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Congress prepares to renew $40bn bill terrorism insurance law

The Terrorism Risk Insurance Act has never covered a single company from terrorism costs and has earned $40bn in revenue for insurance companies. But Congress is too afraid to end it

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On Thursday, the House financial services committee debated whether to renew a law mandating a bailout of sorts for the insurance industry: a government backstop for insurance companies to provide terrorism insurance.

Even though this program has existed since 2002 and has never been used, by any US company, its path through Congress has always been frictionless.

Meet the screwed-up, scared congressional dynamic around 'Tria'.

The Terrorism Risk Insurance Act provides a government backstop to insurance companies in the event of a terrorist attack. Tria arrived in the wake of the September 11 attacks, when it arose as a way for the government to protect the insurance companies from taking huge losses that would put them out of business after a terrorist attack.

The rationale behind Tria is simple. Previously, there was no contract by which companies could protect themselves from terrorism costs. That was a disaster when the insured loss for 9-11 approached $40bn, with most of it paid by insurance companies and the firms who insure *them*, known as reinsurers.

The appeal is clear – to insurers, who have been raking in cash. Over 60% of all businesses have purchased government-subsidized terrorism insurance since 2002. The program has cost the government $1m a year – almost nothing – but has made an estimated $40bn in revenue for insurance companies, who have never paid a claim, or given a dime to the government for their reinsurance protection.

“This is largely a handout to the insurers and the insured industries,” said Mark Calabria, director of financial regulation studies at the libertarian Cato Institute.

Some wonder whether the program, designed to limit the economic fallout from terrorism, has simply built the insurance industry a money machine, subsidizing their business with risk-free profits.

“To me it’s a subsidy that largely benefits corporations,” Calabria said, arguing that insurance companies get a lower risk to their profits, and businesses get artificially cheap insurance. “You’re not minimizing the costs of terrorism, just shifting them from corporations to the taxpayer.”

Clearly the insurance industry likes the guarantee, having profited handsomely from it. So they have no motivation to change the status quo.

And lawmakers are in a tough spot, responding to the fear of economic calamity in the event of an attack by effectively giving the insurance industry a free lunch.

Yet Tria sails on blithely, drawing support from Democrats and Republicans every time, without fail. The association with anti-terrorism virtually assures passage through Congress – despite little public debate over what this legislation actually does and who it benefits.

Profits from terrorism protection

Here's how Tria rewards insurance companies: Tria only gets triggered if the Treasury secretary designates an attack as a “terrorist event."

That's a high bar: Even the Boston Marathon bombing was not considered a terrorist attack for insurance purposes. In fact, the industry got a boost from that event, as more businesses decided to buy terrorism coverage in the aftermath.

The law creates a threshold of total insurance losses from terrorist attacks in a given year, originally $10bn (the threshold has risen over the years to $27.5 bn).

After that, the government kicks in, effectively becoming the reinsurer on terrorism claims, and paying a whopping 85% of the costs. The law allows the government to recoup those payouts in subsequent years with a 3% surcharge on annual premiums, but the industry pays nothing up-front for the reinsurance protection -- which would cost them a lot if they had to buy it from a private company.

Tria has been popular with the financial and real-estate industries in particular. Financiers for everything from office parks to college buildings want the protection, and wouldn’t fund large-scale construction without it. The Coalition to Insure Against Terrorism includes policyholders from just about every large business sector, from Citigroup to Campbell’s Soup, from hotels to chain restaurants. They believe the federal backstop supports the economy by facilitating investments and making insurance prices affordable for companies.

In 2002, terrorism was an imminent risk. But in the subsequent 12 years, Tria has never paid out, nor have any insurance companies, according to experts.

“The only cost to the program has been administrative, about $1m a year,” said Henry Willis, director of the Rand Corporation’s Homeland Security and Defense Center.

Because Tria forced transparency from insurers for the cost of terrorism insurance, we have a decent handle on precisely how much insurance companies have collected from companies in premiums.

Tom LaTourette, a Senior Physical Scientist with Rand, ran the calculations. “In the end, I came up with $4.6bn a year,” he said.

From that estimate, you can make a reasonable guess that the insurance industry has accumulated over $40bn in revenue from terrorism insurance premiums since the introduction of TRIA -- without ever paying a claim, and without giving a dime to the government for their reinsurance protection.

Tria: the never-used legislation that Congress loves

Calabria, a staffer for the Senate banking committee in 2002 when the issue first passed, says that the insurers pitched Tria as a temporary measure. Given the atmosphere in Washington after 9/11, it was an easy sell.

Tria has been reauthorized twice, in 2005 and 2007, and a third extension would push it out to at least 2019.

After a bipartisan deal on a seven-year extension, the Banking committee passed it unanimously earlier this month. House Republicans created a five-year extension that would increase the trigger for Tria to kick in, and lower the government share of the costs from 85% to 80%. Democrats objected, but supported "moving the process forward," and the House version passed out of committee Thursday on a party-line vote.

The House Republican version also includes a study on whether to charge insurance companies for the government reinsurance protection. But in Washington, commissioning a study is what you do when you don't actually want to change anything.

The probability of a terrorist attack is vanishingly low, and government already funds insurance against it in the form of the Department of Homeland Security and the massive budgets for intelligence and defense. But Tria will nonetheless almost certainly get renewed. “You can count the opposition on one hand,” Calabria said.

The birth of terrorism insurance

When TRIA was first created, the 9/11 attacks had created a financial catastrophe for insurance companies. Terrorism wasn't covered in any of their policies. The expense was so high, and the event so anomalous, that reinsurers subsequently refused to reimburse the insurers for all the costs of corporate property damage.

Insurance companies responded by seeking state-by-state terrorism exclusion clauses, similar to exclusions for events like war. But New York, California and Texas held out. These states, considered at greatest risk for future attacks, feared being on the hook for bailing out the insurers and companies affected in the aftermath.

At the same time, financiers pressured developers of large buildings to get insurance protection from terrorism, but without government subsidies, insurers were reluctant to offer it. Billions of dollars in real estate projects were stalled or canceled as a result.

Replacing government-backed terrorism insurance

Tria is just profit-boosting kabuki, critics say.

Mark Calabria of Cato sees this as a total giveaway. He also considers the program unnecessary. He supports either a return to private reinsurance options, or voluntary, multi-state risk-sharing pools, without federal backing.

Congress could make this a fully public program, removing the taint of what looks like an insurance industry bailout. But insurers get all kinds of largesse from Congress; just this month they engineered one of the few changes to the Dodd-Frank Act, simply to relieve them from a regulatory burden.

Other experts argue that the insurance industry could not figure it out on its own; it just cannot mathematically predict the risk.

“We have learned about terrorism risk, but it’s hard to model those really catastrophic events we’ve never seen but can’t discount entirely,” said Henry Willis of Rand, who wrote a recent report on the subject. “That’s where government steps in.”

Rand and other government-funded studies argue that costs are actually lower with the backstop than if Tria went away. Federal disaster assistance would be more expensive, they argue.

But without a public discussion, it’s hard to see whether Tria merely facilitates commerce and lowers the risk of a terrorist attack becoming an economic disaster, or if it just facilitates corporate welfare, with government guaranteeing the costs, and insurance companies taking the profits.