June 4, 2014

Financial Services Committee Update – The Terrorism Risk Insurance Act: Summary of Senate Markup and Current State-of-Play

Introduction

On Tuesday, June 3rd, the U.S. Senate Committee on Banking, Housing, and Urban Development met to markup legislation that would reauthorize the Terrorism Risk Insurance Program. This memo provides brief background on the Terrorism Risk Insurance Act (TRIA), the Senate markup, and where the process is likely to lead from here, including possible action in the House of Representatives.

Background on TRIA and S. 2244

The origins of TRIA stem from the terrorist attacks of September 11, 2001. Following the attacks, insurance companies paid $31.6 billion in terrorism-related claims, as insurers had generally covered losses resulting from such acts in their commercial property and casualty insurance policies to that point. Yet in the aftermath, terrorism insurance quickly became either unavailable or extremely costly. For instance, the Real Estate Roundtable found that over $15.5 billion of real estate projects, in 17 states across the country, were canceled or stalled due to the paucity of terrorism insurance in the roughly 14 months following the attacks.[i]

The post-9/11 experience demonstrated that "the dearth of coverage for terrorism losses led to much concern and some emerging evidence that the economy, particularly the real estate and commercial lending sectors, would suffer," according to a RAND Corporation policy brief on TRIA. "Lenders were becoming reluctant to support large commercial developments and other business investments unless they carried terrorism insurance," the brief noted, "and existing development projects were being halted for the same reason."[ii] As such, the Terrorism Risk Insurance Act (TRIA) was enacted after the September 2001 attacks to create a government "backstop" for insurance firms against losses due to a terrorist act of $100 million or more in losses. The current process is detailed in the chart below:

Current Terrorism Risk Insurance Rules

1. A single terrorist attack must cause at least \$5 million in damage for the government to help pay claims.
2. Total insured damages from all terrorist attacks must total at least \$100 million in a year for the program to apply.
3. To qualify for federal help, each insurance company must first pay out enough in claims for terrorist attacks to equal at least 20 percent of the money it takes in each year in premiums.

Once those thresholds are met, the program covers **85 percent** of insured losses due to terrorism, until the aggregate loss totals \$100 billion, after which there is no federal backstop and no requirement for insurers to provide coverage.

- The program is required to recoup **133 percent** of any federal share of losses by the end of 2017, by levying surcharges on property/casualty insurance policies.
- If the insurance industry's uncompensated terrorism loss exceeds **\$27.5 billion**, the Treasury Department is allowed to forgo reclaiming the money.

SOURCE: Congressional Research Service

Without Congressional action, TRIA, which was successfully reauthorized in 2005 and in 2007, will expire at the end of 2014. In April, the Council joined 258 other business organizations from across the country in urging Congress to reauthorize the law. In the letter, the groups noted TRIA's role in fostering certainty in the marketplace and wrote that "maintaining a workable federal terrorism insurance mechanism is vital for our nation's economic security."

Following months of bipartisan discussions, Senator Chuck Schumer (D-NY) introduced S. 2244, the *Terrorism Risk Insurance Program Reauthorization Act of 2014*, on April 10th. The bill extends the program for an additional 7 years, rather than allowing it to expire at the end of 2014. Per Senator Schumer's office, there are only two changes to the current program – phased in over a five-year period, the details of which are below.

1) Co-pay: In the event of a terrorist attack, insurance companies would first be obligated to pay a portion of their premiums (20% of the prior year's direct earned premium for covered commercial lines) as a deductible. Following that deductible payment, however, the program currently requires that the federal government cover 85% of each company's losses until the amount of losses totals \$100 billion. Each company is obligated to pay the other 15% of losses. In other words, after an insurer's losses exceed its deductible, it faces a 15% co-pay on all additional terrorism losses in conjunction with the federal government's 85% recoupable co-pay.

- The proposed legislation would increase an insurers' co-pay from 15 to 20%, with the government still covering 80% of each company's additional losses. As stated, this increase would be phased in incrementally over five years.

2) Recoupment: When aggregate insured losses are less than $27.5 billion, the TRIA program currently imposes mandatory policy surcharges that require recoupment of federal payments made under the program. In other words, recoupment by the federal government is mandatory if the insurance industry's aggregate uncompensated loss is less than $27.5 billion. Additionally, under the current program, when aggregate insurer deductibles and co-payments exceed $27.5 billion, TRIA provides the Secretary of the Treasury the authority to recoup federal payments above that amount based on pre-established factors and conditions.

