The Senate Committee on Banking, Housing, and Urban Affairs held a hearing this morning on the **reauthorization of the Terrorism Risk Insurance Program**.

CHAIRMAN MIKE CRAPO (R-ID) called the hearing to order and moved to executive session. The Committee had intended to vote on nominations today, but Crapo said that it did not appear they'd be able to get a quorum, so they will vote off the floor after the second vote of the series that starts at 2:15 this afternoon. The Chairman reminded members of the nominations:

- Mr. Thomas Feddo to be an Assistant Secretary of the Treasury for Investment Security
- Mr. Ian Paul Steff to be Assistant Secretary of Commerce and Director General of the United States and Foreign Commercial Service
- The Honorable Michelle Bowman to be a member of the Board of Governors of the Federal Reserve System
- Mr. Paul Shmotolokha to be First Vice President of the Export-Import Bank of the United States
- Ms. Allison Herren Lee to be a member of the Securities and Exchange Commission

SENATOR SHERROD BROWN (D-OH) urged his colleagues to gather for a vote this afternoon. All these nominations are important, but he highlighted the nominations of Mr. Shmotolokha, who understands the importance of the Ex-Im Bank, and of Ms. Lee, who will be returning to an agency where she served as a strong enforcement attorney.

Chairman Crapo welcomed and introduced the witnesses:

- **Mr. Tarique Nageer**, Terrorism Placement Advisory and Leader, Property Practice, Marsh
- **Dr. Howard Kunreuther**, Co-Director, Wharton Risk Management and Decision Processes Center
- **Mr. Baird Webel**, Specialist in Financial Economics, Congressional Research Service

Crapo recounted the history of the Terrorism Risk Insurance Act of 2002, enacted after the events of September 11, 2001 to stabilize the market for terrorism risk insurance. Congress has reauthorized the program three times since then: in 2005, 2007, and 2015. His goal in each reauthorization has been to find ways for the private sector to absorb and cover losses for all but the largest acts of terror.

The 2015 reauthorization made several improvements, Crapo said. First, it increased the program's trigger from $100 million to $200 million in increments of $20 million a year. It increased the aggregate retention amount of $2 billion/year to an amount that eventually will be based on average insurance deductibles. And it decreased the co-insurance rate from 85% to 80% in one-percent increments each year. It passed the Senate by a vote of 93-4.

The program is set to expire on December 31, 2020, but well ahead of that date, the Banking Committee has begun to meet with key stakeholders to look for additional balanced reforms that will reduce taxpayer exposure without having a material negative effect on costs or take-up rates.

In 2018, the Treasury released a report on the success of the program that also discussed new developments in the marketplace for terrorism risk insurance. Treasury concluded that the program has accomplished its principal goals, but also observed that private reinsurance of terrorism risk has significantly increased under this program, and there is now increased private reinsurance capacity for the risks that remain solely within the private sector.

Today's witnesses have written extensively on the program, its effects, and market developments, Chairman Crapo said. In 2018, Dr. Kunreuther co-authored a report that found that overall, TRIA has worked well. Marsh's 2019 Terrorism Risk Report discussed take-up rates as well as costs, geographic, and corporate trends in terrorism risk insurance. They emphasized that the TRIA federal backstop remains crucial to continued stability. The CRS published a report in April 2019 providing a comprehensive history of the program and key considerations for this Congress.

Crapo said he looked forward to hearing more about specific considerations in evaluating the program's effectiveness, how the program has evolved over time, how the marketplace has responded, what additional room exists to reduce taxpayer exposure, and how market participants may react to changes.

SENATOR BROWN said that after the last reauthorization, they all understand the need to start this process early, well before the next expiration date at year-end 2020. TRIA is critical to economic stability, he said, even in the absence of terrorist attacks. Businesses rely upon it in order to get access to credit, and without government assistance, companies could not provide this coverage, especially to small businesses.

Brown noted that TRIA was originally supposed to be temporary, but both parties have agreed on the value of keeping it. "Terrorism" applies not only to major cities but also to smaller places, in cases of domestic terrorism as well as international terrorism. He's glad they've been able to work on this in a bipartisan way.

Brown said that some would prefer that government not make these types of guarantees — for pensions, or social security, or mortgages and affordable housing, or health care, or food for low-income families — but he thinks this program and others are emblematic of their power to use government to make the economy work better for everyone. The last bipartisan authorization struck a balance that seems to work well, he said. They have the opportunity to make the program even more effective this time around, through a long-term extension.

