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TERRORISM RISK INSURANCE PROGRAM REAUTHORIZATION ACT OF 2014

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Mr. JOHNSON of South Dakota, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

R E P O R T

The Committee on Banking, Housing, and Urban Affairs, to which was referred the bill (S. 2244) to extend the termination date of the Terrorism Insurance Program established under the Terrorism Risk Insurance Act of 2002, and for other purposes, having considered the same, reports favorably thereon, with amendments, and recommends that the bill, as amended, do pass.

INTRODUCTION

On June 3, 2014, the Senate Committee on Banking, Housing, and Urban Affairs considered S. 2244, entitled "Terrorism Risk Insurance Program Reauthorization Act of 2014," a bill to extend the termination date of the Terrorism Risk Insurance Program established under the Terrorism Risk Insurance Act of 2002, and for other purposes. By a unanimous vote of 22–0, the Committee voted to report favorably the bill, as amended, to the Senate.

BACKGROUND

Insurance coverage for losses from terrorist attacks prior to September 11, 2001, were typically included in general insurance policies without specific cost to commercial policyholders. However, large losses experienced by the private insurance and reinsurance markets resulting from the September 11th attacks dramatically altered the market for terrorism risk insurance. An estimate of the insurance industry losses from the September 11th attacks was

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$31.5 billion at the time, or $41.8 billion in 2014 dollars.[1] Following the attacks, many insurance companies began to exclude losses resulting from acts of terrorism from their general policies and not offer standalone terrorism risk insurance. By early 2002, 45 states, the District of Columbia, Puerto Rico, and Guam had approved terrorism damage exclusions from standard commercial policies.[2] The withdrawal of terrorism risk insurance coverage following the September 11th attacks impacted the economy in various ways, most notably in real estate and commercial lending.[3]

To respond to the market disruption and increasing concerns about the negative economic impact following the September 11th terrorist attacks, as well as to address the inability of the private insurance and reinsurance markets to provide coverage relating to terrorism risk in a meaningful way, Congress passed the Terrorism Risk Insurance Act of 2002 (TRIA).[4] TRIA created the Terrorism Risk Insurance Program, which provided a government reinsurance backstop in the case of foreign terrorist attacks. Since originally passing TRIA in 2002, Congress has reauthorized and reformed TRIA twice (in 2005 and 2007),[5] with the last reauthorization extending the program for 7 years. Currently, the program is set to expire on December 31, 2014.

The events and aftermath from the September 11th terrorist attacks underscored that terrorism risk is a relatively unique and challenging kind of risk to underwrite from an insurance perspective. Although it has been more than a decade since the attacks, terrorism risk continues to pose significant challenges for insurers to be able to model and price the risk. In a 2014 report, the President's Working Group on Financial Markets (PWG) found that, "According to commenters, a significant challenge to pricing terrorism risk is the lack of credible empirical historical data on which to base loss projections and pricing. . . . Among others, the following impediments to more robust modeling of terrorism have been identified to the PWG: Lack of sufficient experience and historical information by which to validate a model (frequency); Unique nature of terrorism risk; Geographic concentration of terrorism risk (proximity of insured assets to perceived "targets"); Diversity of potential weapons scenarios; Number of potential targets; and Insufficient exposure data."[6]

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[1] The estimate is based on eligible lines of insurance were the Terrorism Risk Insurance Act (TRIA) law at the time of the September 11th attacks. *See* Tom LaTourrette and Noreen Clancy, RAND Corporation Policy Brief, *The Impact on Federal Spending of Allowing the Terrorism Risk Insurance Act to Expire* (Apr. 10, 2014), http://www.rand.org/pubs/research_reports/RR611.html, p. 4.

[2] Jeff Woodward, "The ISO Terrorism Exclusions: Background and Analysis," IRMI Insights, February 2002, available at http://www.irmi.com/expert/articles/2002/woodward02.aspx.

[3] Richard Hillman, then Director of Financial Markets and Community Investment for the U.S. General Accounting Office (GAO, which is now the U.S. General Accountability Office), testified before Congress in February 2002, stating: "Even in the absence of an actual terrorist event, however, there are growing indications that some sectors of the economy—notably real estate and commercial lending—are beginning to experience difficulties because some properties and businesses are unable to find sufficient terrorism coverage, at any price. If allowed to go unchecked, these difficulties are likely to increase as more insurance contracts come up for renewal over the next year. The resulting economic drag could slow economic recovery and growth." GAO, *Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities* (Feb. 27, 2002), http://www.gao.gov/products/GAO-02-472T, p. 2.

[4] P.L. 107–297.

[5] P.L. 109–144 and P.L. 110–160.

[6] President's Working Group on Financial Markets, *The Long-Term Availability and Affordability of Insurance for Terrorism Risk* (April 2014), http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/PWG_TerrorismRiskInsuranceReport_2014.pdf, pp. 15–16.

There is some data available about the terrorism risk insurance market since Congress passed TRIA. The President's Working Group on Financial Markets and others have issued reports showing various trends on pricing, premiums and capacity across a range of affected industries.[7] There have also been recent studies on TRIA's impact on Federal spending, national security, and workers' compensation insurance markets.[8] As far as take-up rates go, Marsh, Inc. has reported that only 27 percent of their commercial clients bought terrorism insurance in 2003. The take-up rate, however, climbed relatively quickly to 49 percent in 2004 and 58 percent in 2005. Since 2005, the take-up rate has leveled off around 60 percent.[9]

To date, the private insurance and reinsurance markets continue to exhibit an inability to offer coverage without a government backstop. The 2014 PWG report states, "Challenges continue to exist regarding the ability of the private market to provide terrorism risk insurance without a federal backstop, particularly with respect to the ability of insurers to model the frequency and severity of losses that could arise from acts of terrorism. Also, reinsurers and the capital markets appear reluctant to provide further support to the terrorism risk insurance market. Private reinsurance does not appear to be a sufficient substitute for the market certainty provided by TRIA."[10]

