

# CRS Report for Congress

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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<sup>1</sup> (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 109<sup>th</sup> Congress, two bills have been introduced: S. 467 by Senator Christopher Dodd and H.R. 1153 by Representative Michael Capuano. The Senate Banking Committee held an oversight hearing on TRIA on April 14, 2005. On June 30, 2005, the Treasury issued a report opposing the extension of TRIA, on the grounds that the economy has improved since 9/11 and that TRIA has the effect of crowding out innovation and capacity building by private insurers. This report provides an overview of the 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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<sup>1</sup> 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 107<sup>th</sup> 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, which was subsequently passed. The President signed it on November 26, 2002, and it became P.L. 107-297, also known as TRIA.

## **TRIA's Goals and Substance<sup>2</sup>**

TRIA's goals are 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

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<sup>2</sup> 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.

that 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 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. This "make available" provision is in effect 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 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. These include treatment of captive insurers, studies required by the act, and access to information about rates.

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 must 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 in stages, with additional rules still expected,<sup>3</sup> and is also carrying out the studies and making determinations as directed by Congress. 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. In June 2004, Treasury made the determination that the “make available” provisions should be extended through the end of the program in 2005. Aside from the group life determination, Treasury’s actions have generally not been viewed as controversial to date. It is possible, however, that if losses due to another terrorist attack on the United States occur, Treasury’s rules on issues such as certifying “an act of terrorism,” certifying and paying claims, determining insurer and policyholder shares, and approving settlements could become controversial.

Early reports on TRIA’s required offers of coverage suggested that premiums were considered too expensive for many policyholders to purchase, as high as 30% of a policy’s

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

cost,<sup>4</sup> and take-up rates were as low as the 10% range.<sup>5</sup> Premiums have dropped significantly though 2003 and into 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.<sup>6</sup> Unsurprisingly, take-up rates have climbed as prices are dropping reaching 46.3% in the second quarter of 2004.<sup>7</sup>

On June 30, 2005, the Treasury issued its report on TRIA and recommended that the act not be extended. Treasury's analysis 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.<sup>8</sup>

## 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. Letters supporting an extension of the "make available" provisions were sent to the Secretary of the Treasury in April by both the majority and minority sides of the House Financial Services Committee. As was noted above, the Secretary made the determination on June 18, 2004, that the make available provisions would be extended to the end of 2005.

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 the past have 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 ongoing study (which was issued on June 30, 2005, and opposed extension).

In the 109<sup>th</sup> Congress, the Senate Banking, Housing, and Urban Affairs Committee held an oversight hearing on TRIA on April 14, 2005.

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<sup>4</sup> 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.

<sup>5</sup> "Brokers, Insurers Struggle with Rollout of Terror Coverage," *BestWire*, Apr. 8, 2003.

<sup>6</sup> *Marketwatch: Property Terrorism Insurance 2004*, Marsh, Inc., Apr. 2004, p. 21.

<sup>7</sup> "Marsh: Demand for Terror Cover Rises," *BestWire*, Aug. 26, 2004.

<sup>8</sup> See: [<http://www.ustreas.gov/press/releases/js2618.htm>].

**TRIA Extension Legislation.** Two bills, S. 467 and H.R. 1153, have been introduced in the 109<sup>th</sup> Congress to extend TRIA, while three bills were introduced in the 108<sup>th</sup> Congress. One of these bills, H.R. 4634, was reported favorably by the Financial Services Committee to the full House but proceeded no further in the legislative process. All the legislation has provided for extension of the program without fundamental restructuring, however, the bills do make some changes and differ on specific points. Differences include, the treatment of group life insurance, the size of the individual insurer deductible, the size of the aggregate industry loss retention amount, and the exact length of the extension, in particular the inclusion of what has been called a “soft landing” year in which new policies would not be covered but policies written in the previous year would be covered by TRIA.

Senator Dodd introduced S. 467 on February 18, 2005. S. 467 is identical to the bill, S. 2764, introduced by Senator Dodd in the 108<sup>th</sup>. The bill would explicitly extend TRIA for two years, until the end of 2007, but also would add 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 is to remain at 15% of earned premiums during the extension, while the insurance industry aggregate loss retention amount is to increase from the current \$15 billion in 2005 to \$17.5 for 2006 and finally \$20 billion for 2007. S. 467 would extend the make available provisions for two years and would direct the Treasury to promulgate new rules including group life insurance under TRIA.

Representative Capuano introduced H.R. 1153 on March 8, 2005. H.R. 1153 would extend the TRIA sunset date and “make available” provisions for two years. It would also explicitly provide for a soft landing year in 2008, the “Final Program Year.” The aggregate loss retention threshold would be raised to \$17.5 billion in 2006 and \$20 billion in 2007. Also in 2007, the individual insurer deductible would be raised from 15% to 20%. Group life insurance is to be explicitly included in the program under the same rules as regular property/casualty insurance. It should be noted that, while Representative Capuano also introduced a TRIA extension bill, H.R. 4772, in the 108<sup>th</sup> Congress, the current bill is not a reintroduction of the older bill. Instead, H.R. 1153 largely follows the amended version of H.R. 4634 as it was reported favorably from the House Financial Services Committee on November 18, 2004. That bill, however, did not include a final program year as the current H.R. 1153 does.