108TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
108–780

TERRORISM INSURANCE BACKSTOP EXTENSION ACT OF 2004

NOVEMBER 18, 2004.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. OXLEY, from the Committee on Financial Services, submitted the following

R E P O R T

together with

DISSENTING VIEWS

[To accompany H.R. 4634]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 4634) to extend the terrorism insurance program of the Department of the Treasury, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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39–006

AMENDMENT

The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Terrorism Insurance Backstop Extension Act of 2004".

SEC. 2. EXTENSION OF TERRORISM INSURANCE PROGRAM.

(a) PROGRAM YEARS 4 AND 5.—Paragraph (11) of section 102 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended by adding at the end the following new subparagraphs:

"(E) PROGRAM YEAR 4.—The term 'Program Year 4' means the period beginning on January 1, 2006 and ending on December 31, 2006.

"(F) PROGRAM YEAR 5.—The term 'Program Year 5' means the period beginning on January 1, 2007 and ending on December 31, 2007.".

(b) INSURER DEDUCTIBLE.—Paragraph (7) of section 102 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended—

(1) by redesignating subparagraph (E) as subparagraph (G);

(2) in subparagraph (D), by striking "and" at the end;

(3) by inserting after subparagraph (D) the following new subparagraphs:

"(E) for Program Year 4, the value of an insurer's direct earned premiums over the calendar year immediately preceding Program Year 4, multiplied by 15 percent;

"(F) for Program Year 5, the value of an insurer's direct earned premiums over the calendar year immediately preceding Program Year 4, multiplied by 20 percent; and"; and

(4) in subparagraph (G) (as so redesignated by paragraph (1)) of this subsection—

(A) by striking "(D)" and inserting "(F)"; and

(B) by striking "or Program Year 3" and inserting "Program Year 3, Program Year 4, or Program Year 5".

(c) MANDATORY AVAILABILITY.—Subsection (c) of section 103 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended—

(1) by striking all of the matter that precedes subparagraph (A) of paragraph (1) and inserting the following:

"(c) MANDATORY AVAILABILITY.—During the Program, each entity that meets the definition of an insurer under section 102—";

(2) by striking paragraph (2); and

(3) by redesignating subparagraphs (A) and (B) as paragraphs (1) and (2) and realigning such paragraphs, as so redesignated, so as to be indented 2 ems from the left margin.

(d) INSURED LOSS SHARED COMPENSATION.—Subsection (e) of section 103 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended

(1) in paragraph (2)(A), by striking "or Program Year 3" and inserting ", Program Year 3, Program Year 4, or Program Year 5";

(2) in paragraph (3), by striking "or Program Year 3" and inserting ", Program Year 3, Program Year 4, or Program Year 5";

(3) in paragraph (6)—

(A) in subparagraph (B), by striking "and" at the end;

(B) in subparagraph (C) by striking the period at the end and inserting a semicolon; and

(C) by adding at the end the following new subparagraphs:

"(D) for Program Year 4, the lesser of—

"(i) $17,500,000,000; and

"(ii) the aggregate amount, for all insurers, of insured losses during such Program Year;

"(E) for Program Year 5, the lesser of—

"(i) $20,000,000,000; and

"(ii) the aggregate amount, for all insurers, of insured losses during such Program Year; and"; and

(4) in paragraph (7)—

(A) in subparagraph (A), by striking "and (C)" and inserting "(C), (D), and (E)"; and

(B) in subparagraphs (B) and (C), by striking "or (C)" each place such term appears and inserting "(C), (D), or (E)".

(e) COVERAGE OF GROUP LIFE INSURANCE.—

(1) IN GENERAL.—Paragraph (5) of section 102 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended in the matter that precedes subparagraph (A) by inserting "or group life" after "property and casualty".

(2) TECHNICAL AND CONFORMING AMENDMENTS.—The Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended—

(A) in section 102—

(i) in paragraph (1)—

(I) in subparagraph (B)(i), by inserting "or group life insurance" after "workers' compensation"; and

(II) in subparagraph (B)(ii), by inserting "and group life insurance" after "property and casualty insurance";

(ii) in paragraph (4)—

(I) by inserting "or for group life insurance" after "property and casualty insurance"; and

(II) by striking "paragraph (5)" and inserting "paragraph (6)";

(iii) in paragraph (5), by inserting "and group life insurance" after "workers' compensation"; and

(iv) in paragraph (6)—

(I) in subparagraph (A)(i), by inserting "property and casualty or group life" after "excess";

(II) in subparagraph (B), by inserting "or group life insurance coverage" after "property and casualty insurance coverage";

(v) by redesignating paragraphs (5) through (16) as paragraphs (6) through (17), respectively; and

(vi) by inserting after paragraph (4), the following new paragraph:

"(5) GROUP LIFE INSURANCE.—The term 'group life insurance' means an insurance contract that provides term life insurance coverage, accidental death coverage, or a combination thereof, for a number of persons under a single contract, on the basis of a group selection of risks.";

(B) in section 103—

(i) in subsection (b)(1), by inserting "(including a named beneficiary in the case of a group life insurance policy)" before the second comma;

(ii) in subsection (c)—

(I) in paragraph (1) (as so redesignated by subsection (c)(3) of this section), by inserting "and group life" after "property and casualty"; and

(II) in paragraph (2) (as so redesignated by subsection (c)(3) of this section), by inserting "and group life" after "property and casualty";

(iii) in subsection (e)—

(I) in paragraph (6), by striking "For " and inserting "Except as provided in subparagraph (F) of this paragraph, for";

(II) in paragraph (6), by inserting after subparagraph (E) (as added by subsection (d)(3)(C) of this section) the following new subparagraph:

"(F) for each of the periods referred to in subparagraphs (A) through (E), the amounts provided under such subparagraphs, as such amounts shall be increased by the Secretary before the expiration of the 90-day period beginning on the date of the enactment of the Terrorism Insurance Backstop Extension Act of 2004, based on the increase in the size of the Program caused by the inclusion of group life insurance pursuant to such Act, in proportion to the increased premiums involved.";

(III) in paragraph (7)(C), by inserting "or group life insurance" after "workers compensation";

(IV) in paragraph (8)(A)(i), by inserting "and group life" after "property and casualty"; and

(V) in paragraph (8), by inserting "or group life" after "property and casualty" each place such term appears in subparagraphs (A)(iii) and (C); and

(iv) by striking subsection (h);

(C) in section 105(c), by inserting "or group life" after "property and casualty"; and

(D) in section 108(d)(1), by inserting "and the group life insurance industry" after "property and casualty insurance industry".