In the Fiscal Year 2015 budget, the Obama Administration announced its support of a long-term extension of TRIA, saying "In order to preserve the long-term availability and affordability of property and casualty insurance for terrorism risk, the Budget proposes to extend the Terrorism Risk Insurance Program and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality."[11]

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[7] See, e.g., President's Working Group on Financial Markets, *Terrorism Risk Insurance* (2006), http://www.treasury.gov/resource-center/fin-mkts/Documents/report.pdf, Market Conditions for Terrorism Risk Insurance (2010), http://www.treasury.gov/resource-center/fin-mkts/Documents/PWG%20Report%20Final%20January%2013.pdf, and *The Long-Term Availability and Affordability of Insurance for Terrorism Risk* (April 2014), http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/PWG_TerrorismRiskInsuranceReport_2014.pdf; Marsh, Inc., *2010 Terrorism Risk Insurance Report* (June 23, 2010), http://www.insurancemarketreport.com/LinkClick.aspx?fileticket=6HBpiRJJTgs%3D&tabid=7464, and *2013 Terrorism Risk Insurance Report* (Apr. 30, 2013), http://www.insureagainstterrorism.org/MMC%20TRIA%20Report%2004-2013.pdf.

[8] See, e.g., Henry H. Willis and Omar Al-Shahery, RAND Corporation Policy Brief, *National Security Perspectives on Terrorism Risk Insurance in the United States* (Mar. 6, 2014), http://www.rand.org/pubs/research_reports/RR573.html; Tom LaTourrette and Noreen Clancy, RAND Corporation Policy Brief, *The Impact on Federal Spending of Allowing the Terrorism Risk Insurance Act to Expire* (Apr. 10, 2014), http://www.rand.org/pubs/research_reports/RR611.html, which noted that, "In the absence of a terrorist attack, TRIA costs taxpayers little, and in the event of a terrorist attack comparable to any experienced before, it is expected to save taxpayers money." (p. 1); and Henry H. Willis and Omar Al-Shahery, RAND Corporation Policy Brief, *The Impact on Workers' Compensation Insurance Markets of Allowing the Terrorism Risk Insurance Act to Expire* (May 7, 2014), http://www.rand.org/pubs/research_reports/RR643.html.

[9] Marsh, Inc., 2013 *Terrorism Risk Insurance Report* (Apr. 30, 2013), http://www.insureagainstterrorism.org/MMC%20TRIA%20Report%2004-2013.pdf, p. 9; and President's Working Group on Financial Markets, *The Long-Term Availability and Affordability of Insurance for Terrorism Risk* (April 2014), http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/PWG_TerrorismRiskInsuranceReport_2014.pdf, p. 30.

[10] President's Working Group on Financial Markets, *The Long-Term Availability and Affordability of Insurance for Terrorism Risk* (April 2014), http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/PWG_TerrorismRiskInsuranceReport_2014.pdf, p. 37.

[11] U.S. Department of the Treasury, *The Budget in Brief—FY 2015* (Mar. 4, 2014), http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/Treasury_FY_2015_BIB.pdf, pp. 4–5.

PURPOSE OF THE LEGISLATION

On April 10, 2014, Senators Schumer, Kirk, Reed, Heller, Murphy, Johanns, Warner and Blunt introduced the Terrorism Risk Insurance Program Reauthorization Act of 2014. The legislation, as amended by the Committee, will extend TRIA for 7 years until December 31, 2021. The legislation bolsters the existing taxpayer protections the program currently has by increasing the amount of co-payments insurance companies must pay to 20 percent from the existing 15 percent. The legislation would also raise the mandatory recoupment threshold from the current $27.5 billion to $37.5 billion. The changes in co-payment and recoupment would be gradually phased in over 5 years.

As amended by the Committee, the legislation would require a GAO study on the viability and effects of the Federal Government assessing and collecting upfront premiums on insurers that offer TRIA-backed coverage. The legislation, as amended, would also require a study and rulemaking on the certification process to improve transparency and market certainty in the aftermath of any event that could realistically be certified under the program.

In considering the legislation in Committee[12], Chairman Johnson said, "This bipartisan legislation is the result of a tough but fair compromise that will extend the TRIA program for another 7 years. Congress first passed TRIA in response to the insurance industry no longer offering coverage for the commercial property market following the tragic September 11th terrorist attacks. Today the private insurance industry has returned to the marketplace and is now able to serve this vital market because of TRIA, not in spite of it. From its inception, this program was designed to protect taxpayers, and with the work of the members of this Committee, this bipartisan bill continues to bolster these protections."

Ranking Member Crapo said, "The TRIA program allows the insurance industry to absorb and cover the losses of all but the largest acts of terror, ones in which the Federal Government would likely be forced to step in if the program were not there. As a part of this reauthorization, I and others pushed to decrease the size of the backstop. In order to do that, we have examined each of the policy levers in the program. This bill would increase the insurance industry's aggregate retention level and the company coinsurance level."

In discussing what kinds of acts of terrorism would be covered by TRIA, Senator Schumer said, "I have been struck over the last few months about the discussion of 'conventional' terrorist attacks. It is sort of an oxymoron. Not using a nuclear weapon does not mean that it is not a terrorist attack. I can tell you, as somebody who lives in New York City, that was, I suppose, a conventional terrorist attack. But it still, if you—in the parlance, but there is nothing conventional about it, the uncertainty and fear we faced in the immediate aftermath of the day, the talk that there would be no building in southern Manhattan, the fact that businesses would flee, and it began to dawn on people throughout the world that a terrorist attack could cause such devastation that no free market

[12] Hearing transcript, Senate Committee on Banking, Housing and Urban Affairs, *Executive Session to consider S. 2244, the Terrorism Risk Insurance Program Reauthorization Act of 2014* (June 3, 2014).

mechanism could make up for it. A terrorist attack is not part of the conventional thinking of a free market, and that if we did not have some kind of backstop, the amount of building, the amount of construction, the amount of jobs would greatly decrease."

