CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 24, 2014

S. 2244
Terrorism Risk Insurance Program Reauthorization Act of 2014

As reported by the Senate Committee on Banking, Housing, and Urban Affairs on June 23, 2014

SUMMARY

S. 2244 would extend the Terrorism Risk Insurance Act (TRIA)[1] for seven years—through calendar year 2021. The bill also would increase the share of insured losses paid by private insurers under the program and require the Government Accountability Office (GAO) to prepare a report for the Congress that assesses the effects of collecting premiums on insurers that participate in the program.

The program requires insurance firms that sell commercial property and casualty insurance to offer clients insurance coverage for damages caused by terrorist attacks by foreign or domestic interests. Under TRIA, the federal government would help insurers cover losses in the event of a terrorist attack under certain conditions, and would impose assessments on the insurance industry to recover all or a portion of the federal payments. The program is set to expire at the end of calendar year 2014; no federal payments have been made under the program since its inception in 2002.

There is no reliable way to predict how much insured damage terrorists might cause, if any, in any specific year. Rather, CBO's estimate of the cost of financial assistance provided under the bill represents an expected value of payments from the program—a weighted average that reflects industry experts' opinions of the probability of various outcomes ranging from zero damages up to very large damages resulting from 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 expected losses from providing this insurance, although firms do not pay any upfront premium for the federal assistance available under TRIA.

1. The Terrorism Risk Insurance Act, P.L. 107-297, was enacted on November 2, 2002; the Act was extended on December 22, 2005 upon enactment of the Terrorism Risk Insurance Extension Act of 2005, P.L. 109-144. On December 26, 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007, P.L. 110-160, extended the program again. In this estimate, CBO refers to the original Act as subsequently amended, as TRIA.

On this basis, CBO estimates that enacting the bill would increase direct spending by $1.7 billion over the 2015-2019 period and by $3.5 billion over the 2015-2024 period. An additional $460 million would be spent after 2024.

CBO estimates that enacting the legislation also would increase revenues. S. 2244 would direct the Department of the Treasury to recoup some or all of the costs of providing financial assistance through taxes imposed on certain policyholders (referred to as surcharges in the legislation). CBO expects that federal spending for financial assistance to insurers would be largely offset (on a cash basis) by an increase in revenues. We expect that, following a covered loss, the Secretary of the Treasury would impose those surcharges in a way that meets the deadlines for collections specified in the bill. Thus, CBO estimates that enacting the recoupment provision in the bill would increase revenues by about $1.8 billion over the 2015-2019 period and by about $4.0 billion over the 2015-2024 period, net of income and payroll tax offsets.[2]

Considering both the direct spending and revenue impacts of the bill, CBO estimates that enacting the bill would reduce budget deficits by $460 million over the 2015-2024 period. Federal spending, however, would continue beyond 2024; CBO estimates that over the full term of federal financial assistance, revenues would fully offset direct spending, resulting in no net effect on the deficit.

The bill would impose intergovernmental and private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) by extending and expanding some requirements on insurers and policyholders, including the payment of surcharges. State, local, or tribal governments could be required to pay a surcharge as purchasers of property and casualty insurance, but CBO estimates that the aggregate cost to public entities of complying with those mandates would probably fall below the annual threshold established in UMRA ($76 million for intergovernmental mandates in 2014, adjusted annually for inflation). CBO estimates that the aggregate cost to private insurers and policyholders to comply with those mandates would exceed the annual threshold established in UMRA ($152 million in 2014, adjusted annually for inflation) in each year policyholders pay a surcharge.

2. When excise taxes and other types of "indirect" taxes are imposed on goods and services, they tend to reduce income for workers or business owners in the taxed industry and others throughout the economy. Consequently, revenue derived from existing "direct" tax sources—such as individual and corporate income taxes and payroll taxes—will also be reduced. To approximate that effect, CBO and the staff of the Joint Committee on Taxation apply an offset when estimating the net revenue that legislation imposing some form of indirect tax is expected to generate. The amount of the offset ranges from 25.2 percent in 2015 to 26.2 percent in 2024.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of S. 2244 is shown in the following table. The costs of this legislation fall within budget function 370 (commerce and housing credit).

