M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Staff

Date: November 8, 2013

Subject: November 13, 2013, Housing and Insurance Subcommittee Hearing entitled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure"

The Subcommittee on Housing and Insurance will hold a hearing entitled "The Future of Terrorism Insurance: Fostering Private Market Innovation to Limit Taxpayer Exposure" at 10:00 a.m., on Wednesday, November 13, 2013, in Room 2128 of the Rayburn House Office Building. This hearing will examine the Terrorism Risk Insurance Act of 2002, as amended (TRIA), with a specific focus on whether the program created by that act can leverage private sector capital and innovation to limit taxpayer exposure.

This will be a one-panel hearing with the following witnesses:

- Mr. Sean McGovern, Director, Risk Management & General Counsel, Lloyd's of London
- Mr. Kean Driscoll, Chief Executive Officer, Validus Reinsurance, Ltd.
- Mr. Ernest N. Csiszar, Former Director of Insurance, State of South Carolina
- Dr. John Seo, Co-Founder and Managing Principal, Fermat Capital Management, LLC
- Dr. Robert P. Hartwig, Pres. & Economist, Insurance Information Institute

Background

Before the terrorist attacks of September 11, 2001, insurers generally covered losses resulting from terrorist acts as part of commercial property and casualty insurance policies. As a result of the 9-11 attacks, insurance companies paid $31.6 billion (around $40 billion in current dollars, adjusted for inflation) in terrorism-related claims. The September 11 attacks led reinsurance and insurance companies to recognize potential terrorism losses as a new and significant kind of risk that they could not sufficiently model at that time, making such insurance either unavailable or unaffordable. Reinsurance and insurance companies thus began excluding terrorism coverage from their insurance policies.

According to some industry observers, these exclusions created a void in the insurance market, making terrorism coverage unavailable for businesses and employers, some of whom were contractually obliged to obtain terrorism coverage as a condition for financing. This inability to obtain terrorism coverage thus jeopardized economic development, particularly in large urban areas. To fill this void, some industry participants and analysts called for the creation of a temporary federal government backstop—a form of federal reinsurance—that would allow insurers to offer policyholders coverage for terrorism-related losses. Proponents argued that a temporary government backstop would give the insurance industry the time and opportunity to develop methods of calculating risk, assess capacity, and build accurate models so that appropriately priced, privately-backed coverage could again be made available. Opponents argued that a temporary government backstop would inhibit the development of a functioning reinsurance marketplace by crowding out private insurers.

In response to these calls for a temporary government backstop, Congress enacted TRIA (P.L. 107-297), which established a Terrorism Risk Insurance Program, to be administered by the Treasury Department, the purpose of which was to make terrorism insurance coverage more widely available. Under the program, which was to sunset after three years, the federal government shared the risk of loss from future terrorist attacks with the insurance industry. TRIA mandated that insurers participate in the program and required that insurers make terrorism coverage available in all commercial property and casualty insurance policies. TRIA did not, however, require that businesses purchase terrorism coverage.

Congress designed TRIA as a temporary, transitional federal backstop, with the expectation that the industry would eventually model and price for terrorism risk. While the initial TRIA may have helped address an economic need, the private market did not recover as quickly as many had hoped. As a result, in late 2005, Congress passed the Terrorism Risk Insurance Extension Act (P.L. 109-144) (TRIEA). TRIEA extended TRIA for two more years, until December 31, 2007. The extension left much of the original TRIA program intact, but raised industry retention levels and pared back the insurance lines covered. TRIA now requires $100 million in aggregate industry losses and an individual insurer deductible of 20 percent of premiums before the federal government shares 85 percent of the insured losses.

Despite this extension—or as some critics have argued, because of it—a private market for terrorism insurance has failed to develop. In 2007, with TRIA scheduled to expire for a second time, the 110th Congress again considered legislation to extend TRIA. The House and the Senate initially passed competing bills to significantly expand and extend TRIA: the House bill would have extended TRIA for 15 years, and the Senate bill for 7 years. Ultimately, Congress enacted H.R. 2761, the Terrorism Risk Insurance Program Reauthorization Act of 2007 (P.L. 110-160). The bill extended the TRIA program for seven years (through December 31, 2014), added domestic terrorism coverage to TRIA, modified TRIA's annual liability cap so that insurers are not responsible for losses exceeding $100 billion, and made other changes to insurers' mandatory surcharge and recoupment amounts.

While the backstop has never been used because there have been no terrorist attacks since 9-11 that met TRIA's loss-sharing criteria, opponents of extending the program beyond 2014 argue that it exposes taxpayers to potentially billions of dollars in losses that the private sector should, some 13 years after 9-11, be prepared to bear on its own. Critics of the program also claim that the existence of a government-provided backstop under TRIA has inhibited the return of private-sector terrorism insurance.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) established a Federal Insurance Office at the Treasury Department, headed by a Director. Among other things, the Director of the Federal Insurance Office is charged with assisting the Treasury Secretary in administering TRIA.

Legislative Proposals for the 113th Congress

Three bills have been introduced in this Congress to extend or modify TRIA:

- Rep. Michael Grimm has introduced H.R. 508, the Terrorism Risk Insurance Act of 2002 Reauthorization Act of 2013, which would extend TRIA through December 31, 2019, and require the Treasury Secretary to collect all mandatory premiums for any act of terrorism that occurs on or after January 1, 2012, by September 30, 2024.

- Rep. Michael Capuano has introduced H.R. 2146, the Terrorism Risk Insurance Program Reauthorization Act of 2013, which extends TRIA through December 31, 2024, and requires the Treasury Secretary to collect all mandatory premiums for any act of terrorism occurring on or after January 1, 2012, by September 30, 2027. H.R. 2146 would also require the President's Working Group on Financial Markets to report in 2017, 2020, and 2023 on its findings regarding the long-term availability and affordability of terrorism risk insurance.

- Rep. Bennie Thompson has introduced H.R. 1945, the Fostering Resilience to Terrorism Act of 2013, which extends TRIA through December 31, 2024, and revises the definition of an "act of terrorism" to mean any act certified by the Secretary of Homeland Security in concurrence with the Secretary of the Treasury as meeting the criteria for such an act, among other changes to TRIA.