Acknowledging the evolving nature of terrorism since TRIA was first enacted into law by Congress, including new threats of cyber-attacks, the Committee maintains the Treasury Secretary's existing broad discretion and authority to certify any kind or mode of terrorist attack regardless of how the attack is carried out provided that the certification criteria is met. As Senator Reed stated during consideration of the legislation, "In short, reauthorizing TRIA is not only a matter of economic security; it is also a matter of national security. And, indeed, while TRIA is silent on whether a nuclear-, chemical-, biological-, or radiologic-related terrorist attack or any kind of cyber-related attack are covered, I believe our intent with S. 2244 is that these attacks would continue to fall within the scope of TRIA's covered lines, as they do today, provided that the statutory prerequisites are met."

It is also the view of the Committee that the legislation, by striking Section 103(e)(7)(B) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note), would remove a superfluous provision regarding the computation of the amount subject to mandatory recoupment, and should not be construed as conveying any kind of new authority to the Treasury Secretary to reimburse or pay claims on a negative calculation derived from Section 103(e)(7)(A) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note). Any negative number calculated under Section 103(e)(7)(A) should be considered otherwise moot.

The legislation is supported by a number of organizations, including the American Association of Port Authorities, American Bankers Association, American Bankers Insurance Association, American Bankers Securities Association, American Council of Engineering Companies, American Gaming Association, American Hotel and Lodging Association, American Land Title Association, American Public Gas Association, American Public Power Association, American Resort Development Association, American Society of Association Executives, Associated Builders and Contractors, Associated General Contractors of America, Association of American Railroads, Association of Art Museum Directors, Building Owners and Managers, Association International, Boston Properties, Campbell Soup Company, Coalition to Insure Against Terrorism, Cornerstone Real Estate Advisers, LLC, CRE Finance Council, CSX Corporation, Emerson, Financial Services Roundtable, Food Marketing Institute, Helicopter Association International, Hilton Worldwide, Host Hotels & Resorts, Inc., Institute of Real Estate Management, InterContinental Hotel Group, International Council of Shopping Centers, International Franchise Association, International Safety Equipment Association , International Speedway Corporation, Long Island Import Export Association, Marriott International, Mortgage Bankers Association, NAIOP, National Apartment Association, National Association of Chain Drug Stores, National Association of Home Builders, National Association of Manufacturers, National Association of REALTORS, National Association of Real Estate Investment Trusts, The National Association for Stock Car Auto Racing (NASCAR), National Association of Waterfront Employers, National Basketball Association, National Collegiate Athletic Association, National Council of Chain Restaurants, National Football League, National Hockey League, National Multifamily Housing Council, National Restaurant Association, National Retail Federation, National Roofing Contractors Association, National Rural Electric Cooperative Association, New England Council, Partnership for NYC, Public Sector Alliance, Public Utilities Risk Management Association, Office of the Commissioner of Baseball, The Real Estate Board of New York, The Real Estate Roundtable, Securities Industry and Financial Markets Association, Self-Insurance Institute of America, Inc., Starwood Hotels and Resorts, Tenaska, Taxicab, Limousine & Paratransit Association, UJA-Federation of New York, United Airlines, Union Pacific, University Risk Management and Insurance Association, U.S. Chamber of Commerce, and the U.S. Travel Association.

HEARINGS

On September 25th, 2013, the Committee held a hearing entitled, "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market." The hearing discussed the need for reauthorization of the Terrorism Risk Insurance Program. Witnesses were: Mr. Peter Beshar, Executive Vice President and General Counsel, Marsh & McLennan Companies; Mr. Erwann O. Michel-Kerjan, Professor and Managing Director, Center for Risk Management and Decision Processes, The Wharton School, University of Pennsylvania; and Mr. Robert Hartwig, Insurance Information Institute.

At the hearing, Mr. Beshar spoke to the role TRIA has played in the terrorism risk insurance market after the September 11th attacks, saying, "We consider TRIA to be a model of a public-private partnership. TRIA restored insurance capacity at a critical time after 9–11 and has been important in fostering a well-functioning terrorism insurance market since that time. . . . Thankfully, thus far, the federal government has not made any payments under TRIA. The only federal appropriations associated with the program have been for its administration." [13]

Dr. Hartwig made this observation, "The unambiguous success of TRIA demonstrates that the Act has become an invaluable component of the country's national security infrastructure. The continued operation of the nation's financial institutions—including its insurers—during and throughout the aftermath of a major terrorist attack—is absolutely essential to ensure a smooth and expedited recovery from the massive economic and operational shocks of the sort that occurred after the 9/11 attacks and that are certain to accompany future such events, irrespective of where in the country they occur. Failure to institutionalize a permanent plan to protect the nation's financial infrastructure leaves the country unnecessarily vulnerable to economic instability and risk of recession." [14]

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[13] Peter J. Beshar, Executive Vice President and General Counsel, Marsh & McLennan Companies, testimony before the Senate Committee on Banking, Housing and Urban Affairs, *Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market* (Sep. 25, 2013), http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=24ef097c-574c-4ebc-a705-5e35173d1ee7, p. 2.

[14] Robert Hartwig, Ph.D., President & Economist, Insurance Information Institution, testimony before the Senate Committee on Banking, Housing and Urban Affairs, *Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market* (Sep. 25, 2013), http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=8213e203-2743-4c66-a58d-6664c82c6857, pp. 4–5.