	By Fiscal Year, in Billions of Dollars											
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-2019	2014-2024
CHANGES IN DIRECT SPENDING												
Estimated Budget Authority	120	280	370	440	480	510	540	410	240	150	1,690	3,540
Estimated Outlays	120	280	370	440	480	510	540	410	240	150	1,690	3,540
CHANGES IN REVENUES												
Estimated Revenues	0	200	400	500	670	400	380	440	450	560	1,770	4,000
NET INCREASE OR DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Impact on Deficit	120	80	-30	-60	-190	110	160	-30	-210	-410	-80	-460

Note: CBO estimates that implementing S. 2244 would not have a significant effect on discretionary costs over the 2015-2019 period.

BASIS OF ESTIMATE

For this estimate, CBO assumes that S. 2244 will be enacted before the end of calendar year 2014. We estimate that enacting the bill would increase direct spending by about $3.5 billion and increase revenues by $4.0 billion over the 2015-2024 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 are likely to vary significantly from the estimated amounts. Such costs could be either higher or lower than the expected-value estimates provided for each year.

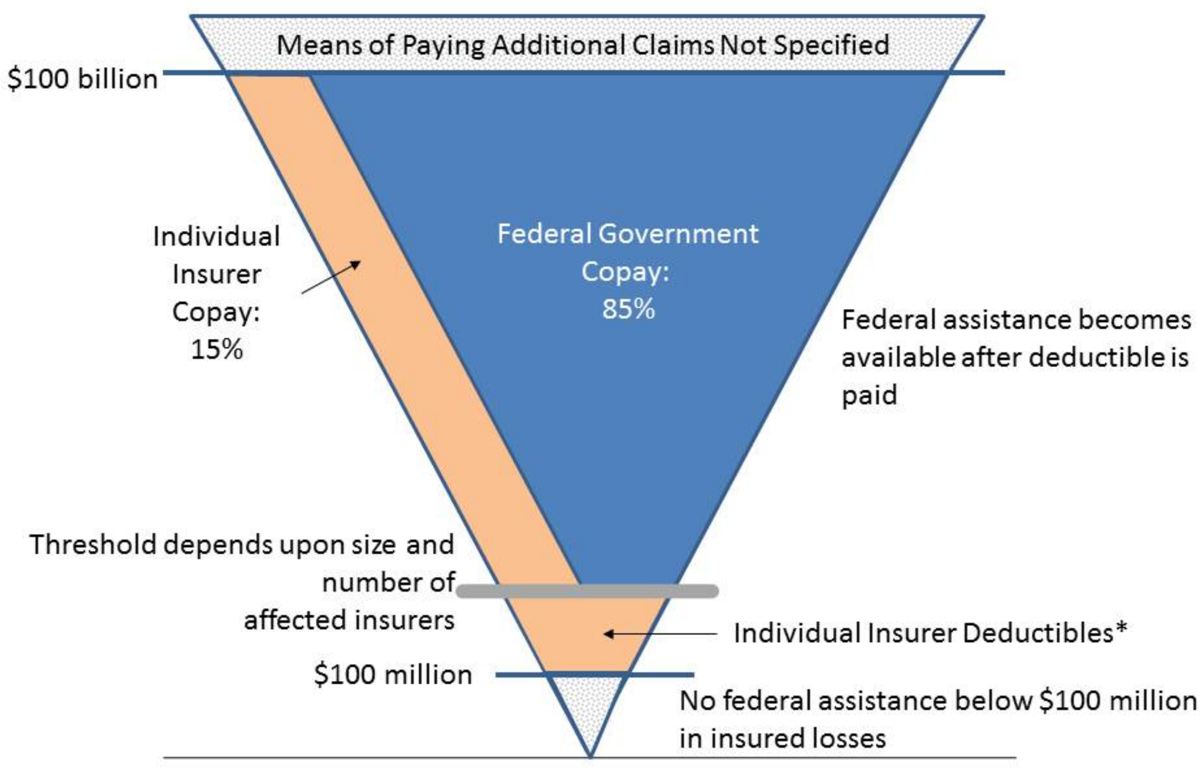
Terrorism Risk Insurance Act Under Current Law