Testimony

MR. NAGEER said that Marsh & McClennan lost 295 colleagues and scores of associates on 9/11. As the leading risk advisor in the insurance market, Marsh has a unique perspective on the terrorism risk insurance program.

Terrorism remains an evolving, expanding, and ever-present risk, which is why it remains so important to keep the terrorism risk insurance program in place to ensure stability. They have seen a decline in the frequency and severity of terrorism incidents in the US, and there have been no certified terrorism losses in the US since the enactment of TRIA. This is not a reason to end the program, though, and Marsh called for its reauthorization and modernization, including an expansion of the exisiting public-private partnership.

He said that his testimony would cover four areas:

First, findings from Marsh's 2019 terrorism risk insurance report highlighted that terrorism risk is not only a big business or big city issue. Education entities were the most frequent purchasers of terrorism risk insurance in 2018, while companies in hospitality, health care, gaming, life sciences, and nonprofits were also among the top 10 buyers. The uptake for TRIA coverage in property policies averaged 62% in 2018. A wide array of industries rely on this coverage.

Second, while there have been no significant insured losses in recent years, and the industry remains well-capitalized, access to terrorism risk insurance still depends on insurers' preference, appetite, and aggregate constraints. If the federal backstop disappears, Nageer said, there's a strong possibility that premiums will rise across multiple insurance lines, not just terrorism, and a major market disruption would be likely.

Third, TRIA plays an integral role in the availability and affordability of workers' compensation insurance. As long as the federal backstop remains in place, there should be adequate capacity for terrorism-related workers' compensation coverage. Under state regulations, workers' compensation policies cannot limit coverage for injuries caused by terrorism or nuclear/chemical/biological/radiological causes (NCBR). NCBR coverage is typically not included in reinsurance contracts, and in 2014, the uncertainty around TRIA reauthorization caused some insurers to step back from insuring companies with high employee concentrations in certain cities. As insurers begin to review policies with expiration dates past 2020, this is likely to recur unless Congress steps forward to renew TRIA promptly.

Finally, he said, Marsh is already seeing an effect on policies that expire past 2020, with some companies unwilling to renew policies with expiration dates past the TRIA expiration date, or increasing their prices to cover additional risk.

Marsh believes that the Terrorism Risk Insurance Program is "a model public-private partnership" that benefits everyone, and called for a seamless renewal process with robust reauthorization. Nageer thanked the Committee for starting this process early.

DR. KUNREUTHER said that the Wharton Risk Center had produced several studies on the 2014 TRIA reauthorization process. His testimony, he said, would focus on potential modifications to improve the public-private partnerships. He cited his book The Ostrich Principle, which identified five biases that reduce companies' willingness/ability to prepare for disaster:

1. Myopia, the tendency to focus on short-term costs over long-term benefits;
2. Amnesia, the tendency to forget too quickly the lessons of past disasters;
3. Optimism, the tendency to underestimate the likelihood that losses will occur;
4. Simplification, the tendency to attend to only a subset of relevant facts when making risk evaluations; and
5. Herding, the tendency to base choices on the observed actions of others.

He suggested four areas of action to address these biases:

1. Incentivizing cost-effective mitigation measures by firms, which TRIA does not currently do; long-term mitigation loans, such as those offered by FEMA to address flood prevention, could be one approach, while insurers could offer premium discounts for firms that make those investments.
2. Federal protection against catastrophic losses. It is important that the federal government cover NCBR losses and recoup expenses under TRIA. This is the intent of current law, but Kunreuther is not sure the law actually does this. Congress and stakeholders should not exhibit optimism or amnesia biases here, believing it will not happen in the US because it hasn't happened yet.
3. Setting expectations for behavior of insurers and Congress after attacks; will insurers follow the simplification bias of addressing only the worst cases? What will Congress do if insurers ratchet up premiums? Insurers might consider multi-year policies.
4. Look at interdependencies, particularly in areas such as cyberspace. Treasury and the private insurers need to interact with each other to identify and address these interdependencies.

