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United States House of Representatives
Committee on Financial Services
2128 Rayburn House Office Building
Washington, D.C. 20515

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RANKING MEMBER

October 10, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: Protecting America: A Review of the Terrorism Risk Insurance Program

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The Subcommittee on Housing, Community Development and Insurance and the Subcommittee on National Security, International Development, and Monetary Policy will hold a joint legislative hearing entitled, "Protecting America: A Review of the Terrorism Risk Insurance Program" at 2:00pm. on Wednesday, October 16, 2019, in room 2128 of the Rayburn House Office Building. This will be a single-panel hearing with the following witnesses:

- **Chlora Lindley-Myers**, Director, Missouri Department of Commerce and Insurance, *on behalf of* the National Association of Insurance Commissioners
- **Dawn Dinkins**, COO, Reinsurance of AXA XL, *on behalf of* the Reinsurance Association of America
- **Joe Carter**, Acting CEO, United Educators, *on behalf of* the American Property Casualty Insurance Association
- **John Doyle**, President & CEO, Marsh
- **Baird Webel,** Specialist in Financial Economics, Congressional Research Service

Background

The September 11, 2001 terrorist attacks resulted in estimated insured losses of more than $45 billion in current dollars, the largest insured losses from a non-natural disaster on record.[1] Prior to these terrorist attacks, terrorism coverage was generally included in commercial insurance policies without a separate charge for its inclusion. However, due to the catastrophic losses that insurance and reinsurance companies sustained as a result of the attacks of September 11th, the insurance industry began to exclude or deny coverage for terrorism risk altogether, making this coverage unavailable or extremely expensive. Analysts warned that the disappearance of affordable terrorism risk coverage would negatively affect the larger U.S. economy due to the importance of commercial insurance in a variety of business transactions.[2]

In response, Congress passed the Terrorism Risk Insurance Act of 2002 (TRIA), which established the first federal backstop for terrorism risk insurance. Specifically, TRIA established the Terrorism Risk Insurance Program (TRIP) within the Department of Treasury to provide

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[1] Insurance Information Institute (III), Background on: Terrorism Risk and Insurance

[2] See, e.g. The Real Estate Roundtable, "Terror Insurance Drag on Real Estate Still Climbing," Sep. 19, 2002

federal reinsurance in the event of catastrophic losses. The stated goal of TRIA was to "protect consumers by addressing market disruptions and ensure the widespread availability and affordability of property and casualty insurance for terrorism risk."[3] TRIA was originally intended to be a temporary fix to "allow for a transitional period for the private markets to stabilize…"[4] However, due in large part to the lack of public data on, or modeling of, the scope and nature of terrorism risk, which has proven to be a persistent issue, insurers and other stakeholders have continued to advocate for the need for TRIA to maintain stability in the market and ensure the availability of affordable terrorism risk insurance. Congressed has reauthorized TRIA three times since its enactment, in 2005, 2007, and 2015. There was a lapse in TRIA in early January 2015 when Congress failed to provide a timely reauthorization. TRIP is now set to expire at the end of December 2020.

Terrorism Risk Insurance Program

Mandatory Offer and Scope of Coverage. Under TRIA, insurers are required to make available, in all of their commercial property and casualty insurance policies (except those specifically excluded in statute), coverage for terrorism risks that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from other risks. The definition of property and casualty insurance policies covered under TRIA includes workers' compensation, business interruption, and many types of liability insurance, but does not include health insurance, life insurance, medical malpractice insurance, auto insurance, and several other types of insurance coverage that are explicitly excluded in statute. TRIA does not specifically address about coverage for nuclear, biological, chemical, or radiological (NBCR) risks, which were typically excluded by insurers before September 11, 2001 and continue to be excluded form most policies today this is generally not the case with workers compensation insurance because states require workers compensation insurance policies to include terrorism risk without exclusions. TRIA also does not specifically address about coverage of cyber terrorism risks, but Treasury has provided guidance clarifying that stand-alone cyber insurance policies are included in the definition of property and casualty insurance under TRIA.[5]