The Terrorism Risk Insurance Act provides financial assistance to commercial property and casualty insurers for losses above certain thresholds (illustrated in figure 1) caused by terrorist attacks by individuals acting on behalf of foreign or domestic interests. For such assistance to be provided, the Secretary of the Treasury must certify that a terrorist attack has occurred in the United States or other specified locations. TRIA is set to expire on December 31, 2014.

TRIA does not require commercial property and casualty insurance policies to cover losses from terrorist attacks involving nuclear, biological, chemical, or radioactive (NBCR) materials. If, however, an insurer and a policyholder choose to include losses from terrorist attacks involving NBCR materials in such a policy, TRIA would cover a portion of the losses resulting from such attacks.

For the Secretary of the Treasury to certify a terrorist attack, insured damages resulting from the attack must exceed $5 million. Financial assistance becomes available to insurers suffering losses from a certified attack once the insurers suffering losses have aggregate insured losses from an attack that exceed $100 million. Once that threshold is met, insurance companies that suffer losses are responsible for paying claims up to a deductible amount that equals 20 percent of the premiums they collected for certain lines of insurance in the calendar year preceding a certified attack. The total amount of deductibles paid by insurers would depend on the amount of losses from an attack and the particular insurers involved.

Figure 1. Loss-sharing Under Terrorism Risk Insurance Act (TRIA)



Notes: Diagram not drawn to scale.

* Deductible = 20% of each insurer's direct earned premiums in the previous year for TRIA-covered insurance lines.

After meeting their individual deductibles for damage claims, insurers that suffered losses and the federal government would each pay a portion of the losses above the deductible (in 2014, the federal government would pay 85 percent of insured losses and individual insurers would pay 15 percent) up to total losses of as much as $100 billion. The law does not specify how any claims above the $100 billion cap would be paid.

The Secretary of the Treasury is authorized to recover payments made by the federal government through taxes in the form of surcharges paid by all purchasers of commercial property and casualty insurance. The Secretary is required to recoup any federal payments made to cover losses, but only if those recoveries plus other amounts paid by directly affected insurers do not exceed $27.5 billion—known as the retention amount. If insured losses from a terrorist attack are large enough that insurers pay more than the industry retention amount, the Secretary would not be required to recoup any federal payments. The program provides the Secretary of the Treasury with authority, however, to recover federal payments in that instance after considering the ultimate cost to taxpayers, economic conditions, and the affordability of commercial insurance.

Modifications to TRIA Under S. 2244

S. 2244 would extend TRIA for seven years, through December 31, 2021. The bill also would make incremental changes in program parameters that would increase the share of insured losses paid by private insurers in the event of an attack.

As under current law, an insurer suffering losses as a result of a certified attack would pay claims up to a specified deductible. The bill would retain the same deductible limits, 20 percent of certain premiums collected in the calendar year preceding an attack, as in current law.

S. 2244 also would continue the payment-sharing process that exists under current law. Insurers and the federal government would each pay a portion of the losses over the deductibles up to the $100 billion limit for the program. However, the bill would decrease the federal government's portion by one percentage point per year over a five-year period that starts on January 1, 2016. Currently, the federal portion is equal to 85 percent of covered losses above the deductible; under the bill, that rate would be reduced to 80 percent of covered losses by 2020, and remain there until the program expires at the end of 2021.

Finally, the bill would increase the industry retention amount—the limit used to calculate the amount of federal spending that would be recovered from policyholders—from $29.5 billion to $37.5 billion over a five-year period starting in the first year after enactment.