In his testimony, Dr. Hartwig also outlined eight distinct layers of taxpayer protections that the current structure of the TRIA program provides: (1) an act of terror meets a detailed set of certification criteria; (2) an act may not be certified if aggregate losses do not exceed $5 million; (3) no Federal funds may be paid if aggregate losses do not exceed $100 million; (4) individual insurers must pay a deductible that covers losses that are 20 percent of an insurer's direct earned premiums for commercial property and casualty insurance; (5) individual insurers must also make a co-payment of 15 percent of the remaining losses above their 20 percent deductible; (6) industry in the aggregate covers up to $27.5 billion of losses that must be recouped; (7) government is required to recoup 133 percent of the difference between Federal payments and retained losses paid by insurers through deductibles and co-payments up to $27.5 billion of losses, and has further discretion to recoup losses above $27.5 billion; and (8) the program is capped at total losses (Federal payments plus losses retained by insurers through deductibles and co-payments) of $100 billion in a year. Dr. Hartwig testified that taxpayers are further protected by other program features, such as restrictions on the lines of insurance that are covered and the program's make available requirement.[15]

On February 25th, 2014, the Committee held a hearing entitled, "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II." The hearing discussed the need for reauthorization of the Terrorism Risk Insurance Program. Witnesses were: Mr. W. Edward Walter, President and CEO, Host Hotels & Resorts, on behalf of the Coalition to Insure Against Terrorism; Ms. Carolyn Snow, President, Risk and Insurance Management Society; Mr. Bill Henry, CEO, McQueary, Henry Bowles and Troy, on behalf of the Council of Insurance Agents & Brokers; Mr. Vincent T. Donnelly, President and CEO, PMA Insurance Group, on behalf of the Property Casualty Insurers Association of America; Mr. Warren W. Heck, CEO and Chairman of the Board, Greater New York Insurance Companies, on behalf of the National Association of Mutual Insurance Companies; and Mr. Douglas G. Elliot, President of Commercial Markets, The Hartford, on behalf of the American Insurance Association.

At the hearing, witnesses discussed the need for a long-term reauthorization of TRIA in response to a question from Chairman Johnson.[16] Mr. Walter responded, "Senator, I would think that a seven-year extension would probably be the minimum that we should consider, and it would be better if we were to consider a longer period of time. For those of us in the real estate industry, we are typically making investments where we are looking at 7 to 10 to 15 or longer time frames. When we invest in Europe and some other markets around the world, one of the issues we do not have to worry about is how this issue will be dealt with because they have permanent programs. In the U.S., we have not necessarily had the benefit, certainly so far, of a permanent program.

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[15] Robert Hartwig, Ph.D., President & Economist, Insurance Information Institution, testimony before the Senate Committee on Banking, Housing and Urban Affairs, *Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market* (Sep. 25, 2013), http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=8213e203-2743-4c66-a58d-6664c82c6857, pp. 6–10.

[16] Hearing transcript, Senate Committee on Banking, Housing and Urban Affairs, *Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II* (Feb. 25, 2014).

But having something that would be longer-term, that would allow us to know that for the period of financing or for the period of ownership that we might have in that particular investment, that this issue would be covered by the TRIA program would be advantageous. And I think it would encourage incremental real estate investment."

Mr. Henry responded by saying, "Senator, basically, the independent agents and the Council agents would love to see this become permanent. It is an extremely uninsurable program. It is not going to change over the next 5 or 10 years. We will still have the same problem at that time. So this is a permanent problem, and we would like to see a permanent solution."

The other witnesses—Ms. Snow, Mr. Donnelly, Mr. Heck, and Mr. Elliot—also agreed that a long-term extension was preferable from their organizations' perspectives.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

Section 2. Extension of Terrorism Insurance Program

This section amends section 108(a) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note). This section would extend the Terrorism Risk Insurance Program until December 31, 2021.

Section 3. Federal share

This section amends section 103(e)(1)(A) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note). This section would gradually phase-down the share of the insurer loses that the Federal government would be required to provide following a certified act of terrorism. The Federal share would begin decreasing by 1 percentage point each year on January 1, 2016 until the Federal share has been lowered to 80 percent.

Section 4. Recoupment of Federal share of compensation under the program

This section amends section 103(e) of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note). This section would gradually increase the amount of Federal assistance that the Secretary of the Treasury must recoup from the private industry following a certified act of terrorism. The current mandatory recoupment amount of $27,500,000,000 will be increased by $2,000,000,000 each calendar year until that mandatory recoupment amount reaches $37,500,000,000.

This section would also clarify that the Secretary of the Treasury must recoup any federal assistance provided under the Terrorism Risk Insurance Program up to the mandatory recoupment amount required under the Act, no matter the size of the certified act of terrorism, assuming that the mandatory recoupment amount calculated under the Act was a positive amount.

Section 5. Technical amendments

Section 6. Improving the certification process

This section would require the Secretary of the Treasury to conduct a study on the process which the Secretary would use to decide whether to certify an act an act of terrorism under the Act including an examination and analysis of the establishment of a reason timeline for the Secretary to use in making such determination. After the conduction of the study, the Secretary would be required to issue regulations under existing authorities governing the certification process to address the finding of the study.

Section 7. GAO study on upfront premiums

This section would require the Comptroller General of the United States to conduct a study on the viability and effects of the Federal Government assessing and collecting upfront premiums on insurers that participate in the Terrorism Insurance Program.

COST OF LEGISLATION

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

Summary: S. 2244 would extend the Terrorism Risk Insurance Act (TRIA)[17] for seven years—through calendar year 2021. The bill also would increase the share of insured losses paid by private insurers under the program and require the Government Accountability Office (GAO) to prepare a report for the Congress that assesses the effects of collecting premiums on insurers that participate in the program.

The program requires insurance firms that sell commercial property and casualty insurance to offer clients insurance coverage for damages caused by terrorist attacks by foreign or domestic interests. Under TRIA, the federal government would help insurers cover losses in the event of a terrorist attack under certain conditions, and would impose assessments on the insurance industry to recover all or a portion of the federal payments. The program is set to expire at the end of calendar year 2014; no federal payments have been made under the program since its inception in 2002.