(3) REQUIRED RULEMAKING.—Not later than 90 days after the date of the enactment of this Act, the Secretary of the Treasury shall issue final regulations to carry out this subsection.

(f) STUDY ON LONG-TERM SOLUTIONS.—Section 103 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended by striking subsection (i) and inserting the following new subsection:

"(h) STUDY ON LONG-TERM SOLUTIONS.—By June 1, 2005, the Secretary shall conduct a study and submit a report to the Congress on alternatives for expanding the availability and affordability of terrorism insurance after the termination of the Program that do not involve a Federal financial backstop.".

(g) TERMINATION OF PROGRAM.—

(1) TERMINATION.—Subsection (a) of section 108 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended by striking "December 31, 2005" and inserting "December 31, 2007".

(2) FINAL GAO STUDY AND REPORT.—Subsection (d) of section 108 of the Terrorism Risk Insurance Act of 2002 (15 U.S.C. 6701 note) is amended by adding at the end the following new paragraph:

"(3) FINAL GAO STUDY AND REPORT.—The Comptroller General of the United States shall conduct an assessment of the matters referred to in paragraph (1) and shall submit a report to the Congress, not later than June 30, 2007, on the results of such study.".

PURPOSE AND SUMMARY

H.R. 4634, the Terrorism Insurance Backstop Extension Act of 2004, extends the Terrorism Risk Insurance Act (TRIA) for two years while maintaining a gradual increase in TRIA's taxpayer protections. H.R. 4634 also adds group life insurers to the TRIA program and requires the Treasury Department to report on long-term alternative solutions for expanding the availability and affordability of terrorism insurance. The bill also requires the Government Accountability Office (GAO) to report to Congress by June 30, 2007 on TRIA's effectiveness and the capacity of insurers to offer terrorism insurance after TRIA expires, as well as the availability of terrorism insurance for various policyholders.

BACKGROUND AND NEED FOR LEGISLATION

The terrorist attacks of September 11, 2001 resulted in a tragic number of deaths and injuries, along with the destruction of the World Trade Center and other buildings and businesses. After sustaining approximately $40 billion in losses on that day, many insurers and reinsurers began to exclude terrorism coverage from commercial policies. Architects, engineers, construction workers, real estate professionals and other Americans whose jobs depended on the availability of insurance coverage faced work stoppages and unemployment.

Congress passed the Terrorism Risk Insurance Act of 2002 (Public Law 107–297) to address concerns that the lack of terrorism insurance could have significant adverse effects on jobs and economic growth. The purpose of TRIA was twofold: to make terrorism insurance widely available and affordable for the duration of the Act, and to provide a transition period during which insurance market participants could diversify their exposure and develop resources and mechanisms that would enable them to offer terrorism insurance after TRIA expired on December 31, 2005.

TRIA is a public-private partnership designed to allow the private market to develop mechanisms to provide terrorism risk coverage while guaranteeing that any Federal assistance in the interim is partly repaid by the insurance industry and beneficiaries of the program. The bill established the Terrorism Risk Insurance Program in the Department of the Treasury, through which the Federal government would share the risk of loss from future terrorist attacks with the insurance industry for a temporary period of time. TRIA expires on December 31, 2005.

Under TRIA, the Federal government shares 90 percent of each insurer's covered terrorism losses beyond a per company deductible. The insurance marketplace as a whole is then required to pay back a portion of the Government share over time (the "retention"). The insurer deductibles are gradually increased each year (10 percent to 12.5 percent to 15 percent), as are the retention levels ($10 billion to $12.5 billion to $15 billion). This annual increase in the insurer deductibles and retentions is intended to ensure that TRIA does not become permanent by slowly phasing out the Government share and thereby encouraging the development of alternative terrorism coverages.

The GAO found that TRIA has improved the availability of terrorism insurance and has prompted reinsurers to offer a limited amount of coverage for terrorist events. In particular, terrorism coverage has been made available for high-risk properties. Additionally, TRIA has contributed to better credit ratings for some commercial mortgage-backed securities.

Despite TRIA's impending expiration, no viable alternatives to the Federal backstop have been developed. According to the GAO, "Most industry experts are tentative about predictions of the level of reinsurer and insurer participation in the terrorism market after TRIA expires * * * [Also,] to date there has been little discussion of possible alternatives for ensuring the availability and affordability of terrorism coverage after TRIA expires." This view was echoed by Gregory Serio, Superintendent of Insurance for the State of New York, at a joint hearing held in the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and the Committee on Oversight and Investigations on April 28, 2004. According to Superintendent Serio, "Current marketplace dynamics will be seriously and adversely impacted if TRIA, in some form or another, is not reauthorized or if reinsurers that vacated the market for terrorism insurance coverage after September 11th, do not reenter the market. This is borne out by the fact that since September 11th there has been no meaningful coverage available for non-certified acts of terrorism."

The bill as ordered reported extends TRIA for two years and requires terrorism insurance coverage to be "made available" for the entire duration of the Program. It maintains the gradual increase in TRIA's taxpayer protections, continuing to slowly phase out the Program by increasing the taxpayer reimbursement from $15 billion in Program Year 3 to $17.5 billion in Year 4 and $20 billion in Year 5. The legislation also maintains steady increases in insurer deductibles, holding the deductible at 15 percent in Program Year 4, but continuing to phase out the program with a 20 percent deductible in Program Year 5.

