Consumer Federation of America

Senator Michael Crapo
Chairman
Banking Housing and
Urban Affairs Committee
United States Senate
Washington, DC 20510

Senator Sherrod Brown
Ranking Member
Banking Housing and
Urban Affairs Committee
United States Senate
Washington, DC 20510

Tuesday, May 28, 2019

Dear Chairman Crapo and Ranking Member Brown,

Consumer Federation of America, a nonpartisan nonprofit organization, urges you to review the extraordinary growth and level of the property/casualty insurance industry's surplus capital as you contemplate the next steps for the Terrorism Risk Insurance Act (TRIA). It is our assessment that industry has the capacity to insure properties against terrorism losses without continuing the massive taxpayer subsidies it has been provided under TRIA, and we believe the program should not be renewed. As we discuss below, an alternative to ending TRIA would be to charge an actuarially sound premium to insurers for the federal backstop that TRIA makes available.

By the end of 2018, the surplus of the property/casualty insurance industry (the amount of money backing up the business the insurers write) was $742 billion, according to data released by the Insurance Services Office and American Property Casualty Insurance Association.[1] Prior to the 9/11 attacks, the industry's surplus was $326 billion, or only 44 percent of the current surplus. TRIA was not, of course, in effect at the time of 9/11 and the industry survived that large claim in 2001 without much difficulty.

The current industry surplus of $742 billion dwarfs the $27 billion (in 2019 dollars) of insurer losses from 9/11. Even in the extremely unlikely event of a claim or series of claims totaling four times larger than 9/11, the industry is financially positioned to handle the losses. Under the current rules of TRIA, we estimate that insurers would be responsible for about $85 billion of losses before the federal reinsurance kicked in. Without TRIA, the industry would be responsible for an additional $23 billion, the full $108 billion of such an extraordinary event or series of events. That is well within the capacity of the insurance industry without any need for a federal bailout.

[1] Property/Casualty Insurance Results: 2018, ISO and APCIA, available here.

The key measure of the safety and soundness of the property/casualty industry is its ratio of net written premiums to policyholder surplus. In recent years, because of the increase in weather-related catastrophic events and fear of terrorism, the ratio considered to be safe by experts has been lowered from 2.00 to 1.50. However, at the end of last year, the industry's ratio stood at an extremely safe level only 0.82. The after-tax effects of $85 billion of industry losses from a terrorist event equivalent to four 9/11s would only increase this ratio to a still extremely safe level of 0.93. If TRIA expired, the ratio, after paying $108 billion claims from four 9/11 size events would be a mere, and still overcapitalized 0.97. Indeed, the industry could sustain a series of claims 12 times the size of 9/11 and still maintain a safe premium to surplus ratio of 1.47.

It is clear that the industry does not need any taxpayer support for even extreme terrorist events. Since the industry does not need TRIA, why is it urging Congress to renew the act? One explanation for industry insistence that TRIA continue unchanged is that, despite the absence of any significant terrorist losses since 9/11, they have become risk averse on the issue, preferring extreme caution to (a) the risk-taking role that is the purpose of the industry and (b) the loss mitigation role in which the industry develops safeguards to help insureds make properties less vulnerable to loss. As an example of what should be expected of the insurance industry, we note more appropriate responses from the sector in years past. In response to increasing auto accident risks, insurers developed the Institute for Highway Safety to make roads and cars safer; the industry developed Underwriters Labs to make homes safe from electrical appliance risk; and insurers invented lifeboats for cruise lines and developed safe boilers in reaction to increasing claims for those risks. But with limited terrorism exposure, the industry has less incentive to address terror loss mitigation and resilience.

Another explanation is that insurers are profiting from TRIA. In 2007, the Congressional Budget Office estimated that, from 2008 through 2012, the cost to U.S. taxpayers would be $3.1 billion, with an additional $3.3 billion expense projected through 2017. CFA estimated at that time that the total subsidy from 2002 to 2012 was $7 billion and now estimates that the corporate welfare to insurers from 2002 to date approaches $10 billion. The subsidy occurs because the federal reinsurance program in TRIA, which backs up the private insurers, is free – no premiums are charged. Had actuarially sound premiums been charged, the Treasury would have collected nearly $10 billion in premiums that would be reserved to offset future terrorist attack costs. To this end, the industry appears to support the promise of a permanent government giveaway to surplus-rich insurers, even though TRIA was never intended to be permanent.

Given the devastating loss of life and property and the social and cultural shock of 9/11, we acknowledge the possibility that an event an order of magnitude more destructive than 9/11 could occur. Such a large-scale, widespread act of terror – possibly involving nuclear, biological, chemical, or cyber-attacks – may lead us to, once again, contemplate federal taxpayer assistance for insurers. Therefore, we propose that Congress eliminate TRIA and replace it with a mechanism in FEMA designed to react to the details of any such extreme event and provide taxpayer funded coverage for an act of terror only if, and after the industry surplus is diminished by 30%.

It is not surprising that insurance giants want to keep a free reinsurance program and further expand their profits, but at a time of record-breaking federal budget deficits and near all-time high insurer surpluses, we question the wisdom of providing multi-billion dollar subsides to an industry that can easily afford to insure several terrorist events even larger than 9/11. If there are instances where it has been difficult to obtain insurance coverage, the Federal Insurance Office should work with appropriate state insurance departments to examine and efficiently mitigate these deficiencies.

While it is our view that a reauthorization of TRIA is not necessary and that an alternative backstop for an extreme series of events could be developed, we also offer an alternative to non-renewal of TRIA. TRIA is a reinsurance policy for property and casualty insurers. Its primary difference from reinsurance is that the insurance companies that benefit from this ceding of coverage above a certain amount do not pay any premium for capping their exposure. If Congress feels that insurance companies need access to reinsurance and that it is not available in the private market, then taxpayers should receive a premium for that protection. This was the approach used in the Riot Reinsurance Program, under which the federal government profited from the sale of riot reinsurance. In other words, if TRIA is maintained, all insurers that rely on TRIA for coverage above the 20% deductible plus 19% of losses above that deductible should pay a reinsurance premium to the Treasury of the United States to spare burdening the public with further subsidies to this industry.

We would be happy to discuss our views on TRIA further at your convenience. Thank you for your consideration.

Sincerely,

J. Robert Hunter
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Rachel Weintraub
CFA, General Counsel and Legislative Director