Direct Spending

By extending financial assistance to certain commercial insurers for losses from future acts of terrorism against insured private property, enacting S. 2244 would expose the federal government to potentially large liabilities for seven more years (2015 through 2021). For any particular year, the amount of insured damage caused by terrorists could range from zero to many billions of dollars. CBO's estimate of the cost of this program reflects how much, on average, the government could be expected to pay to insurers and recover from the industry over the 2015-2024 period.

The following sections describe our method for estimating the expected value of financial assistance under the bill and explain how we convert that cost to estimates of annual federal expenditures.

Estimating the Expected Cost of Federal Assistance. For this estimate, CBO discussed the process of estimating insured losses with industry actuaries and reviewed models used by firms to set premiums for the terrorism component of property and casualty insurance that 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 set 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 other catastrophic events—namely, natural disasters. Setting premiums for hurricanes and earthquakes, for example, involves determining areas that could sustain damage, the value of the losses that could result 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 potential attacks. Because there is a very 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 as well as information about attempted attacks that were not successful.

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 TRIA coverage under the bill would be about $2.1 billion (in 2014 dollars). This estimate incorporates industry expectations of the probabilities of terrorist attacks, encompassing the possibility of attacks that result in enormous loss of life and property damage, as well as a significant likelihood that no such attacks would occur in any given year. This estimate also reflects our expectation that some portion of losses from terrorism would not be covered by TRIA because some policyholders choose not to purchase insurance coverage for terrorism risks.

CBO's estimate incorporates an expectation that, in most years, losses from terrorist attacks covered by TRIA would cost significantly less than $2.1 billion. We expect that there is a significant chance that no terrorist attacks covered by TRIA would occur in a given year. Since enactment of TRIA, no covered events have occurred, though several attempts 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 causing losses similar in scale to those sustained on September 11, 2011, in New York City are likely to occur very rarely, if at all.[3]

Our estimate of average annual losses includes about $650 million in losses resulting from terrorist attacks involving NBCR materials. Under current law, insurers are not required to offer this coverage, although if an insurer and a policyholder voluntarily agree to include this coverage in a property and casualty policy, TRIA would cover some of those losses. While the bill would not require property and casualty policies to include coverage for losses resulting from attacks using NBCR materials, information provided by the industry indicates that a small amount of coverage is currently in place for such losses. Thus, under the bill, the government's exposure to losses resulting from terrorist attacks involving NBCR materials would likewise be small compared with losses resulting from attacks using conventional materials. The only exception is in the workers' compensation insurance line, where no exclusions for specific causes are allowed.

Determining the Federal Share of Insured Losses. Federal payments under TRIA would be lower than the total expected losses from terrorist attacks because TRIA places limits on eligibility for federal assistance and requires that insurers that suffer losses as the result of a certified attack pay a share of covered losses. CBO took account of those requirements to estimate federal spending for any given amount of insured losses from future terrorist attacks.

- *Upper and lower limits for federal assistance.* Because federal payments under TRIA would be capped at $100 billion per event, we excluded costs for potential losses above that level. Similarly, S. 2244 would maintain the minimum losses that would trigger federal payments under current law at $100 million; therefore, we excluded potential losses below that minimum level as well.

3. Based on information from the Insurance Information Institute, we estimate that industry losses on September 11, 2001, totaled about $44 billion (in 2014 dollars), including about $35 billion in losses that would have qualified for coverage under TRIA had the law been in effect on that date.

- *Insurers' deductibles.* Before the federal government would make any payments under TRIA, an insurer incurring losses would first pay claims up to a deductible amount. S. 2244 would maintain the current-law deductible of 20 percent of premiums on certain property and casualty lines collected by affected insurers in the calendar year preceding an attack.