To further ensure the development of alternatives to TRIA, the bill requires the Treasury Department to report on long-term solutions for expanding the availability and affordability of terrorism insurance without a Federal backstop. Additionally, the bill also requires the GAO to report to Congress by June 30, 2007 on TRIA's effectiveness and the capacity of insurers to offer terrorism insurance after TRIA expires, as well as the availability of terrorism insurance for various policyholders. A one-time extension to TRIA will provide the additional time needed for the insurance marketplace and Congress to develop long-term solutions while preventing potential market disruptions that might otherwise occur if TRIA was allowed to expire before the terrorism insurance marketplace has stabilized.

It is important to note that the only major change to the program contained in the Committee's amendment is the addition of coverage for group life insurance. Group life was included in the Committee's amendment because two years after TRIA's implementation, the catastrophic reinsurance market for group life has not reemerged as originally hoped. Another 9/11-sized terrorist event could significantly impact the solvency of the group life insurance marketplace. Expanding the TRIA backstop for group life insurance ensures that America's workers will continue to have more options for protecting their families from future terrorist attacks.

HEARINGS

The Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and the Subcommittee on Oversight and Investigations held a hearing on April 28, 2004 on H.R. 4634, the Terrorism Insurance Backstop Extension Act of 2004. The following witnesses testified: The Honorable Wayne A. Abernathy, Assistant Secretary for Financial Institutions, United States Department of the Treasury; The Honorable Gregory V. Serio, Superintendent, New York State Insurance Department; and Mr. Richard J. Hillman, Director, Financial Markets and Community Investment, United States Government Accountability Office.

COMMITTEE CONSIDERATION

Pursuant to rule 5(b)(3) of the Rules of the Committee on Financial Services for the 108th Congress, the Chair discharged the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises from the further consideration of the bill on September 24, 2004.

The Committee on Financial Services met in open session on September 29, 2004 and ordered H.R. 4634, the Terrorism Insurance Backstop Extension Act of 2004, favorably reported to the House, with an amendment, by a voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. No record votes were taken with in conjunction with the consideration of this legislation. A motion by Mr. Oxley to report the bill to the House with a favorable recommendation was agreed to by a voice vote.

The following other amendments were also considered by the Committee:

An amendment by Mr. Oxley, No. 1, to include group life coverage under the Terrorism Risk Insurance Program and direct GAO to conduct a study on terrorism insurance, was agreed to by a voice vote.

An amendment by Mr. Sherman, No. 2, requiring annual reports on the availability of homeowner's insurance for losses resulting from catastrophic disasters, was withdrawn.

An amendment by Mr. Capuano, No. 3, requiring a "soft landing" in the year following Program Year 5, was withdrawn.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee held a hearing and made findings that are reflected in this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

> The Department of the Treasury will use the authority granted in this legislation to extend the Terrorism Risk Insurance Program until December 31, 2007 and to expand TRIA to include group life insurers.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee finds that this legislation would result in budget authority, entitlement authority, or tax expenditures or revenues consistent with the estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, November 18, 2004.

Hon. MICHAEL G. OXLEY,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4634, the Terrorism Insurance Backstop Extension Act of 2004.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Megan Carroll and Melissa E. Zimmerman.

Sincerely,

ELIZABETH ROBINSON
(For Douglas Holtz-Eakin, Director).

Enclosure.

H.R. 4634—Terrorism Insurance Backstop Extension Act of 2004

Summary: H.R. 4634 would extend the Terrorism Risk Insurance Act (TRIA) through calendar year 2007 and would add group life insurance to the lines of coverage offered under TRIA. Enacted in 2002, TRIA requires insurance firms that sell commercial property and casualty insurance to offer clients insurance coverage for damages caused by terrorist attacks. Under the act, the government would help insurers cover losses in the event of a terrorist attack. Under current law, TRIA will expire at the end of the calendar year 2005.

CBO cannot predict how much insured damage terrorists would cause in any specific year. Instead, our estimate of the cost of financial assistance provided under H.R. 4634 represents an expected value of payments from the program—a weighted average that reflects the probabilities of various outcomes from zero damages up to very large damages due to 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 average annual loss from providing this insurance, although firms do not pay any premium for the assistance offered by TRIA.

On this basis, CBO estimates that enacting H.R. 4634 would increase direct spending by about $1.1 billion over the 2005–2009 period and by $1.3 billion over the next 10 years. Under TRIA, the Treasury Department would recoup some or all of the costs of providing financial assistance through surcharges; hence, over many years, CBO expects that an increase in spending for financial assistance would be nearly offset (on a cash basis) by a corresponding increase in governmental receipts (i.e., revenues). We assume, however that the Secretary would not impose any surcharges until one year after federal assistance is provided and that those amounts would be collected over several years. Thus, CBO estimates that enacting H.R. 4634 would increase governmental receipts by about $70 million over the 2005–2009 period and by $480 million over the next 10 years.

H.R. 4634 would extend or expand several intergovernmental and private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the aggregate costs of complying with those mandates would not exceed the annual thresholds established by UMRA ($60 million for intergovernmental mandates and $120 million for private-sector mandates in 2004, adjusted annually for inflation).

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 4634 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By fiscal year, in millions of dollars—									
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
CHANGES IN DIRECT SPENDING										
Estimated Budget Authority	10	200	390	310	170	80	50	30	20	20
Estimated Outlays	10	200	390	310	170	80	50	30	20	20
CHANGES IN REVENUES										
Estimated Revenues	0	0	0	20	50	70	80	80	90	90

Basis of estimate: For this estimate, CBO assumes that H.R. 4634 will be enacted by the end of calendar year 2004. We estimate that enacting H.R. 4634 would increase direct spending by about $1.3 billion and would increase governmental revenues by $480 million over the 2005–2014 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 could vary greatly from the estimated amounts.