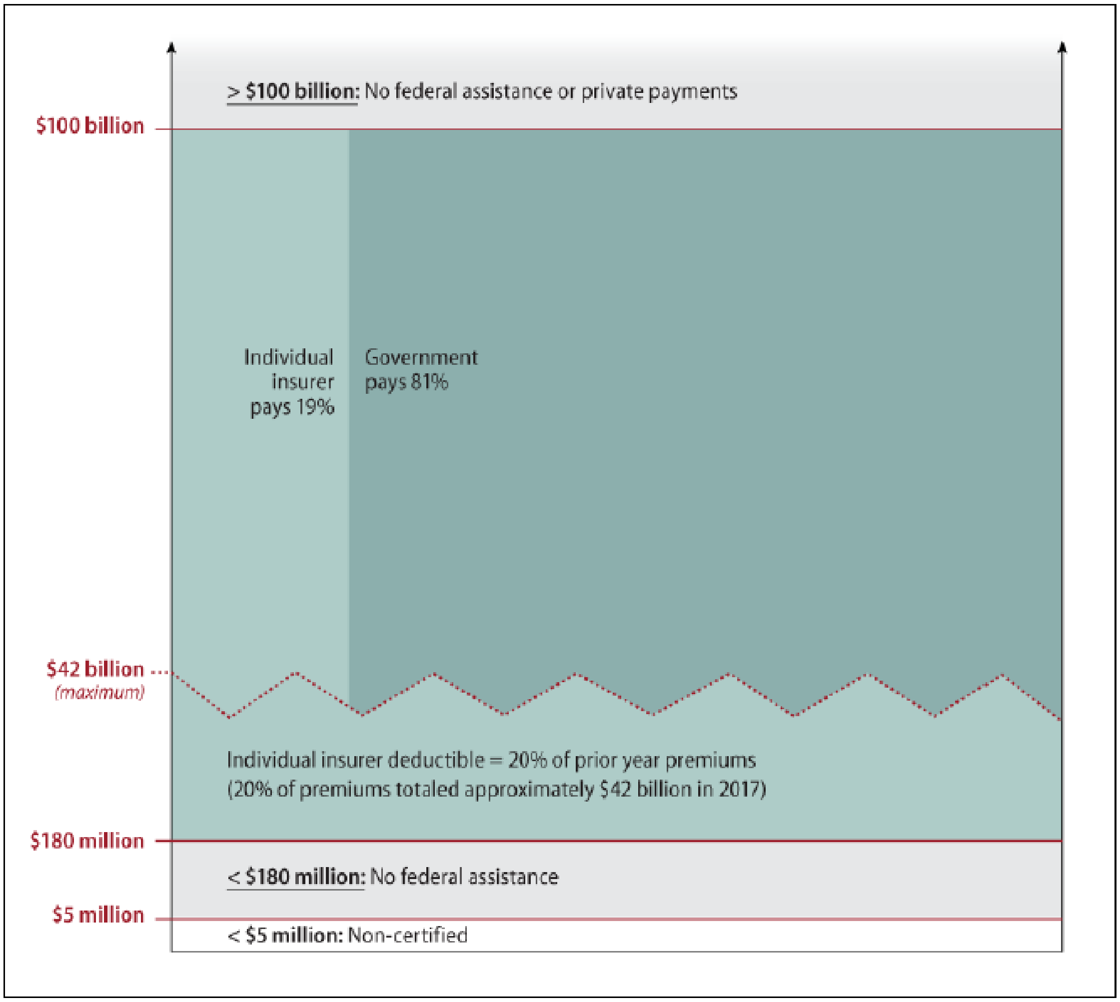
"Certified" Act of Terrorism and the "Program Trigger." In order to support the private market in providing coverage for terrorism risks, TRIA provides a mechanism for the federal government to share losses with the private sector in the event of catastrophic losses. The federal government's involvement only occurs if certain thresholds and requirements are met. First, the terrorist act must be certified by the Secretary of the Treasury, in consultation with the Secretary of Homeland Security, and the U.S. Attorney General. In order to be certified, the terrorist act must meet a few statutory requirements, including having resulted in property and casualty insurance losses exceeding $5 million for an individual event. The 2007 reauthorization of TRIA removed the requirement that a certified act of terror be committed by a foreign actor or interest, making it possible for terrorist acts committed by domestic actors or interests to be eligible for certification if other requirements are met. Second, the aggregate losses covered under TRIA for all certified terrorist acts in a given calendar year must exceed the "program trigger," which is

[3] P.L. 107-297; 116 Stat. 2322, codified at 15 U.S.C. §6701 note.
[4] *Id*.
[5] Department of Treasury, "Guidance Concerning Stand-Alone Cyber Liability Insurance Policies Under the Terrorism Risk Insurance Program," 81 Federal Register 95313, Dec. 27, 2016.

