Terrorism Risk Financing: A National Commission Needed

By Howard Kunreuther and Erwann Michel-Kerjan
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While the impacts of the 2005 hurricane season have grabbed media attention this fall, Congress will determine in the coming days the final shape of the renewed Terrorism Risk Insurance Act of 2002 (TRIA) that expires on December 31.

TRIA established a temporary three-year national program, based on a private-public risk-sharing arrangement that provides up to $100 billion of commercial coverage against terrorism losses perpetrated by foreign interests on U.S. soil.

The large-scale attacks of September 11, 2001, which inflicted $33 billion of insured losses and induced $7 billion in federal payments to civilian and first responder victims’ families, have tragically raised a fundamental question about the responsibilities of the public and private sectors in reducing terrorism risk and in providing adequate financial protection to victims of such catastrophes.

Four years have passed since 9/11. Although numerous efforts have been undertaken during this time to prevent new attacks on U.S. soil, the economic impact of another mega attack here has to be seriously considered. Who should pay for those losses? The federal government? The insurers? The victims themselves?

Before the Thanksgiving recess the Senate voted to renew TRIA, as did the House on Wednesday, but the two bills differ on a number of important dimensions. One of the areas that we urge be carefully considered in resolving these differences is the path taken to develop a long-term program.

The three years of TRIA’s operation were supposed to give the country enough time to analyze these issues rigorously and determine an appropriate long-term program. We have not seen it. Until now, the debate has been primarily between the insurance industry (not united on the question) and the U.S. Treasury, as to whether TRIA should be renewed. But a long term program is not only about insurance. It should address a more fundamental question: What is the most effective way for the nation to prepare and recover from terrorist attacks?

Hurricane Katrina has highlighted this problem. It demonstrates how the lack of preparation of the impacts of large-scale disasters aggravates the social and financial consequences following such events. A Wharton study on TRIA and Beyond, released in August 2005, concluded that there is a need to rethink, in detail, the appropriate role of the public and private sectors in providing financial protection to those at risk. It also highlighted the importance of developing strategies for encouraging measures to reduce the need for large government outlays after another 9/11-type disaster.

Terrorism insurance and national security issues are intertwined. We urge Congress or the White House to establish a National Commission on terrorism risk management and financing, before more permanent legislation is enacted. Its mandate should be to combine economic/financial questions with national security issues. That was the conclusion of the TRIA and Beyond report as
well as the National Symposium Wharton co-organized with the RAND Corporation and the University of Southern California on October 7, 2005 in Congress.

Although both the House and Senate bills call for some type of working groups, the suggested membership is highly restricted. In addition to the insurance industry, there is a need to include representation from sectors of the economy who are affected by the terrorism risk such energy, transportation, real estate and health. U.S. Treasury representation should be supplemented by key individuals from federal agencies, such as the Department of Homeland Security and the Department of Defense who are concerned with national security issues.

The proposed mandate of such a National Commission should be broader than what is currently envisioned in the House and Senate bills. Such a commission could explore the objectives of a terrorism risk financing program and how to achieve them through alternative risk sharing mechanisms. In addressing these issues there is a need for collaboration with the homeland security/intelligence community to measure what potential threats are. A National Commission could also examine how other countries cope with the terrorism risk to determine whether these approaches merit consideration for the United States.

The insurance infrastructure would undoubtedly play a key role in such a program, but it should be viewed as part of a broader strategy for dealing with terrorism. For example, the public and private sectors could provide economic incentives in the form of lower taxes, subsidies or lower insurance premiums to encourage those at risk to adopt higher security and loss reduction measures. There will likely be a need for well-enforced regulations and standards to complement these incentive programs.

In the past four years, the country has suffered large-scale events as never before. Attacks in Madrid, London, and just last month in Amman, Jordan have demonstrated that the United States and its allies remain a prime target for terrorist groups. The American public and business enterprises deserve nothing less than a robust National Commission for recommending the nature of a long-term program for dealing with terrorism risk financing. This should be done very soon when Congress tries to reconcile the Senate and House bills, and determines the form that TRIA’s renewal should take. The countdown has started.

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