- The proposed legislation would raise the mandatory recoupment threshold to $37.5 billion, so that when the insurance industry's aggregate uncompensated losses are below $37.5 billion the government will be required to recoup its TRIA payments outlaid to insurers.[iii]

Summary of Senate Banking Committee Markup

On Tuesday, June 3, 2014, the Senate Banking Committee met to mark up S. 2244, the *Terrorism Risk Insurance Program Reauthorization Act of 2014*. The Committee adopted S. 2244 as modified by a vote of 22-0. The legislation as introduced includes a seven-year reauthorization of the Terrorism Risk Insurance Program, and two modifications to the co-pay and recoupment measures, which are phased in over five years.

The package that was approved by the committee also included several amendments from committee members that were unanimously agreed to en bloc, including an amendment from Senators Elizabeth Warren (D-MA) and Tom Coburn (R-OK) requiring the Government Accountability Office to undertake a study assessing the federal government's efforts to collect up-front premiums on insurers that participate in the TRIA program; and another from Senator David Vitter (R-LA) which would strike the current provision of law that prohibits mandatory recoupment in the event of large scale terrorist attacks and replace it with an explicit requirement that the Treasury Secretary must recoup the aggregate retention amount established by law while leaving discretion for the Secretary to recoup any financial assistance above that amount.

The committee also took a roll call vote on one amendment from Senator Tom Coburn to provide the Treasury Secretary with discretion to extend the deadline for mandatory recoupment collection to 10 years from an event if the mandatory recoupment is larger than $1 billion, which failed on a 6-16 vote.

Amendments Voted on in Senate Banking Markup

Coburn Amendment #14 – Senator Tom Coburn (R-OK) filed an amendment to provide the Treasury Secretary with flexibility in the mandatory recoupment process. Senator Coburn noted that, under S. 2244, the federal share of payment must be recouped within an arbitrary window based not on the scale, cost, or timing of a terrorist attack, but rather on statutory budget concerns of the Congressional Budget Office (CBO). As such, recoupment timelines could be as short as 21 months under the legislation with the likelihood being that, if faced with having to recoup a large sum via policyholder surcharges in a short period of time, Congress will simply waive the recoupment and taxpayers will never see a return.

Senator Coburn's amendment would allow the Secretary of the Treasury to adjust the mandatory recoupment payment timeline beyond the statutory deadline dates, but within 10 years of the event, if the required recoupments exceed $1 billion. Senator Coburn argued that his amendment would provide legitimacy, and inject common sense, into the recoupment process.

Chairman Johnson said that he and his staff have worked with CBO to provide additional flexibility in a budget-neutral way, without success thus far. He urged his colleagues to oppose the amendment on the basis that it would harm the prospects for passing the legislation because of the cost it would incur. When pressed for specific figures by Senator Bob Corker (R-TN), the Chairman simply pointed to CBO's statement that such an amendment would create "a substantial negative score."

The amendment garnered support from five Republicans and one Democrat, Virginia Senator Mark Warner, but was defeated 6-16.

<u>Amendments Discussed but Not Voted On</u>

(*NOTE: none of these amendments were related to the underlying legislation on TRIA*)

Vitter Amendment #6 – Senator David Vitter (R-LA) filed an amendment to require the federal Reserve Board of Governor to have at least one member with community banking or community bank supervision experience at all times. The amendment contained the same language as his standalone bill S. 2252, the *Community Bank Preservation Act of 2014*, which he introduced on April 10th and has 7 bipartisan cosponsors. Chairman Johnson and Ranking Member Crapo indicated their support for Senator Vitter's efforts. Senator Vitter withdrew his amendment after discussing it.

Johanns-Brown Amendment #10 – Senator Mike Johanns (R-NE) filed an amendment with Senator Sherrod Brown (D-OH) which would provide a fix to the confusion over the so-called Collins Amendment from the Dodd-Frank Act (Section 171). It is the same concept that Senators Susan Collins (R-ME), Johanns, and Brown introduced in a standalone bill – S. 2270, the *Capital Standards Clarification Act of 2014* – on April 29th. The legislation would clarify the Federal Reserve's authority to recognize the distinctions between banking and insurance when implementing Section 171 of the Dodd-Frank Act; while many contend that the Fed already has that authority, the agency insists that it does not and that legislative clarification is required. Senator Brown noted that in a March hearing before the Banking Subcommittee on Financial Institutions and Consumer Protection, where he is the Chairman, witnesses agreed that the approach offered by the bipartisan group of Senators is the right one in addressing this problem. Both Chairman Johnson and Ranking Member Crapo indicated their support for moving the standalone bill, which currently has 27 cosponsors, either by Unanimous Consent through the full Senate, or failing that, as an amendment to the TRIA reauthorization bill when it comes to the full Senate. Senator Johanns withdrew his amendment after discussing it. (UPDATE: Later on Tuesday, the full Senate passed S. 2270 by unanimous consent).