H.R. 4634 would extend the Terrorism Risk Insurance Act through calendar year 2007. TRIA will expire under current law on December 31, 2005. TRIA provides up to $100 billion in financial assistance to commercial property and casualty insurers for losses above certain thresholds due to certain types of future terrorist acts. Upon enactment, H.R. 4634 would add group life insurance to the lines of insurance that are included in this program. Under TRIA, federal assistance is provided if the Secretary of the Treasury certifies that a terrorist attack has occurred in the United States or other specifically covered location. Generally, for a terrorist attack to be certified, it must have been committed by a foreign interest and cause insured damages of at least $5 million. Furthermore, property and casualty insurance policies may exclude losses due to events involving nuclear, biological, or chemical materials. Thus, insurance coverage may not be available to policyholders for terrorist attacks involving those materials. An insurer suffering losses as a result of an attack would first pay claims up to a deductible, calculated as a specified percentage of its aggregate property and casualty insurance premiums for the preceding calendar year. Those deductible amounts increase each year under TRIA and would continue to increase under H.R. 4634, reaching 20 percent of premiums by 2007.

Once insurers have met their individual deductibles for damage claims due to a terrorist attack, the federal government would pay 90 percent of claims above the deductible amount up to the $100 billion in total insured losses. Insurers would be responsible for the remaining 10 percent. The federal government would be required to make future surcharges on the insurance industry to recoup some of the costs of federal assistance and would have the discretion to impose surcharges sufficient to recover all federal payments.

Direct Spending

By extending financial assistance to commercial property and casualty insurers for future acts of terrorism against insured private property, enacting H.R. 4634 would expose the federal government to potentially huge liabilities for two more years (2006 and 2007). For any year, CBO has no basis for estimating the likelihood of terrorist attacks or the amount of insured damage they may cause. Instead, our estimate of the cost of this program reflects how much, on average, the government could be expected to pay to insurers.

In the following sections, we describe our method for estimating the expected-value cost of providing financial assistance under H.R. 4634 and explain how we convert the expected-value cost to annual estimates of spending.

Estimating the Expected Cost of Federal Assistance. For this estimate, CBO discussed the concepts involved in estimating insured losses with industry actuaries and reviewed the models used by firms to set premiums for the terrorism component of property and casualty insurance 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 get 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 catastrophic events—namely, natural disasters. Setting premiums for hurricanes and earthquakes, for example, involves determining potential areas that could sustain damage, the value of the losses resulting 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 such attacks. Because there is a 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 rather than on historical data.

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 coverage under TRIA would be about $1.5 billion, including $100 million from the inclusion of group life insurance policies under TRIA. This estimate incorporates industry expectations of the probabilities of terrorist attacks, encompassing the possibility of ones that result in enormous loss of life and property damage as well as the likelihood that no such attacks would occur.

CBO's estimate assumes that, in most years, terrorist attacks would cost less than $1.5 billion. We expect that there is a significant probability—approaching 50 percent—that no terrorist attacks that would be covered by TRIA would occur in a given year. Clearly, since enactment of TRIA, no covered events have occurred; we do not know whether attacks have been planned or attempted but 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 similar in scale to losses sustained on September 11, 2001, in New York City (an estimated $20 billion) are likely to occur very rarely.[1]

Adjusting insured losses to determine federal payments. To determine federal payments under TRIA, CBO made two adjustments to the expected value of estimated insured losses from a future terrorist attack. First, because federal payments under TRIA would not apply to losses that exceed $100 billion per event, we excluded potential costs about that level. Second, we decreased estimated losses to account for the deductible that would be paid by affected insurers in the event of a covered attack. Individual insurers would pay such deductibles before the federal government would make any payments under TRIA, and the total deductible paid by individual insurers could range from zero to several billion dollars depending on the number of insurers affected by a particular event.

CBO estimates that the Secretary would need to charge almost $700 million in each of calendar years 2006 and 2007 to fully compensate the government for the average annual cost of having to help pay for losses due to terrorist attacks under H.R. 4634. In addition, in calendar year 2005, the bill would add coverage for group life insurance policies to the current TRIA program. We estimate that provision would cost about $50 million.

In total, CBO estimates that the expected cost to the government of enacting H.R. 4634 would be about $1.4 billion. Actual spending, however, would be spread out over many years and would repaid, at least in part, by surcharges imposed on policyholders.

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 additional outlays under H.R. 4634 would total about $1.3 billion over the 2005–2014 period and about $100 million after 2014. 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. For this estimate, we assumed that financial assistance to property and casualty insurers would be paid over several years, with most of the spending occurring within the first five years.

Revenues

Under H.R. 4634, CBO estimates that the Secretary of the Treasury would impose surcharges on policyholders that would increase revenues by $480 million over the 2005–2014 period. Surcharges would continue for many years beyond 2014.

Surcharges. If a terrorist attack were to require the Treasury Secretary to provide financial assistance, the government would recoup some of that cost through surcharges paid by the insurance industry and purchasers of commercial property and casualty insurance. H.R. 4634 would require the Secretary to recoup federal assistance up to a fixed "retention amount" set in the bill, less the amount already paid by insurers through the insurer deductibles and the 10 percent share of losses over the deductibles assigned to insurance firms. Under TRIA, that retention amount is $15 billion

[1] Industry estimates of losses on September 11, 2001, range from $30 billion to $40 billion, including about $20 billion in losses in New York City that would have qualified for coverage under TRIA had the law been in effect on that date.

in 2005. Under H.R. 4634, the retention amounts would be $17.5 billion in 2006 and $20 billion in 2007, plus a slight adjustment upward to account for the increased exposure from the addition of group life insurance. Under H.R. 4634 (as under current law), the Secretary of the Treasury also would have the option to recover any federal assistance above the retention amount up to the total amount of federal assistance provided.

Under TRIA, the recoupment of financial assistance would be recovered by assessing each insurer based on its portion of aggregate property and casualty or group life insurance premiums for the preceding calendar year. Surcharges would apply to insurance sold following a terrorist attack that necessitated federal assistance, and each company's surcharge would be limited to 3 percent of aggregate premiums. H.R. 4634 would direct the Secretary to impose surcharges for as long as is necessary to recover the required portion of financial assistance. Thus, the government could collect surcharges for many years depending on the amount of financial assistance. CBO estimates that surcharges would total $480 million over the next 10 years for a two-year extension of TRIA and the addition of group life insurance coverage under the program.

