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TERRORISM RISK INSURANCE

Market Challenges May Exist for Current Structure and Alternative Approaches

GAO Highlights

Highlights of GAO-17-62, a report to congressional committees

Why GAO Did This Study

After the terrorist attacks of September 11, 2001, insurers generally stopped covering terrorism risk because losses could be too high relative to the premiums they could charge. Congress enacted TRIA to share losses from a certified act of terrorism between insurers and the government, address market disruptions, and help ensure widespread availability and affordability of terrorism coverage. TRIA does not include an up-front federal charge for the government's share of potential losses. The act mandates that, when private industry's losses are below a certain amount, the federal government recoups some or all of the federal share of losses through policyholder surcharges.

The Terrorism Risk Insurance Program Reauthorization Act of 2015 includes a provision for GAO to review alternative funding approaches for TRIA. Among other things, this report examines (1) how insurers manage their terrorism exposure and federal recoupment of losses, (2) how alternative funding approaches could be designed and implemented, and (3) the potential effects of these approaches as well as the current structure. To assess these funding approaches, GAO reviewed related studies, analyzed several terrorism loss scenarios for each funding approach to estimate potential effects on market participants, and interviewed industry participants.

Treasury and NAIC provided technical comments on a draft of this report, which GAO incorporated as appropriate. GAO also incorporated technical comments received from selected third parties, as appropriate.

View GAO-17-62. For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or garciadiazd@gao.gov.

What GAO Found

Under the Terrorism Risk Insurance Act's (TRIA) current structure, insurers manage their terrorism exposure to cover their share of losses and not the federal share of losses, which may be recouped from policyholders after an event. Specifically, insurers do not assume the risk of the federal share of potential losses and, thus, do not consider the potential federal share of losses in how they manage their terrorism risk exposure and price coverage. Many insurers include a nominal charge for terrorism risk coverage, if they charge for it at all. Most insurers manage their exposure by limiting the amount of coverage they provide in certain geographic areas. Under the current structure, in some scenarios federal losses must be recouped through premium surcharges on policyholders with TRIA-eligible insurance coverage after a certified terrorism event. However, depending on the size of the terrorism event and the aggregate premiums of affected insurers, the federal government may not be required to recoup all of its losses. To date, no terrorism events have been certified under TRIA.

Designing and implementing alternatives to TRIA's current funding structure, such as a federal terrorism risk insurance charge or set-aside of insurer funds, would require trade-offs among various policy goals and involve complexities. For example,

Federal charge. A charge on insurers or policyholders could either (1) be a risk-based charge intended to help pay for the federal share of potential losses, replacing the current recoupment structure, or (2) be a charge, or fee, paid to the Treasury for the promise of payment of the federal share of loses with recoupment in place to cover the actual losses. A federal charge could help cover potential losses, but determining a price based on risk would be difficult.

Terrorism set-asides. An insurer set-aside to explicitly address terrorism exposure through liabilities, capital, or assets could be designed as (1) loss reserves for future terrorism losses, (2) separate or additional capital requirements for terrorism risk, or (3) separate assets that only could be used for terrorism losses. A set-aside of insurer funds could help cover insurers' potential losses but some approaches would be complex to implement due to implications related to current accounting practices and state laws.

TRIA's current recoupment structure and some alternative approaches could increase prices for policyholders and have various effects on market participants and the federal government. GAO's analysis indicated that the current structure and some alternative approaches could affect the price of coverage and policyholder decisions to purchase terrorism coverage. In addition, one set-aside approach could restrict the flexibility with which insurers can use assets (generally, for a variety of risks) and thus hamper risk management. Under each option, federal fiscal exposure exists. For example, a charge to cover the federal share of losses may be insufficient to cover losses in the near term. However, the design of an alternative approach can, in part, mitigate the magnitude of these effects. For example, lengthening recoupment time frames, charging a broad group of policyholders, or allowing flexibility in applying a set-aside could help mitigate the effects.