$180 million in 2019 and set to increase to $200 million in 2020. There has never been a certified act of terrorism since the enactment of TRIA and no federal loss sharing has occurred.

Deductible, Coinsurance, and Cap. If the first and second conditions are met, an individual insurer can then only benefit from TRIA if it reaches and exceeds a deductible of 20 percent of its annual premiums. For the largest companies, this deductible exceeded $2 billion in 2018.[6] For losses exceeding the insurer's deductible the federal government provides coinsurance to cover 81 percent of losses while the insurer covers 19 percent. TRIA provides a maximum cap of $100 billion in annual, aggregate losses covered under TRIA, such that the federal government will not provide assistance exceeding this cap, and insurers will not be liable for losses exceeding this cap.

Figure 1. Initial Loss Sharing Under Current TRIA Program



Source: Congressional Research Service (CRS), adapted from Congressional Budget Office, *Federal Reinsurance for Terrorism Risks: Issues in Reauthorization*, August 1, 2007, p. 12.

Note: Aggregate of all individual insurer deductibles totaled approximately $42 billion in 2017, according to Department of the Treasury data and CRS calculations. Loss sharing is likely to begin well under this amount as the distribution of terrorism losses is unlikely to be equally spread among insurers.

[6] According to the Congressional Research Service, calculated using Treasury data.

Recoupment. If all of these conditions are met and the federal government steps in to cover a share of the losses, the Treasury Secretary is then required to establish surcharges on TRIA-eligible property and casualty insurance policies to recoup a portion or all of the federal assistance that it paid out. Specifically, for attacks that result in losses covered under TRIA below the "aggregate retention amount," the Treasury Secretary is required to recoup 140 percent of the federal assistance provided with all of the recoupment occurring by the end of FY2024. The aggregate retention amount for 2019 is defined as the lesser of $37.5 billion and the aggregate amount of all losses covered under TRIA for all insurers during a calendar year.[7] For events exceeding the aggregate retention amount, the Treasury Secretary has discretion to recoup some or all of the federal assistance provided beyond the threshold. This provides flexibility for the Treasury Secretary to limit recoupment surcharges if there is a risk of market disruption due to the impact of the surcharges on affordability.

<u>Reforms Enacted Since Inception</u>

Since the enactment of TRIA, Congress has made several reforms in subsequent reauthorizations to increase the amount of risk borne by insurers while increasing the amount that the federal government must recoup. For example, the insurer deductible has increased from 7 percent to 20 percent and the mandatory recoupment percentage increased from 100 percent to 140 percent. Some of these changes still have not fully been implemented. For example, the federal share of coinsurance beyond the insurer's deductible was at 15 percent in the 2015 reauthorization but scheduled to increase annually by 1 percent until it reaches 20 percent in 2020. See the Appendix for more detailed information on the changes that have been made and are still scheduled to take place. According to the Congressional Budget Office, the aggregate retention amount is now high enough that insurers and commercial policyholders would bear all or almost all of the losses that would follow an attack similar in size to the 9/11 attacks.[8] According to the Congressional Research Service, continuing to increase the amount of risk borne by insurers "could eventually result in TRIA effectively sharing little terrorism risk and blunting the effectiveness of the program in the event of a terrorist attack."[9]

The Market for Terrorism Risk Insurance Today

According to a 2018 Treasury report,[10] 78 percent of all TRIA-eligible policies included terrorism risk insurance coverage, and these entities paid an average of 2.5 percent of their total premiums for terrorism risk alone in 2017. It was the first year that Treasury collected and reported data on cyber insurance, and Treasury data showed that the take-up rate for cyber insurance covering terrorism risk is similar to the take-up rates generally, and that terrorism risk insurance premiums comprised a relatively small percentage of total cyber premiums charged. Treasury data also showed that the take-up rate for terrorism risk insurance did not vary significantly by region (74 percent in the Northeast, 82 percent in the Midwest, 76 percent in the South, and 82 percent in the West). Based on this and other data in the report, Treasury came to the following findings about the effectiveness of TRIA in meeting its intended purposes:

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[7] In 2020, the aggregate retention amount is set to change (see Appendix for more info).
[8] CBO, "Federal Reinsurance for Terrorism Risk in 2015 and Beyond," June 2015.
[9] CRS, "The Terrorism Risk Insurance Act," February 1, 2019.
[10] Treasury, "Report on the Effectiveness of the Terrorism Risk Insurance Program," Jun. 2018.