Timing. CBO expects that the Secretary probably would not recoup the entire cost of financial assistance during the 2005–2014 period. Based on information from the insurance industry on aggregate premiums collected in recent years, CBO estimates that the administrator would recoup no more than about $100 million a year. The bill would allow the Secretary to reduce annual charges considering the effect on taxpayers, the economy, or burdens on small and medium-sized businesses. Therefore, if annual losses were very high, we expect that the Secretary would limit annual collections by spreading them over many years. CBO assumes it would take the Secretary at least 10 years to recoup the costs of any financial assistance provided under H.R. 4634. Thus, we estimate that around half of the surcharge collections would occur after 2014.

Intergovernmental and private-sector impact: H.R. 4634 would extend or expand several integovernmental and private-sector mandates. However, CBO estimates that the aggregate costs of complying with those mandates would not exceed the annual thresholds established by UMRA ($60 million for intergovernmental mandates and $120 million for private-sector mandates in 2004, adjusted annually for inflation).

Extension and Expansion of Mandates

The bill would extend several mandates contained in the 2002 Terrorism Risk Insurance Act and expand two of those mandates to group life insurers. Those mandates would:

- Require that certain insurers offer terrorism insurance;
- Require that certain insurers and their policyholders repay the federal government for the cost of assistance (in the form of surcharges); and
- Preempt state laws regulating insurance.

Requirement To Offer Insurance

Current law requires certain insurance companies to offer terrorism insurance as part of a property and casualty insurance policy through calendar year 2005. H.R. 4634 would extend the requirement to offer terrorism insurance through calendar year 2007. Under the bill, insurers that offer group life insurance would be required to include coverage of terrorist incidents. According to industry representatives, the direct cost for insurance companies to continue making terrorism insurance available under property and casualty policies and for group life insurers to offer such insurance would be minimal. The bill would only require that firms offer terrorism insurance, but they would set their own premium rates and policyholders could choose whether or not to purchase such insurance. Insurers who offer terrorism insurance would receive financial assistance to cover a portion of their losses in the event of a terrorist attack.

Repayment of Assistance

The bill would extend the requirement that the federal government recoup some of the costs of such financial assistance provided to certain insurers and the government's authority to make assessments sufficient to recover all federal payments. Those costs would be recouped through future surcharges paid by the insurance industry. The bill also would expand the requirement to include purchasers of group life insurance.

Taken individually, some insurers might benefit from the financial assistance, while others might face only the cost of the surcharges. But for the insurance industry as a whole, the cost of the surcharges would be no greater than the financial assistance received, so the net cost of this mandate would be zero.

Preemption of State Law

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

Estimate prepared by: Federal Costs: Megan Carroll and Melissa E. Zimmerman; Impact on State, Local, and Tribal Governments: Sarah Puro; and Impact on the Private Sector: Paige Piper/Bach.

Estimate approved by: Robert A. Sunshine, Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional Authority of Congress to enact this legislation is provided by Article 1, section 8, clause 1 (relating to the general welfare of the

United States) and clause 3 (relating to the power to regulate interstate commerce).

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This section establishes the short title of the bill, the "Terrorism Insurance Backstop Extension Act of 2004."

Section 2. Extension of Terrorism Insurance Program

This section extends TRIA for two years and maintains the gradual increase in taxpayer protections in the Program. Subsection (a) adds Years 4 and 5 to the Program. Subsection (b) maintains the steady increases in insurer deductibles, with a deductible set at 15 percent in Program Year 4 and set at 20 percent in Program Year 5. Subsection (c) requires terrorism insurance coverage to be "made available" for the entire duration of the Program. Subsection (d) maintains the gradual increase in TRIA's taxpayer protections, continuing to phase out the Program with an increase in the taxpayer reimbursement from $15 billion in Program Year 3 to $17.5 billion in Year 4 and $20 billion in Year 5. Subsection (e) expands TRIA to include group life insurance, which Congress intends to mean an insurance contract that solely provides term life insurance coverage, accidental death coverage, or a combination of both for a number of persons under a single contract and that provides such coverage on the basis of a group of selection risks. Subsection (f) requires the Treasury Secretary to report on alternatives for expanding the availability and affordability of terrorism insurance without a Federal backstop. Subsection (g) terminates the TRIA Program on December 31, 2007 and requires the GAO to report to Congress by June 30, 2007 on TRIA's effectiveness and the capacity of insurers to offer terrorism insurance after TRIA expires, as well as the availability of terrorism insurance for various policyholders.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

TERRORISM RISK INSURANCE ACT OF 2002

* * * * * * *

TITLE I—TERRORISM INSURANCE PROGRAM

* * * * * * *

SEC. 102. DEFINITIONS.

In this title, the following definitions shall apply:

(1) ACT OF TERRORISM.—

(A) * * *

(B) LIMITATION.—No act shall be certified by the Secretary as an act of terrorism if—

(i) the act is committed as part of the course of a war declared by the Congress, except that this clause shall not apply with respect to any coverage for workers' compensation *or group life insurance*; or

(ii) property and casualty insurance *and group life insurance* losses resulting from the act, in the aggregate, do not exceed $5,000,000.

* * * * * * *

(4) DIRECT EARNED PREMIUM.—The term "direct earned premium" means a direct earned premium for property and casualty insurance *or for group life insurance* issued by any insurer for insurance against losses occurring at the locations described in subparagraphs (A) and (B) of paragraph ⟦(5)⟧ *(6)*.

(5) GROUP LIFE INSURANCE.—The term "group life insurance" means an insurance contract that provides term life insurance coverage, accidental death coverage, or a combination thereof, for a number of persons under a single contract, on the basis of a group selection of risks.

⟦(5)⟧ *(6)* INSURED LOSS.—The term "insured loss" means any loss resulting from an act of terrorism (including an act of war, in the case of workers' compensation *and group life insurance*) that is covered by primary or excess property and casualty *or group life* insurance issued by an insurer if such loss—

(A) occurs within the United States; or

(B) occurs to an air carrier (as defined in section 40102 of title 49, United States Code), to a United States flag vessel (or a vessel based principally in the United States, on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States), regardless of where the loss occurs, or at the premises of any United States mission.