Johanns Amendment #9 – Senator Johanns also filed an amendment to clarify the exemption for farmers, ranchers, manufacturers, and small businesses from margin requirements included in the Dodd-Frank Act. The amendment is based on bipartisan legislation (S. 888) he and others introduced last May. That bill currently has 19 cosponsors. Sen. Johanns argued that these non-financial, commercial end users who utilize derivatives do so to manage risk, not create it, and should be clearly and explicitly exempt from costly margin requirements, which he said was consistent with Congress' intent in the Dodd-Frank Act. In his remarks, Sen. Johanns noted that companion legislation (H.R. 634) has passed the House Financial Services Committee 59-0 and the full House by a vote of 411-12. Senator Johanns withdrew his amendment after discussing it.

Background on House Efforts to Reauthorize TRIA

Now that the Senate Banking Committee has passed its version of TRIA reauthorization, all eyes turn to the House, where there is an effort underway by conservative members of the House Financial Service Committee to produce a competing measure to S. 2244 that would make more significant changes to the program.

Congressman Michael Capuano (D-MA), Ranking Member of the House Financial Services Subcommittee on Housing and Insurance, has already introduced H.R.2146, the *Terrorism Risk Insurance Program Reauthorization Act of 2013*. His bill would reauthorize the Terrorism Risk Insurance Program for an additional 10 years, without making significant changes. The bill currently has 70 cosponsors. This bill will form the basis for a markup in the committee at a time TBD later this month. However, it is expected that the language developed by committee Republicans, in consultation with members from the minority, will replace the Capuano language moving out of committee.

Rep. Randy Neugebauer (R-TX), Chairman of the House Financial Services Subcommittee on Housing and Insurance, began circulating a draft proposal in early May. Specifically, while reauthorizing TRIA for three years through 2017, the proposal creates a two-tiered system for classifying terrorist attacks by raising the trigger for nonnuclear, biological, radiological, and/or chemical (NBCR) events from $100 million to $500 million. It would also lower the deferral share of insurers' losses for any non-NBCR events from an 85 percent copay to 75 percent, and the total $100 billion cap on federal payments and insurer liability would drop to $75 billion for non-NCBR events. These and other changes would be phased in by 2017, with no major operational changes occurring in the first year of reauthorization.

However, Rep. Neugebauer noted that the proposal was not a final product, and at a May 20th committee hearing, stated that he "hope[s] to make some refinements in that framework, and sit down with the minority" in order to "put out a bipartisan…bill on TRIA." Reports indicate that negotiations are still ongoing, but it appears that the new proposal will contain at least the following elements as of now (this list is not exhaustive and may be adjusted based on further negotiations):

- Five-year reauthorization period
- Retain the current $100 billion annual program cap
- Keep the current definition of covered "acts of terrorism"
- Retain the original House proposal's bifurcation of NBCR and "conventional" losses
- Retain the original House proposal's $500 million trigger on conventional losses, which would be phased in over 5 years
- Increase the insurer co-share to 80%, similarly phased in over 5 years
- Include a "small insurer" opt-out
- A policyholder recoupment amount equal to the sum of insurer deductibles for the preceding year

House Financial Services Chairman Jeb Hensarling (R-TX) has indicated a willingness to move a TRIA reauthorization bill through his committee this month, and will likely have to give his approval to any deal that is reached. According to a June 4th article in The Hill, a committee spokesman says that "Chairman Hensarling has been working with Chairman Neugebauer on a TRIA reform bill and both of them have been discussing it with other members of the committee. We expect the bill to be introduced soon and that the committee will mark it up in the coming weeks."[iv] Meanwhile, House Majority Leader Eric Cantor (R-VA) is likely to support the legislation that comes out of the committee, increasing the odds that it will appear before the entire House for a vote this year.