MR. WEBEL said he had been working on this issue at CRS since 2003, so has seen the reauthorizations. Congress has faced three broad questions in these reauthorizations:

1. Is a federal terrorism risk insurance program needed? TRIA was specifically passed as a temporary three-year program. Congress has seen a need to extend the program to give the private market additional time to respond to the threat of terrorism-related losses.
2. How should insurers share in funding terrorism risk? The program includes a deductible and a program trigger, which is an aggregate amount of losses needed before the TRIP kicks in; there is an individual insurer deductible, set according to their exposure; and there is an insured loss share compensation, which is essentially a co-pay. Finally, there are terrorism loss-spreading premiums, which charge premiums after the fact. All of these have been adjusted over the life of TRIA to increase the participation of the private sector.
3. What should a federal terrorism insurance program cover? Right now, TRIA works through the private insurance market, as a backstop for insurance lines defined by TRIA. If an insurer offers coverage for fire damage, for example, it must cover losses from fires caused by terrorism. But customers are not required to buy those policies, and the terms and conditions that apply are the same for accidental causes as for terrorism-related causes. This has become particularly important for losses caused by NCBR, because most private insurance policies exclude NCBR-related losses regardless of the source. These are the terrorist attacks that cause the most damage, and they are the least likely to be covered.

Q&A

CHAIRMAN CRAPO said he had two priorities in this process: making sure that TRIA continues to stabilize the market, and minimizing taxpayer exposure. He asked Mr. Webel what factors CRS looks at to determine whether TRIA has been effective and to measure its future success.

Webel said the take-up rate is important, as we've seen in the case of flood insurance, where a lot of people affected by flooding have not purchased flood insurance policies. An insurance program doesn't help if people aren't buying the policies. Private reinsurance capacity is another measure of how well the private market is responding.

Crapo asked Mr. Nageer to describe how changes to TRIA's co-insurance rate and program trigger may affect smaller and larger insurers. Nageer said that a few levers have been adjusted over the lifespan of TRIA, and insurers have been able to adjust to these incremental changes to the trigger levels and co-insurance rates. The marketplace can respond to this because it has adequate capital, but it's important that these changes be incremental, with plenty of notice. The 20% deductible is a big number for the very large insurers, but Guy Carpenter analysts have found that the biggest impact of any abrupt changes to the trigger would fall on about 240 insurers that fall between the $100 million and $500 million levels of policyholder surplus.

Crapo asked Dr. Kenreuther about his call for incentivizing mitigation — how would this work? Kenreuther said that mitigation is not currently part of TRIA because it's always a challenge to get measures, although there's been work done in this area. If costs of mitigation can be spread over time, chances of successful investment will be higher because people will no longer be making short-term decisions that prevent long-term benefits. FEMA has done this for flooding; banks and financial institutions could do this, but the federal government could do it, too. The benefits of mitigation include premium reductions that might be greater than the annual cost of the loan.

SENATOR BROWN said there had been a number of white supremacist attacks on places of worship, and recently the Jewish Federation of Cleveland has had a hard time getting insurance against these attacks. He asked Mr. Webel whether these were the kind of problems TRIA was designed to addres.

Webel said that TRIA didn't specify types of terrorism, and a previous reauthorization removed the requirement that it apply only to foreign terrorism. It only requires that an act be certified as terrorism by the Secretary of the Treasury.

Brown asked whether having insurance available but priced out of affordability meets Congressional intent. Webel said that the law was silent on this; it doesn't set standards for affordability. Brown said that if you can't afford it, you really don't have access to it. Webel said that some state laws stipulate that these premiums are not supposed to be "excessive." TRIA defaults to these state standards. Brown said it might be Congress's obligation to pressure state regulators to make this affordable.

Brown said that Treasury had used its discretion to clarify TRIA's applicability to cyber terrorism risk. Does Treasury have the ability to make sure religious-affiliated institutions have access to terrorism risk insurance? Webel said he saw no direct lever in the current law for Treasury to do this. Mr. Nageer said they believed the terrorism insurance market was quite competitive, with lots of companies having the capacity to offer terrorism risk insurance for all ranges of motives. TRIA served to create this vibrant marketplace.

Brown asked whether Congress should extend TRIA for a longer period of time, and if so, for how long? Nageer said the last reauthorization had been for five years, but the one before that was for seven years, and that worked well; he'd like to see an extension for 7-10 years. It would allow the marketplace to adapt and grow, and add capital. Dr. Kunreuther said a longer period is always desirable, but there are tradeoffs — you can't always know what you'll need to address, as in the case of cyber. Webel said that CRS has no position, but insurers prefer longer terms for planning purposes.

SENATOR THOM TILLIS (R-NC) asked Dr. Kunreuther and Mr. Nageer how the low incidence of losses is affecting terrorism risk insurance premiums. Nageer said that premiums have been trending down because insurers are well capitalized and haven't had to pay a major claim recently.