  The total amount of the deductibles could range from a few million dollars to several billion dollars, depending on how many insurers provide coverage for losses resulting from a particular terrorist attack. In addition, the value of each individual insurer's deductible would vary greatly across the industry. For this estimate, CBO considered a range of possibilities regarding the share of federal assistance, using industry data to estimate insurers' deductibles under the bill. The range encompasses the possibility that an attack would affect only a few insurers with relatively small deductibles or several insurers with relatively large deductibles. CBO expects that insured losses below a few hundred million dollars would most likely be covered by insurers' deductibles, and therefore, would not result in a significant increase in federal spending.

- *Shared payments if losses exceed insurers' deductibles.* Once affected insurers have paid claims up to their deductibles, the federal government would share a portion of the losses above the deductibles. Under S. 2244, the federal government's share of claims above the deductible would fall from the current-law level of 85 percent of total losses to 80 percent, up to the $100 billion limit covered by the program, by 2020.

After taking into account minimum and maximum limits, deductibles, and the insurers' share of payments above the deductibles, CBO estimates that enacting the bill would increase direct spending by $4.0 billion over the full life of the program. That amount translates into an average of roughly $570 million for each of the seven years for which the program would be extended. Actual spending would be spread out over many years, and those costs would be recovered through surcharges imposed on policyholders (which are discussed in the section on revenues below).

Taken another way, if the Secretary of the Treasury were authorized to collect premiums for the program, CBO estimates that the Secretary would need to charge, on average, about $570 million per year (for seven years) to offset the government's projected losses under the bill. The bill, however, would not authorize any charges prior to a certified attack. The bill also does not contain an explicit requirement for the Secretary to recoup interest that would accrue on amounts outstanding.

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 outlays under the bill would total about $3.5 billion over the 2015-2024 period; about $460 million would be spent after 2024. 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. Under this bill, we expect that financial assistance to insurers would be paid over several years, with most of the spending occurring within the first five years following a certified event.

Revenues

Enacting S. 2244 would affect federal revenues by authorizing the Secretary of the Treasury to impose taxes in the form of surcharges on all holders of property and casualty insurance policies in order to recover the amount of federal payments made under the program, with certain limitations. CBO estimates that this provision would increase revenues by $4.0 billion over the 2015-2024 period.

Surcharges. If a terrorist attack were to require the government to provide financial assistance, the bill would require the Secretary of the Treasury to recoup some or all of that cost through taxes paid by purchasers of commercial property and casualty insurance. Specifically, the Secretary would be required to recoup federal payments to the extent that the total amount paid by insurers (for deductibles and the industry's share of payments over the deductibles) is less than the lower of total insured losses or the industry retention amount.

If insured losses from a terrorist attack are large enough that insurers pay more than the industry retention amount, then the Secretary would not be required to recoup any federal payments—although the Secretary could choose to do so. In that case, the amount the Secretary would collect would be based on economic conditions, the affordability of commercial insurance, and the cost to taxpayers of no additional recoupment. CBO expects that the Secretary would not seek to recover financial assistance provided above the industry retention amount and would not collect interest on outstanding amounts.

The recoupment of financial assistance would be accomplished by assessing a surcharge on premiums for property and casualty insurance policies and would apply to policies in force following a terrorist attack that necessitated federal assistance. The amount to be recovered would be 135.5 percent of the difference between the industry retention amount, which grows from $29.5 billion to $37.5 billion over the term of the program, and the Secretary's estimate of the total amount paid by insurers for deductibles and their share of payments over the deductibles. CBO estimates that surcharges resulting from a seven-year extension of TRIA would total, in an expected-value sense, $5.4 billion over the 2015-2024 period.

Timing and Tax Offset. The bill would require the Secretary to recover all or a portion of amounts due for events occurring before December 31, 2017, by the end of fiscal year 2019. For losses from events occurring between January 1, 2018, and the end of the program, the Secretary would be required to recoup all amounts due by the end of fiscal year 2024.