There is no reliable way to predict how much insured damage terrorists might cause, if any, in any specific year. Rather, CBO's estimate of the cost of financial assistance provided under the bill represents an expected value of payments from the program—a weighted average that reflects industry experts' opinions of the probability of various outcomes ranging from zero damages up to very large damages resulting from possible future terrorist attacks. The expected value can be thought of as the amount of an insurance premium that would be necessary to just offset the government's expected losses from providing this insurance, although firms do not pay any upfront premium for the federal assistance available under TRIA.

[17] The Terrorism Risk Insurance Act, P.L. 107–297, was enacted on November 2, 2002; the Act was extended on December 22, 2005 upon enactment of the Terrorism Risk Insurance Extension Act of 2005, P.L. 109–144. On December 26, 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007, P.L. 110–160, extended the program again. In this estimate, CBO refers to the original Act as subsequently amended, as TRIA.

On this basis, CBO estimates that enacting the bill would increase direct spending by $1.7 billion over the 2015–2019 period and by $3.5 billion over the 2015–2024 period. An additional $460 million would be spent after 2024.

CBO estimates that enacting the legislation also would increase revenues. S. 2244 would direct the Department of the Treasury to recoup some or all of the costs of providing financial assistance through taxes imposed on certain policyholders (referred to as surcharges in the legislation). CBO expects that federal spending for financial assistance to insurers would be largely offset (on a cash basis) by an increase in revenues. We expect that, following a covered loss, the Secretary of the Treasury would impose those surcharges in a way that meets the deadlines for collections specified in the bill. Thus, CBO estimates that enacting the recoupment provision in the bill would increase revenues by about $1.8 billion over the 2015–2019 period and by about $4.0 billion over the 2015–2024 period, net of income and payroll tax offsets.[18]

Considering both the direct spending and revenue impacts of the bill, CBO estimates that enacting the bill would reduce budget deficits by $460 million over the 2015–2024 period. Federal spending, however, would continue beyond 2024; CBO estimates that over the full term of federal financial assistance, revenues would fully offset direct spending, resulting in no net effect on the deficit.

The bill would impose intergovernmental and private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) by extending and expanding some requirements on insurers and policyholders, including the payment of surcharges. State, local, or tribal governments could be required to pay a surcharge as purchasers of property and casualty insurance, but CBO estimates that the aggregate cost to public entities of complying with those mandates would probably fall below the annual threshold established in UMRA ($76 million for intergovernmental mandates in 2014, adjusted annually for inflation). CBO estimates that the aggregate cost to private insurers and policyholders to comply with those mandates would exceed the annual threshold established in UMRA ($152 million in 2014, adjusted annually for inflation) in each year policyholders pay a surcharge.

Estimated cost to the Federal Government: The estimated budgetary effect of S. 2244 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

[18] When excise taxes and other types of "indirect" taxes are imposed on goods and services, they tend to reduce income for workers or business owners in the taxed industry and others throughout the economy. Consequently, revenue derived from existing "direct" tax sources—such as individual and corporate income taxes and payroll taxes—will also be reduced. To approximate that effect, CBO and the staff of the Joint Committee on Taxation apply an offset when estimating the net revenue that legislation imposing some form of indirect tax is expected to generate. The amount of the offset ranges from 25.2 percent in 2015 to 26.2 percent in 2024.

	By fiscal year, in billions of dollars—											
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014–2019	2014–2024
CHANGES IN DIRECT SPENDING												
Estimated Budget Authority	120	280	370	440	480	510	540	410	240	150	1,690	3,540
Estimated Outlays	120	280	370	440	480	510	540	410	240	150	1,690	3,540
CHANGES IN REVENUES												
Estimated Revenues	0	200	400	500	670	400	380	440	450	560	1,770	4,000
NET INCREASE OR DECREASE (−) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Impact on Deficit	120	80	−30	−60	−190	110	160	−30	−210	−410	−80	−460

Note: CBO estimates that implementing S. 2244 would not have a significant effect on discretionary costs over the 2015–2019 period.

Basis of estimate: For this estimate, CBO assumes that S. 2244 will be enacted before the end of calendar year 2014. We estimate that enacting the bill would increase direct spending by about $3.5 billion and increase revenues by $4.0 billion over the 2015–2024 period. While this estimate reflects CBO's best judgment on the basis of available information, the cost of this federal program is a function of inherently unpredictable future terrorist attacks. As such, actual costs are likely to vary significantly from the estimated amounts. Such costs could be either higher or lower than the expected-value estimates provided for each year.

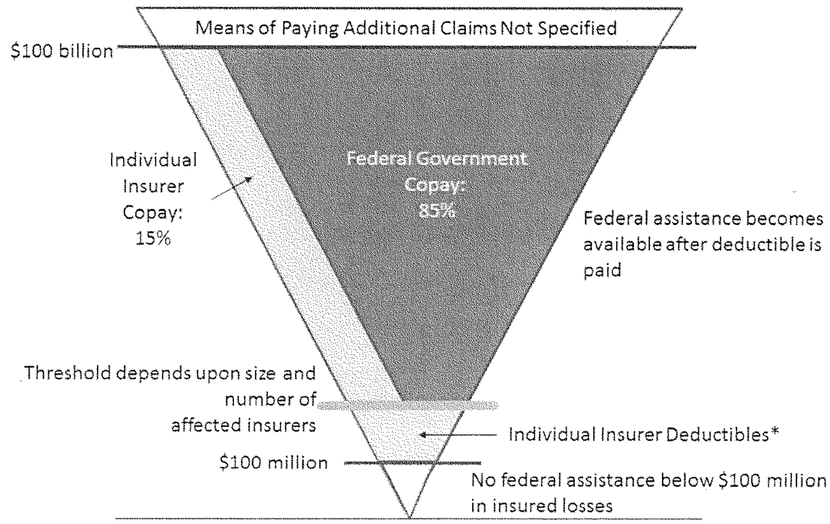
Terrorism Risk Insurance Act Under Current Law

The Terrorism Risk Insurance Act provides financial assistance to commercial property and casualty insurers for losses above certain thresholds (illustrated in figure 1) caused by terrorist attacks by individuals acting on behalf of foreign or domestic interests. For such assistance to be provided, the Secretary of the Treasury must certify that a terrorist attack has occurred in the United States or other specified locations. TRIA is set to expire on December 31, 2014.