Tillis said he didn't believe they should have a permanent reauthorization, because the world changes. He does think they should have a discussion about what a reasonable planning horizon might be. He asked Dr. Kunreuther whether they should be looking at any specific areas for modernization or reform.

Kunreuther said that one of the challenges is that when you have a recoupment, companies aren't looking to set premiums based on the catastrophic losses that the government would cover. There are advantages to this, but Congress should be asking what types of risk transfer mechanisms are available in the form of reinsurance or catastrophe bonds, and what role these mechanisms could play. They're experimenting with catastrophe bonds in the UK.

Tillis said that mitigation had been a thorn in his side on flood insurance, because they talk a lot about it but never do anything. But it seems that given the nature of the terrorism threat, there's only so much a company can do; what types of mitigation are available in this area? Kunreuther said this was an excellent point, because you can't model terrorism attacks. But the UK is pursuing some mitigation measures such as concrete structures and other safety measures. We all want to reduce these losses. Tillis agreed that the more we can do to reduce losses, the safer everyone would be, and some of these mitigation measures could eliminate categories of attacks. He thinks this is worth pursuing. Kunreuther said this also addresses the affordability issue.

Nageer cautioned that as one protects the hard targets, softer targets appear. Smaller cities offer softer targets.

SENATOR ROBERT MENENDEZ (D-NJ) said that insurance markets are generally private, and the government's role is limited unless there's a public interest or a breakdown in the public market. Terrorism risk insurance falls into both of those categories. Insurance companies, for example, can't have their own intelligence agencies. He asked the witnesses to elaborate on how terrorism differs from other risks.

Dr. Kunreuther said that a real challenge is estimating the likelihood of success of a terrorist attack. Before 9/11, insurers weren't worried about this. Catastrophic losses and the potential for catastrophic losses discourage private insurers from offering coverage, but TRIA provides a backstop that makes coverage possible. Insurers have found that a number of companies are willing to buy these policies.

Menendez said we don't know what the next form of terrorism will be, or its magnitude. The iterations will always be beyond our imagination. Banks often require terrorism coverage as a condition for loans, and allowing TRIA to lapse could have serious consequences. He asked Mr. Nageer what happened in the commercial real estate lending markets in 2014, when Congress allowed TRIA to expire for 12 days.

Nageer said that acts of terrorism are not like acts of nature, so they are very difficult for insurers to model. 9/11 remains the key data point on the model. In 2014, the uncertainty "was very hectic" — insurers on both property and workers' compensation were putting sunset provisions on policies, in case TRIA wasn't renewed. They're already considering sunset clauses for any policy that starts on January 1, 2020 or later. Menendez said that lenders were likely to be much less willing to lend if they know an insurance policy might lapse at the end of next year. Nageer said that lender requirements on construction deals, in particularly, will be onerous in these situations.

SENATOR JACK REED (D-RI) asked Mr. Webel how TRIA treats NCBR events. Webel said that TRIA treats NCBR like any other mode of attack, but most private insurance policies exclude these events regardless of whether they're accidents or terrorism. If a private insurance policy excludes it, it is effectively excluded under TRIA. A dirty bomb or an anthrax attack, for example, might not be covered by TRIA because the underlying private insurance policies don't cover it.

Reed asked whether the CRS had any changes to suggest in this area. Webel said that the TRIA mechanism has worked really well through the private market. It would be possible for Congress to nullify certain exclusions, or to create more incentives for NCBR coverage — lowering deductibles, triggers, or co-shares.

Dr. Kunreuther said that he believed it was always Congress's intent to provide some coverage for NCBR events in the absence of private insurance coverage, but this was not explicit. It may be necessary to include this explicit language in the law. Webel agreed, but said they'd still need to figure out what the mechanism for this coverage would be. If the private companies are not offering this coverage, how would it be delivered?

Reed asked how they should adapt TRIA to the changing environment — specifically, for cyber risk. Webel said that cyber is the new threat, and Treasury has made it clear that cyber risk insurance will be covered under TRIA. It might still be worthwhile to make this explicit in the statute, because it's unclear what damage would meet the triggers.

CHAIRMAN CRAPO thanked the Senators and the witnesses. Additional questions are due by June 25, and Crapo said the witnesses were likely to receive quite a few, since several Senators were not able to attend today's hearing. The hearing was adjourned.