was repaid. If the aggregate industry loss was greater than the $10 billion - $15 billion amount, then the law imposed no mandatory recoupment surcharge, although the Treasury Secretary was given the authority to impose such a surcharge. The maximum amount that could be paid out under the program in a given year was $100 billion.

The act covered only U.S. commercial property-casualty insured losses due to acts of international terrorism certified by the Treasury Secretary. It did 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 were 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 could 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. The policyholder was not, however, required to purchase coverage. If the policyholder declined to do so, its insurer could exclude terrorism losses. TRIA did not limit what insurers could charge for terrorism risk insurance, though it did give state regulators the authority to modify excessive, inadequate, or unfairly discriminatory rates. The legislation made this "make available" provision effective until the end of 2004, with the Treasury Secretary having the option, subsequently exercised, to continue it until the end of 2005.

TRIA's third goal was to preserve state regulation of insurance. Section 106 did so expressly, with some exceptions. One exception was the definition of an "act of terrorism": TRIA's definition applied despite any other definition in state law. A second exception was TRIA's limited preemption of state rate and form filing requirements. TRIA preempted all prior approvals through December 31, 2003, though it did 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 retained considerable authority over rates and terms for terrorism coverage. A third exception was TRIA's requirement that workers' compensation coverage include not only coverage for terrorism risk but also for war risk. Finally, TRIA directed 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. The subsequent study determined that TRIA should not be extended to group life insurance.

2005 TRIA Extension Legislation

On June 30, 2005, the Treasury issued a 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 had 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. 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.

Two bills, S. 467 and H.R. 4313, were reported out of committee to extend and revise TRIA. Different versions of S. 467 passed both the Senate and the House by early December 2005.[5]

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, extended the program by two years and left the framework largely intact while further limiting federal government exposure, as suggested by Treasury Secretary Snow. Specifically, it removed additional types of insurance (commercial auto, burglary and theft, surety, farm owners multiple peril, and professional liability, except for directors and officers liability); raised the insurer deductible to 17.5% in 2006 and 20% in 2007; increased the insurer co-payment from 10% to 15% for 2007; and raised 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, extended TRIA and revised the program extensively. It limited the types of insurance covered by removing commercial auto, but it expanded the program to cover domestic terrorist events. Also, it increased the types of insurance covered to include group life and specific coverage for nuclear, biological, chemical, and radiological (NBCR) events. It raised the event trigger to $50 million in 2006 and an additional $50 million for every future year the program is in effect. It also changed the insurer

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

5 For additional information, see CRS Report RL33177, *Terrorism Risk Insurance Legislation in 2005: Issue Summary and Side-by-Side*, by Baird Webel.

deductible, but did 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 have raised the insurer co-payment to 20% for events under $10 billion while lowering 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 removed 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 would have created 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.

Although the House called for a conference committee reconciling the differences between the two bills, the Senate did not. Ultimately, a further amendment to S. 467, S.Amdt. 2689, passed the Senate on December 16, 2005, and the House followed, passing S. 467 as amended on December 17, 2005. The President signed the Terrorism Risk Insurance Extension Act of 2005 into law as P.L. 109-144 on December 22, 2005.

P.L. 109-144 closely tracks the Senate version of S. 467 as amended by the Senate Banking Committee. The only substantial difference is an increase of the aggregate industry retention amount from $17.5 billion and $20 billion to $25 billion and $27.5 billion for 2006 and 2007.

Issues and Outlook for the 110th Congress

Passage of TRIEA extended the government backstop for two years until 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 confront 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?