TRIA does not require commercial property and casualty insurance policies to cover losses from terrorist attacks involving nuclear, biological, chemical, or radioactive (NBCR) materials. If, however, an insurer and a policyholder choose to include losses from terrorist attacks involving NBCR materials in such a policy, TRIA would cover a portion of the losses resulting from such attacks.

For the Secretary of the Treasury to certify a terrorist attack, insured damages resulting from the attack must exceed $5 million. Financial assistance becomes available to insurers suffering losses from a certified attack once the insurers suffering losses have aggregate insured losses from an attack that exceed $100 million. Once that threshold is met, insurance companies that suffer losses are responsible for paying claims up to a deductible amount that equals 20 percent of the premiums they collected for certain lines of insurance in the calendar year preceding a certified attack. The total amount of deductibles paid by insurers would depend on the amount of losses from an attack and the particular insurers involved.

Figure 1. Loss-sharing Under Terrorism Risk Insurance Act (TRIA)



Notes: Diagram not drawn to scale.
* Deductible = 20% of each insurer's direct earned premiums in the previous year for TRIA-covered insurance lines.

After meeting their individual deductibles for damage claims, insurers that suffered losses and the federal government would each pay a portion of the losses above the deductible (in 2014, the federal government would pay 85 percent of insured losses and individual insurers would pay 15 percent) up to total losses of as much as $100 billion. The law does not specify how any claims above the $100 billion cap would be paid.

The Secretary of the Treasury is authorized to recover payments made by the federal government through taxes in the form of surcharges paid by all purchasers of commercial property and casualty insurance. The Secretary is required to recoup any federal payments made to cover losses, but only if those recoveries plus other amounts paid by directly affected insurers do not exceed $27.5 billion—known as the retention amount. If insured losses from a terrorist attack are large enough that insurers pay more than the industry retention amount, the Secretary would not be required to recoup any federal payments. The program provides the Secretary of the Treasury with authority, however, to recover federal payments in that instance after considering the ultimate cost to taxpayers, economic conditions, and the affordability of commercial insurance.

Modifications to TRIA Under S. 2244

S. 2244 would extend TRIA for seven years, through December 31, 2021. The bill also would make incremental changes in program parameters that would increase the share of insured losses paid by private insurers in the event of an attack.

As under current law, an insurer suffering losses as a result of a certified attack would pay claims up to a specified deductible. The bill would retain the same deductible limits, 20 percent of certain premiums collected in the calendar year preceding an attack, as in current law.

S. 2244 also would continue the payment-sharing process that exists under current law. Insurers and the federal government would each pay a portion of the losses over the deductibles up to the $100 billion limit for the program. However, the bill would decrease the federal government's portion by one percentage point per year over a five-year period that starts on January 1, 2016. Currently, the federal portion is equal to 85 percent of covered losses above the deductible; under the bill, that rate would be reduced to 80 percent of covered losses by 2020, and remain there until the program expires at the end of 2021.

Finally, the bill would increase the industry retention amount—the limit used to calculate the amount of federal spending that would be recovered from policyholders—from $29.5 billion to $37.5 billion over a five-year period starting in the first year after enactment.

Direct Spending

By extending financial assistance to certain commercial insurers for losses from future acts of terrorism against insured private property, enacting S. 2244 would expose the federal government to potentially large liabilities for seven more years (2015 through 2021). For any particular year, the amount of insured damage caused by terrorists could range from zero to many billions of dollars. CBO's estimate of the cost of this program reflects how much, on average, the government could be expected to pay to insurers and recover from the industry over the 2015–2024 period.

The following sections describe our method for estimating the expected value of financial assistance under the bill and explain how we convert that cost to estimates of annual federal expenditures.

Estimating the Expected Cost of Federal Assistance. For this estimate, CBO discussed the process of estimating insured losses with industry actuaries and reviewed models used by firms to set premiums for the terrorism component of property and casualty insurance that they offer. State insurance regulators generally require such premiums to be grounded in a widely accepted model of expected losses from covered events. After the terrorist attacks on September 11, 2001, the insurance industry began efforts to set premiums for insurance coverage for terrorist events using such models.

Although estimating losses associated with terrorist events is difficult because of the lack of meaningful historical data, the insurance industry has experience setting premiums for other catastrophic events—namely, natural disasters. Setting premiums for hurricanes and earthquakes, for example, involves determining areas that could sustain damage, the value of the losses that could result from various types of events with different levels of severity, and the frequency of such events.

Similarly, estimating premiums for losses resulting from terrorist attacks involves judgments regarding potential targets and the frequency of potential attacks. Because there is a very limited history of terrorist attacks in the United States, many of the parameters needed by the insurance industry to set premiums are based on expert opinion regarding terrorist activities and capabilities as well as information about attempted attacks that were not successful.

Estimating Potential Insured Losses. Based on discussions with insurers and information provided by the insurance industry, CBO estimates that the expected or average annual loss subject to TRIA coverage under the bill would be about $2.1 billion (in 2014 dollars). This estimate incorporates industry expectations of the probabilities of terrorist attacks, encompassing the possibility of attacks that result in enormous loss of life and property damage, as well as a significant likelihood that no such attacks would occur in any given year. This estimate also reflects our expectation that some portion of losses from terrorism would not be covered by TRIA because some policyholders choose not to purchase insurance coverage for terrorism risks.