⟦(6)⟧ *(7)* INSURER.—The term "insurer" means any entity, including any affiliate thereof—

(A) that is—

(i) licensed or admitted to engage in the business of providing primary or excess *property and casualty or group life* insurance in any State;

(B) that receives direct earned premiums for any type of commercial property and casualty insurance coverage *or group life insurance coverage*, other than in the case of entities described in sections 103(d) and 103(f); and

* * * * * * *

⟦(7)⟧ *(8)* INSURER DEDUCTIBLE.—The term “insurer deductible” means—

(A) * * *

* * * * * * *

(D) for Program Year 3, the value of an insurer’s direct earned premiums over the calendar year immediately preceding Program Year 3, multiplied by 15 percent; ⟦and⟧

(E) for Program Year 4, the value of an insurer’s direct earned premiums over the calendar year immediately preceding Program Year 4, multiplied by 15 percent;

(F) for Program Year 5, the value of an insurer’s direct earned premiums over the calendar year immediately preceding Program Year 4, multiplied by 20 percent; and

⟦(E)⟧ *(G)* notwithstanding subparagraphs (A) through ⟦(D)⟧ *(F)*, for the Transition Period, Program Year 1, Program Year 2, ⟦or Program Year 3⟧ *Program Year 3, Program Year 4, or Program Year 5*, if an insurer has not had a full year of operations during the calendar year immediately preceding such Period or Program Year, such portion of the direct earned premiums of the insurer as the Secretary determines appropriate, subject to appropriate methodologies established by the Secretary for measuring such direct earned premiums.

⟦(8)⟧ *(9)* NAIC.—The term “NAIC” means the National Association of Insurance Commissioners.

⟦(9)⟧ *(10)* PERSON.—The term “person” means any individual, business or nonprofit entity (including those organized in the form of a partnership, limited liability company, corporation, or association), trust or estate, or a State or political subdivision of a State or other governmental unit.

⟦(10)⟧ *(11)* PROGRAM.—The term “Program” means the Terrorism Insurance Program established by this title.

⟦(11)⟧ *(12)* PROGRAM YEARS.—

(A) * * *

* * * * * * *

(E) PROGRAM YEAR 4.—The term “Program Year 4” means the period beginning on January 1, 2006 and ending on December 31, 2006.

(F) PROGRAM YEAR 5.—The term “Program Year 5” means the period beginning on January 1, 2007 and ending on December 31, 2007.

⟦(12)⟧ *(13)* PROPERTY AND CASUALTY INSURANCE.—The term “property and casualty insurance”—

(A) * * *

* * * * * * *

⟦(13)⟧ *(14)* SECRETARY.—The term “Secretary” means the Secretary of the Treasury.

⟦(14)⟧ *(15)* STATE.—The term “State” means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, each of the United States Virgin Islands, and any territory or possession of the United States.

❲(15)❳ *(16)* UNITED STATES.—The term "United States" means the several States, and includes the territorial sea and the continental shelf of the United States, as those terms are defined in the Violent Crime Control and Law Enforcement Act of 1994 (18 U.S.C. 2280, 2281).

❲(16)❳ *(17)* RULE OF CONSTRUCTION FOR DATES.—With respect to any reference to a date in this title, such day shall be construed—

(A) to begin at 12:01 a.m. on that date; and

(B) to end at midnight on that date.

SEC. 103. TERRORISM INSURANCE PROGRAM.

(a) * * *

(b) CONDITIONS FOR FEDERAL PAYMENTS.—No payment may be made by the Secretary under this section with respect to an insured loss that is covered by an insurer, unless—

(1) the person that suffers the insured loss, or a person acting on behalf of that person *(including a named beneficiary in the case of a group life insurance policy)*, files a claim with the insurer;

* * * * * * *

❲(c) MANDATORY AVAILABILITY.—

❲(1) INITIAL PROGRAM PERIODS.—During the period beginning on the first day of the Transition Period and ending on the last day of Program Year 2, each entity that meets the definition of an insurer under section 102—❳

(c) MANDATORY AVAILABILITY.—During the Program, each entity that meets the definition of an insurer under section 102—

❲(A)❳ *(1)* shall make available, in all of its property and casualty *and group life* insurance policies, coverage for insured losses; and

❲(B)❳ *(2)* shall make available property and casualty *and group life* insurance coverage for insured losses that does not differ materially from the terms, amounts, and other coverage limitations applicable to losses arising from events other than acts of terrorism.

❲(2) PROGRAM YEAR 3.—Not later than September 1, 2004, the Secretary shall, based on the factors referred to in section 108(d)(1), determine whether the provisions of subparagraphs (A) and (B) of paragraph (1) should be extended through Program Year 3.❳

* * * * * * *

(e) INSURED LOSS SHARED COMPENSATION.—

(1) * * *

(2) CAP ON ANNUAL LIABILITY.—

(A) IN GENERAL.—Notwithstanding paragraph (1) or any other provision of Federal or State law, if the aggregate insured losses exceed $100,000,000,000, during the period beginning on the first day of the Transition Period and ending on the last day of Program Year 1, or during Program Year 2 ❲or Program Year 3❳ *, Program Year 3, Program Year 4, or Program Year 5* (until such time as the Congress may act otherwise with respect to such losses)—

(i) * * *

*   *   *   *   *   *   *

(3) NOTICE TO CONGRESS.—The Secretary shall notify the Congress if estimated or actual aggregate insured losses exceed $100,000,000,000 during the period beginning on the first day of the Transition Period and ending on the last day of Program Year 1, or during Program Year 2 ⟦or Program Year 3⟧, *Program Year 3, Program Year 4, or Program Year 5*, and the Congress shall determine the procedures for and the source of any payments for such excess insured losses.