1. The Program generally has been effective in making terrorism risk insurance available and affordable in the insurance marketplace.
2. The 2016 and 2017 data collected by Treasury indicates that the market for terrorism risk insurance has been relatively stable over this two-year period, with few observable differences in relevant benchmarks, such as price and take-up rate.
3. Treasury has not observed any aspects of the Program (either based upon the collected data or operation of the Program generally) that have had the effect of discouraging or impeding insurers from providing P&C insurance in general, or coverage for acts of terrorism specifically.
4. The Program serves as an important backstop to workers' compensation insurance, given that under state law, workers' compensation insurance must cover terrorism risk, is not subject to limits of liability, and cannot exclude causes of loss, which can pose extreme aggregation risks.
5. Treasury's estimate of total earned premiums for terrorism risk insurance from 2003 to 2017 is approximately $37.6 billion (excepting captive insurers), which is between 1 and 2 percent of the total premiums earned in the TRIP-eligible lines of insurance during that period.

The insurance industry and entities that purchase terrorism risk insurance coverage generally agree with Treasury that TRIA has been effective. In fact over 300 entities signed onto a coalition letter to Members of Congress supporting a clean, long-term reauthorization of TRIA.[11] Others have questioned the need for TRIA, arguing that the industry is "overcapitalized" and should be able to sustain future losses,[12] or arguing that the federal government is providing reinsurance coverage that the private sector could cover.[13] However, industry and other stakeholders disagree with such assertions, arguing that due to the unique nature of terrorism risks and the persistent lack of public data on, or modeling of, the scope and nature of terrorism risk, the private sector is unable to provide affordable coverage for these risks without a federal backstop.[14]

Legislation

- H.R. 4634, from Chairwoman Waters, which would reauthorize the TRIP for ten years.

[11] Available at: https://www.uschamber.com/letters-congress/coalition-letter-reauthorization-of-the-terrorism-risk-insurance-act-tria

[12] See e.g. Consumer Federation of America, "Growing Insurer Surplus Calls into Question Need for Congressional Renewal of Government-Backed Terrorism Insurance," May 28, 2019.

[13] See e.g. Heritage Foundation, "After 12 years of TRIA, It's Time to Let he 'Temporary' Program Expire" Dec. 10, 2014.

[14] *See, e.g*. Insurance Information Institute, "A World Without TRIA: Incalculable Risk," Sep. 2019.

Appendix: Select Provisions of TRIA Reauthorization Acts

	2002 Reauthorization	**2005 Reauthorization**	**2007 Reauthorization**	**2015 Reauthorization**
"Program trigger"	$5M	$50M (2006) $100M (2007)	$100M	$100M (2015) $120M (2016) $140M (2017) $160M (2018) $180M (2019) $200M (2020)
Insurer deductible	7% (2003) 10% (2004) 15% (2005)	17.5% (2006) 20% (2007)	20%	20%
Federal share of coinsurance	90%	90% (2006) 85% (2007)	85%	85% (2015) 86% (2016) 87% (2017) 88% (2018) 89% (2019) 90% (2020)
Aggregate Retention Amount (Lesser of (a) the aggregate amt of insured losses for all insurers during the CY, and (b)…)	$12.5B (2004) $15B (2005)	$25B (2006) $27.5B (2007)	$27.5B	$29.5B (2015) $31.5B (2016) $33.5B (2017) $35.5B (2018) $37.5B (2019) Annual average of the sum of insurer deductibles for all insurers participating in the program for the prior 3 CYs, as determined by the Treasury Sec. (2020)
Mandatory Recoupment (percentage of the difference between aggregate retention amount and aggregate amount of uncompensated insured losses)	100%	100%	133%	140%