CBO's estimate incorporates an expectation that, in most years, losses from terrorist attacks covered by TRIA would cost significantly less than $2.1 billion. We expect that there is a significant chance that no terrorist attacks covered by TRIA would occur in a given year. Since enactment of TRIA, no covered events have occurred, though several attempts were prevented by law enforcement and other security measures. Although the risk of a terrorist attack with many lives lost and substantial property damage still remains, based on industry models, CBO assumes for this estimate that attacks causing losses similar in scale to those sustained on September 11, 2011, in New York City are likely to occur very rarely, if at all.[19]

Our estimate of average annual losses includes about $650 million in losses resulting from terrorist attacks involving NBCR materials. Under current law, insurers are not required to offer this coverage, although if an insurer and a policyholder voluntarily agree to include this coverage in a property and casualty policy, TRIA would cover some of those losses. While the bill would not require property and casualty policies to include coverage for losses resulting from attacks using NBCR materials, information provided by the industry indicates that a small amount of coverage is currently in place for such losses. Thus, under the bill, the government's exposure to losses resulting from terrorist attacks involving NBCR materials would likewise be small compared with losses resulting from attacks using conventional materials. The only exception is in the workers' compensation insurance line, where no exclusions for specific causes are allowed.

Determining the Federal Share of Insured Losses. Federal payments under TRIA would be lower than the total expected losses from terrorist attacks because TRIA places limits on eligibility for federal assistance and requires that insurers that suffer losses as the result of a certified attack pay a share of covered losses. CBO took account of those requirements to estimate federal spending for any given amount of insured losses from future terrorist attacks.

- *Upper and lower limits for federal assistance.* Because federal payments under TRIA would be capped at $100 billion per event, we excluded costs for potential losses above that level. Similarly, S. 2244 would maintain the minimum losses that would trigger fed-

[19] Based on information from the Insurance Information Institute, we estimate that industry losses on September 11, 2001, totaled about $44 billion (in 2014 dollars), including about $35 billion in losses that would have qualified for coverage under TRIA had the law been in effect on that date.

eral payments under current law at $100 million; therefore, we excluded potential losses below that minimum level as well.

• *Insurers' deductibles.* Before the federal government would make any payments under TRIA, an insurer incurring losses would first pay claims up to a deductible amount. S. 2244 would maintain the current-law deductible of 20 percent of premiums on certain property and casualty lines collected by affected insurers in the calendar year preceding an attack.

The total amount of the deductibles could range from a few million dollars to several billion dollars, depending on how many insurers provide coverage for losses resulting from a particular terrorist attack. In addition, the value of each individual insurer's deductible would vary greatly across the industry. For this estimate, CBO considered a range of possibilities regarding the share of federal assistance, using industry data to estimate insurers' deductibles under the bill. The range encompasses the possibility that an attack would affect only a few insurers with relatively small deductibles or several insurers with relatively large deductibles. CBO expects that insured losses below a few hundred million dollars would most likely be covered by insurers' deductibles, and therefore, would not result in a significant increase in federal spending.

• *Shared payments if losses exceed insurers' deductibles.* Once affected insurers have paid claims up to their deductibles, the federal government would share a portion of the losses above the deductibles. Under S. 2244, the federal government's share of claims above the deductible would fall from the current-law level of 85 percent of total losses to 80 percent, up to the $100 billion limit covered by the program, by 2020.

After taking into account minimum and maximum limits, deductibles, and the insurers' share of payments above the deductibles, CBO estimates that enacting the bill would increase direct spending by $4.0 billion over the full life of the program. That amount translates into an average of roughly $570 million for each of the seven years for which the program would be extended. Actual spending would be spread out over many years, and those costs would be recovered through surcharges imposed on policyholders (which are discussed in the section on revenues below).

Taken another way, if the Secretary of the Treasury were authorized to collect premiums for the program, CBO estimates that the Secretary would need to charge, on average, about $570 million per year (for seven years) to offset the government's projected losses under the bill. The bill, however, would not authorize any charges prior to a certified attack. The bill also does not contain an explicit requirement for the Secretary to recoup interest that would accrue on amounts outstanding.

Timing of Federal Spending. To estimate federal spending for this program on a cash basis, CBO used information from insurance experts on historical rates of payment for property and casualty claims following catastrophic events. Based on such information, CBO estimates that outlays under the bill would total about $3.5 billion over the 2015–2024 period; about $460 million would be spent after 2024. In general, following a catastrophic loss, it takes many years to complete insurance payments because of disputes over the value of covered losses by property and business owners. Under this bill, we expect that financial assistance to insurers would be paid over several years, with most of the spending occurring within the first five years following a certified event.

Revenues

Enacting S. 2244 would affect federal revenues by authorizing the Secretary of the Treasury to impose taxes in the form of surcharges on all holders of property and casualty insurance policies in order to recover the amount of federal payments made under the program, with certain limitations. CBO estimates that this provision would increase revenues by $4.0 billion over the 2015–2024 period.

Surcharges. If a terrorist attack were to require the government to provide financial assistance, the bill would require the Secretary of the Treasury to recoup some or all of that cost through taxes paid by purchasers of commercial property and casualty insurance. Specifically, the Secretary would be required to recoup federal payments to the extent that the total amount paid by insurers (for deductibles and the industry's share of payments over the deductibles) is less than the lower of total insured losses or the industry retention amount.

If insured losses from a terrorist attack are large enough that insurers pay more than the industry retention amount, then the Secretary would not be required to recoup any federal payments—although the Secretary could choose to do so. In that case, the amount the Secretary would collect would be based on economic conditions, the affordability of commercial insurance, and the cost to taxpayers of no additional recoupment. CBO expects that the Secretary would not seek to recover financial assistance provided above the industry retention amount and would not collect interest on outstanding amounts.