*   *   *   *   *   *   *

(6) INSURANCE MARKETPLACE AGGREGATE RETENTION AMOUNT.—⟦For⟧ *Except as provided in subparagraph (F) of this paragraph, for* purposes of paragraph (7), the insurance marketplace aggregate retention amount shall be—

(A) * * *

(B) for Program Year 2, the lesser of—

(i) $12,500,000,000; and

(ii) the aggregate amount, for all insurers, of insured losses during such Program Year; ⟦and⟧

(C) for Program Year 3, the lesser of—

(i) $15,000,000,000; and

(ii) the aggregate amount, for all insurers, of insured losses during such Program Year⟦.⟧*;*

(D) for Program Year 4, the lesser of—

(i) $17,500,000,000; and

(ii) the aggregate amount, for all insurers, of insured losses during such Program Year;

(E) for Program Year 5, the lesser of—

(i) $20,000,000,000; and

(ii) the aggregate amount, for all insurers, of insured losses during such Program Year; and

(F) for each of the periods referred to in subparagraphs (A) through (E), the amounts provided under such subparagraphs, as such amounts shall be increased by the Secretary before the expiration of the 90-day period beginning on the date of the enactment of the Terrorism Insurance Backstop Extension Act of 2004, based on the increase in the size of the Program caused by the inclusion of group life insurance pursuant to such Act, in proportion to the increased premiums involved.

(7) RECOUPMENT OF FEDERAL SHARE.—

(A) MANDATORY RECOUPMENT AMOUNT.—For purposes of this paragraph, the mandatory recoupment amount for each of the periods referred to in subparagraphs (A), (B), ⟦and (C)⟧ *(C), (D), and (E)* of paragraph (6) shall be the difference between—

(i) * * *

*   *   *   *   *   *   *

(B) NO MANDATORY RECOUPMENT IF UNCOMPENSATED LOSSES EXCEED INSURANCE MARKETPLACE RETENTION.—Notwithstanding subparagraph (A), if the aggregate amount of uncompensated insured losses referred to in clause (ii) of such subparagraph for any period referred to in subparagraph (A), (B), ⟦or (C)⟧ *(C), (D), or (E)* of paragraph (6) is greater than the insurance marketplace aggregate retention amount under paragraph (6) for such period, the mandatory recoupment amount shall be $0.

(C) MANDATORY ESTABLISHMENT OF SURCHARGES TO RECOUP MANDATORY RECOUPMENT AMOUNT.—The Secretary shall collect, for repayment of the Federal financial assistance provided in connection with all acts of terrorism (or acts of war, in the case of workers compensation *or group life insurance*) occurring during any of the periods referred to in subparagraph (A), (B), ⟦or (C)⟧ *(C), (D), or (E)* of paragraph (6), terrorism loss risk-spreading premiums in an amount equal to any mandatory recoupment amount for such period.

* * * * * * *

(8) POLICY SURCHARGE FOR TERRORISM LOSS RISK-SPREADING PREMIUMS.—

(A) POLICYHOLDER PREMIUM.—Any amount established by the Secretary as a terrorism loss risk-spreading premium shall—

(i) be imposed as a policyholder premium surcharge on property and casualty *and group life* insurance policies in force after the date of such establishment;

* * * * * * *

(iii) be based on a percentage of the premium amount charged for property and casualty *or group life* insurance coverage under the policy.

* * * * * * *

(C) PERCENTAGE LIMITATION.—A terrorism loss risk-spreading premium (including any additional amount included in such premium on a discretionary basis pursuant to paragraph (7)(D)) may not exceed, on an annual basis, the amount equal to 3 percent of the premium charged for property and casualty *or group life* insurance coverage under the policy.

* * * * * * *

⟦(h) GROUP LIFE INSURANCE STUDY.—

⟦(1) STUDY.—The Secretary shall study, on an expedited basis, whether adequate and affordable catastrophe reinsurance for acts of terrorism is available to life insurers in the United States that issue group life insurance, and the extent to which the threat of terrorism is reducing the availability of group life insurance coverage for consumers in the United States.

⟦(2) CONDITIONAL COVERAGE.—To the extent that the Secretary determines that such coverage is not or will not be reasonably available to both such insurers and consumers, the Secretary shall, in consultation with the NAIC—

⟦(A) apply the provisions of this title, as appropriate, to providers of group life insurance; and

⟦(B) provide such restrictions, limitations, or conditions with respect to any financial assistance provided that the

Secretary deems appropriate, based on the study under paragraph (1).

[(i) STUDY AND REPORT.—

[(1) STUDY.—The Secretary, after consultation with the NAIC, representatives of the insurance industry, and other experts in the insurance field, shall conduct a study of the potential effects of acts of terrorism on the availability of life insurance and other lines of insurance coverage, including personal lines.

[(2) REPORT.—Not later than 9 months after the date of enactment of this Act, the Secretary shall submit a report to the Congress on the results of the study conducted under paragraph (1).]

(h) STUDY ON LONG-TERM SOLUTIONS.—By June 1, 2005, the Secretary shall conduct a study and submit a report to the Congress on alternatives for expanding the availability and affordability of terrorism insurance after the termination of the Program that do not involve a Federal financial backstop.

* * * * * * *

SEC. 105. PREEMPTION AND NULLIFICATION OF PRE-EXISTING TERRORISM EXCLUSIONS.

(a) * * *

* * * * * * *

(c) REINSTATEMENT OF TERRORISM EXCLUSIONS.—Notwithstanding subsections (a) and (b) or any provision of State law, an insurer may reinstate a preexisting provision in a contract for property and casualty *or group life* insurance that is in force on the date of enactment of this Act and that excludes coverage for an act of terrorism only—

(1) * * *

* * * * * * *

SEC. 108. TERMINATION OF PROGRAM.

(a) TERMINATION OF PROGRAM.—The Program shall terminate on December 31, [2005] *2007*.

* * * * * * *

(d) STUDY AND REPORT ON THE PROGRAM.—

(1) STUDY.—The Secretary, in consultation with the NAIC, representatives of the insurance industry and of policy holders, other experts in the insurance field, and other experts as needed, shall assess the effectiveness of the Program and the likely capacity of the property and casualty insurance industry *and the group life insurance industry* to offer insurance for terrorism risk after termination of the Program, and the availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit.