Those gross revenue collections would be partially offset by a loss of revenues from income and payroll taxes. Consistent with standard procedures for estimating the revenue impact of indirect business taxes, CBO reduced the gross revenue impact of the insurance surcharges to reflect offsetting effects on income and payroll tax receipts. On balance, CBO estimates that enacting the bill would increase revenues by a total of $4.0 billion over the 2015-2024 period, net of income and payroll tax offsets.

Changes in Spending Subject to Appropriation

S. 2244 would direct the Government Accountability Office to prepare a report assessing the viability of collecting upfront premiums from insurers that participate in the TRIA program. The study would examine, among other things, how the government would determine the price of such premiums, how the premiums would be collected and managed, and how the assessment of premiums would affect take-up rates for terrorism risk coverage. CBO estimates that implementing the new reporting requirement would not have a significant effect on discretionary costs.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for S. 2244, as ordered reported by the Senate Committee on Banking, Housing and Urban Affairs on June 3, 2014

	By Fiscal Year, in Millions of Dollars												
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-2019	2014-2024
NET INCREASE OR DECREASE (-) IN THE DEFICIT													
Statutory Pay-As-You-Go Impact	0	120	80	-30	-60	-190	110	160	-30	-210	-410	-80	-460
Memorandum:													
Changes in Outlays	0	120	280	370	440	480	510	540	410	240	150	1,690	3,540
Changes in Revenues	0	0	200	400	500	670	400	380	440	450	560	1,770	4,000

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

The bill would extend and expand intergovernmental and private-sector mandates contained in the Terrorism Risk Insurance Act. Those mandates would:

- Require property and casualty insurers to offer terrorism insurance;
- Require, under certain circumstances, property and casualty insurers to collect surcharges from policyholders in amounts large enough to pay assessments to the federal government; and
- Preempt state laws regulating insurance.

State, local, or tribal governments could be required to pay surcharges as purchasers of property and casualty insurance, but CBO estimates that the aggregate costs to public entities of complying with those mandates would probably fall below the annual threshold established in UMRA for intergovernmental mandates ($76 million in 2014, adjusted annually for inflation). CBO estimates that the aggregate cost to private insurers and policyholders to comply with the mandates would exceed the annual threshold established in UMRA ($152 million in 2014, adjusted annually for inflation).

Requirement to Offer Insurance

Current law requires that, through calendar year 2014, insurance companies offer terrorism insurance as a part of their property and casualty policies. Those companies may set their own premium rates, and policyholders can choose whether to purchase such insurance. The bill would extend the requirement to offer terrorism insurance through calendar year 2021. According to industry representatives, the cost for public and private insurers to continue making terrorism insurance available under property and casualty insurance policies would be minimal.

Repayment of Assistance

Insurers that offer terrorism insurance would receive financial assistance to cover losses under some conditions in the event of a certified terrorist attack. The bill would extend and expand the requirement that the federal government recoup the costs of such financial assistance through assessments on the insurers and surcharges on purchasers of property and casualty insurance. The requirement to repay the federal government would be both an intergovernmental and a private-sector mandate under UMRA since state and local governments and private entities are both providers and purchasers of insurance.

The cost to insurers to comply with the mandate to administer the surcharges on policyholders and remit the amounts collected to the federal government would be small.

CBO estimates that total surcharges collected by insurers would be about $2.4 billion over the 2015-2019 period. That amount is equal to federal benefits paid over those years plus 35.5 percent of those benefits (see Revenues section for further discussion). Based on information about the purchase of various types of insurance by public entities, CBO assumes that state, local, and tribal governments comprise a small portion of the total market for property and casualty insurance. To the extent that state, local, and tribal governments would be required to pay a surcharge as policy holders, CBO estimates that the aggregate costs to public entities of complying with the mandate would total tens of millions of dollars annually, but probably would not exceed the annual threshold for intergovernmental mandates in any given year. CBO estimates that the aggregate amount of surcharges paid by private entities would amount to hundreds of millions of dollars annually and would exceed the annual threshold for private-sector mandates.

Preemption of State Law

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

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