The recoupment of financial assistance would be accomplished by assessing a surcharge on premiums for property and casualty insurance policies and would apply to policies in force following a terrorist attack that necessitated federal assistance. The amount to be recovered would be 135.5 percent of the difference between the industry retention amount, which grows from $29.5 billion to $37.5 billion over the term of the program, and the Secretary's estimate of the total amount paid by insurers for deductibles and their share of payments over the deductibles. CBO estimates that surcharges resulting from a seven-year extension of TRIA would total, in an expected-value sense, $5.4 billion over the 2015–2024 period.

Timing and Tax Offset. The bill would require the Secretary to recover all or a portion of amounts due for events occurring before December 31, 2017, by the end of fiscal year 2019. For losses from events occurring between January 1, 2018, and the end of the program, the Secretary would be required to recoup all amounts due by the end of fiscal year 2024.

Those gross revenue collections would be partially offset by a loss of revenues from income and payroll taxes. Consistent with standard procedures for estimating the revenue impact of indirect business taxes, CBO reduced the gross revenue impact of the insurance surcharges to reflect offsetting effects on income and payroll tax receipts. On balance, CBO estimates that enacting the bill would increase revenues by a total of $4.0 billion over the 2015–2024 period, net of income and payroll tax offsets.

Changes in Spending Subject to Appropriation

S. 2244 would direct the Government Accountability Office to prepare a report assessing the viability of collecting upfront premiums from insurers that participate in the TRIA program. The study would examine, among other things, how the government would determine the price of such premiums, how the premiums would be collected and managed, and how the assessment of premiums would affect take-up rates for terrorism risk coverage. CBO estimates that implementing the new reporting requirement would not have a significant effect on discretionary costs.

Pay-As-You-Go considerations: The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR S. 2244, AS ORDERED REPORTED BY THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS ON JUNE 3, 2014

	By fiscal year, in millions of dollars—												
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014–2019	2014–2024
	NET INCREASE OR DECREASE (−) IN THE DEFICIT												
Statutory Pay-As-You-Go Impact	0	120	80	−30	−60	−190	110	160	−30	−210	−410	−80	−460
Memorandum:													
Changes in Outlays	0	120	280	370	440	480	510	540	410	240	150	1,690	3,540
Changes in Revenues	0	0	200	400	500	670	400	380	440	450	560	1,770	4,000

Intergovernmental and private-sector impact: The bill would extend and expand intergovernmental and private-sector mandates contained in the Terrorism Risk Insurance Act. Those mandates would:

- Require property and casualty insurers to offer terrorism insurance;
- Require, under certain circumstances, property and casualty insurers to collect surcharges from policyholders in amounts large enough to pay assessments to the federal government; and
- Preempt state laws regulating insurance.

State, local, or tribal governments could be required to pay surcharges as purchasers of property and casualty insurance, but CBO estimates that the aggregate costs to public entities of complying with those mandates would probably fall below the annual threshold established in UMRA for intergovernmental mandates ($76 million in 2014, adjusted annually for inflation). CBO estimates that the aggregate cost to private insurers and policyholders to comply with the mandates would exceed the annual threshold established in UMRA ($152 million in 2014, adjusted annually for inflation).

Requirement to Offer Insurance

Current law requires that, through calendar year 2014, insurance companies offer terrorism insurance as a part of their property and casualty policies. Those companies may set their own premium rates, and policyholders can choose whether to purchase such insurance. The bill would extend the requirement to offer terrorism insurance through calendar year 2021. According to industry representatives, the cost for public and private insurers to continue making terrorism insurance available under property and casualty insurance policies would be minimal.

Repayment of Assistance

Insurers that offer terrorism insurance would receive financial assistance to cover losses under some conditions in the event of a certified terrorist attack. The bill would extend and expand the requirement that the federal government recoup the costs of such financial assistance through assessments on the insurers and surcharges on purchasers of property and casualty insurance. The requirement to repay the federal government would be both an intergovernmental and a private-sector mandate under UMRA since state and local governments and private entities are both providers and purchasers of insurance.

The cost to insurers to comply with the mandate to administer the surcharges on policyholders and remit the amounts collected to the federal government would be small.

CBO estimates that total surcharges collected by insurers would be about $2.4 billion over the 2015–2019 period. That amount is equal to federal benefits paid over those years plus 35.5 percent of those benefits (see Revenues section for further discussion). Based on information about the purchase of various types of insurance by public entities, CBO assumes that state, local, and tribal governments comprise a small portion of the total market for property and casualty insurance. To the extent that state, local, and tribal governments would be required to pay a surcharge as policy holders, CBO estimates that the aggregate costs to public entities of complying with the mandate would total tens of millions of dollars annually, but probably would not exceed the annual threshold for intergovernmental mandates in any given year. CBO estimates that the aggregate amount of surcharges paid by private entities would amount to hundreds of millions of dollars annually and would exceed the annual threshold for private-sector mandates.

Preemption of State Law

The bill also would preempt some state laws that regulate insurance. Based on information from state insurance regulators, CBO estimates that the cost to states of extending those preemptions would be minimal.

Estimate prepared by: Federal Costs: Susan Willie, David Torregrosa, and Perry Beider; Impact on state, local, and tribal governments: Melissa Merrell; Impact on the private sector: Amy Petz and Tristan Hanon.

Estimate approved by: Theresa Gullo, Deputy Assistant Director for Budget Analysis.

REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b), rule XXVI, of the Standing Rules of the Senate, the Committee makes the following statement concerning the regulatory impact of the bill.

This legislation will not have a substantial regulatory impact because it makes changes to the administration of the Terrorism Risk Insurance Program, but does not place regulatory requirements on businesses or individuals directly. Changes to the Terrorism Risk Insurance Program may affect the businesses or individuals who choose to participate in the Terrorism Risk Insurance Program.

CHANGES IN EXISTING LAW (CORDON RULE)

On June 3, 2014, the Committee unanimously approved a motion by Senator Johnson to waive the Cordon rule. Thus, in the opinion of the Committee, it is necessary to dispense with section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.