<u>Prospects for Action and Consequences of Inaction</u>

When passed in 2002, TRIA was designed to be a temporary initiative. Indeed, as a RAND Corporation report detailed, "a key objective of TRIA was to give the private insurance industry a transitional period during which it could begin pricing terrorism insurance and develop ways to cover losses without federal assistance." However, some contend that “terrorism remains fundamentally uninsurable,” with TRIA being “necessary to support a functioning market.”[v] In any event, it seems highly unlikely that at this point in time TRIA will be allowed to simply expire; the bigger question is, what kinds of changes will the program undergo as part of the reauthorization and reform process?

As Congressman Capuano noted in remarks before The New England Council at a May event in Boston, everyone wants to extend TRIA except for a few small interest groups. While there is a group of House conservatives in particular who would prefer to see the program phased out or eliminated altogether, the general consensus is that it is better to have a federal backstop in the case of a large-scale terrorist attack. (As a side note, it appears that those conservatives are save their fire for other programs, such as the Export-Import Bank, where they believe they can make more progress in advancing their goals).

One concern surrounding reauthorization is what the result of a TRIA-less marketplace looks like. According to the 2014 Terrorism Risk Insurance Report issued by Marsh, “[i]f Congress does not renew or extend the federal backstop, the market dynamics for terrorism insurance will be disrupted and will likely result in increased pricing and limited capacity, especially for risks in the central business districts of major cities.”[vi]

Consider that “over the next five years, commercial real estate loans valued at $1.7 trillion are scheduled to mature,” as the Marsh report estimated. Accordingly, “[t]hese loans are at risk of not being eligible for refinancing and could possibly default without terrorism insurance.”[vii] Because “TRIA has been credited with making commercial terrorism insurance generally available nationwide at rates that are viewed as reasonable,” there is great uncertainty about what the terrorism insurance market would look like post-TRIA.[viii]

An additional consideration is what happens to federal government spending absent TRIA. One of the key selling points of TRIA is that “in the absence of a terrorist attack, TRIA costs taxpayers little, and in the event of a terrorist attack comparable to any experience before, it is expected to save taxpayers money.” Should TRIA be eliminated, the result could be increased federal spending to the tune of “$1 billion to $7 billion for terrorist attacks with losses ranging from $14 billion to $26 billion,” RAND found.[ix] A variety of sources would be employed to compensate for the loss of a federal backstop, including a variety of disaster and non-disaster assistance programs and measures, from Small Business Administration (SBA) loans to Community Development Block Grants (CDBG) to tax provisions such as the casualty loss income tax deduction.[x]

At the end of the day, 2014 is an election year, and while there is movement within the committee process in both the House and the Senate, it may ultimately take until November or December of this year – following those elections – to reach agreement on a deal that arrives on the president’s desk. While many would hope for the certainty that comes with an earlier reauthorization, the present bottom line is that the prospects generally look promising for TRIA to at least be reauthorized before it expires at the end of the year. As Congressman Capuano has said, "TRIA is not perfect. It is not ideal. But it is the best solution we have."[xi] Chances are, Congress will agree with that sentiment and come to agreement on a multi-year reauthorization, even if members change the details of the program itself.

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This Committee Update provides general information and not legal advice or opinions on specific facts

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[i] As referenced in www.rer.org/SP-TRIA-CMBS-04-14/.
[ii] Tom LaTourrette, Noreen Clancy, *The Impact on Federal Spending of Allowing the Terrorism Risk Insurance Act to Expire*, Santa Monica, Calif.: RAND Corporation RR-611-CCRMC, 2014.
[iii] United States Senator Charles E. Schumer. (2014). Schumer, Heller, Kirk, Reed, Murphy, Johanns Introduce Critical Bipartisan Agreement to Re-Authorize and Extend Terrorism Risk Insurance Program [Press Release]. Retrieved from http://www.schumer.senate.gov/Newsroom/record.cfm?id=350627&&&search_field=TRIA
[iv] http://thehill.com/policy/finance/208115-business-notches-win-as-terrorism-insurance-advances-in-senate
[v] LaTourrette, Clancy: 2014.
[vi] Marsh Risk Management Research, *2014 Terrorism Risk Insurance Report*.
[vii] Marsh: 2014.
[viii] LaTourrette, Clancy: 2014.
[ix] LaTourrette, Clancy: 2014.
[x] These programs and provisions are discussed further in LaTourrette and Clancy.
[xi] United States Representative Michael Capuano. Statement to the U.S. House of Representatives Committee on Financial Services. *The Terrorism Risk Insurance Act Of 2002*, Hearing, September 19, 2013. Available at: http://www.house.gov/capuano/news/2013/st091913.htm