* * * * * * *

(3) FINAL GAO STUDY AND REPORT.—The Comptroller General of the United States shall conduct an assessment of the matters referred to in paragraph (1) and shall submit a report to the

Congress, not later than June 30, 2007, on the results of such study.

* * * * * * *

DISSENTING VIEWS

Three years ago, when the Committee on Financial Services considered the bill creating the terrorism reinsurance program, I urged my colleagues to reject it. One of the reasons I opposed the bill was my concern that, contrary to the claims of the bill's supporters, terrorism insurance would not be allowed to sunset after three years. As I said then:

> The drafters of H.R. 3210 claim that this creates a "temporary" government program. However, Mr. Speaker, what happens in three years if industry lobbyists come to Capitol Hill to explain that there is still a need for this program because of the continuing threat of terrorist attacks. Does anyone seriously believe that Congress will refuse to reauthorize this "temporary" insurance program or provide some other form of taxpayer help to the insurance industry? I would like to remind my colleagues that the federal budget is full of expenditures for long-lasting programs that were originally intended to be "temporary."

I am disappointed to see that the Committee on Financial Services has proven my words prophetic.

As the committee considers extending this program, I renew my opposition to it for substantially the same reasons I stated three years ago. However, I do have a suggestion on how to improve the program. Since one claimed problem with allowing the private market to provide terrorism insurance is the difficulty of quantifying the risk of an attack, the taxpayers' liability under the terrorism reinsurance program should be reduced for attack occurring when the country is under orange or red alert. After all, the point of the alert system is to let Americans know when there is an increased likelihood of an attack, so it is reasonable to expect insurance companies to demand that their clients take extra precautionary measures during periods of high alert. Reducing taxpayer subsidies will provide an incentive to ensure private parties take every possible precaution to minimize the potential damage from possible terrorist attack.

Since my main objections to the program remain the same as three years ago, I am attaching my statement regarding H.R. 3210, which created the terrorist insurance program in the 106th Congress:

> Mr. Speaker, no one doubts that the government has a role to play in compensating American citizens who are victimized by terrorist attacks. However, Congress should not lose sight of fundamental economic and constitutional principles when considering how best to provide the victims of terrorist attacks just compensation. I am afraid that H.R. 3210, the Terrorism Risk Protection Act, violates

several of those principles and therefore passage of this bill is not in the best interests of the American people.

Under H.R. 3210, taxpayers are responsible for paying 90 percent of the costs of a terrorist incident when the total cost of that incident exceeds a certain threshold. While insurance companies technically are responsible under the bill for paying back monies received from the Treasury, the administrator of this program may defer repayment of the majority of the subsidy in order to "avoid the likely insolvency of the commercial insurer," or avoid "unreasonable economic disruption and market instability." This language may cause administrators to defer indefinitely the repayment of the loans, thus causing taxpayers to permanently bear the loss. This scenario is especially likely when one considers that "avoid * * * likely insolvency, unreasonable economic disruption, and market instability" are highly subjective standards, and that any administrator who attempts to enforce a strict repayment schedule likely will come under heavy political pressure to be more "flexible" in collecting debts owed to the taxpayers.

The drafters of H.R. 3210 claim that this creates a "temporary" government program. However, Mr. Speaker, what happens in three years if industry lobbyists come to Capitol Hill to explain that there is still a need for this program because of the continuing threat of terrorist attacks. Does anyone seriously believe that Congress will refuse to reauthorize this "temporary" insurance program or provide some other form of taxpayer help to the insurance industry? I would like to remind my colleagues that the federal budget is full of expenditures for long-lasting programs that were originally intended to be "temporary."

H.R. 3210 compounds the danger to taxpayers because of what economists call the "moral hazard" problem. A moral hazard is created when individuals have the costs incurred from a risky action subsidized by a third party. In such a case individuals may engage in unnecessary risks or fail to take steps to minimize their risks. After all, if a third party will bear the costs of negative consequences of risky behavior, why should individuals invest their resources in avoiding or minimizing risk?

While no one can plan for terrorist attacks, individuals and businesses can take steps to enhance security. For example, I think we would all agree that industrial plants in the United States enjoy reasonably good security. They are protected not by the local police, but by owners putting up barbed wire fences, hiring guards with guns, and requiring identification cards to enter. One reason private firms put these security measures in place is because insurance companies provide them with incentives, in the form of lower premiums, to adopt security measures. H.R. 3210 contains no incentives for this private activity. The bill does not even recognize the important role insurance plays in providing incentives to minimize risks. By removing an incentive for private parties to avoid or at least mitigate the damage from a future terrorist attack, the government inadvertently increases the damage that will be inflicted by future attacks!

Instead of forcing taxpayers to subsidize the costs of terrorism insurance, Congress should consider creating a tax credit or deduction for premiums paid for terrorism insurance, as well as a deduction for claims and other costs borne by the insurance industry connected with offering terrorism insurance. A tax credit approach reduces government's control over the insurance market. Furthermore, since a tax credit approach encourages people to devote more of their own resources to terrorism insurance, the moral hazard problems associated with federally funded insurance is avoided.

The version of H.R. 3210 passed by the Financial Services Committee took a good first step in this direction by repealing the tax penalty which prevents insurance companies from properly reserving funds for human-created catastrophes. I am disappointed that this sensible provision was removed from the final bill. Instead, H.R. 3210 instructs the Treasury Department to study the benefits of allowing insurers to establish tax-free reserves to cover losses from terrorist events. The perceived need to study the wisdom of cutting taxes while expanding the federal government without hesitation demonstrates much that is wrong with Washington.

In conclusion, Mr. Speaker, H.R. 3210 may reduce the risk to insurance companies from future losses, but it increases the costs incurred by American taxpayers. More significantly, by ignoring the moral hazard problem this bill may have the unintended consequence of increasing the losses suffered in any future terrorist attacks. Therefore, passage of this bill is not in the long-term interests of the American people.

RON PAUL.

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