WHARTON RISK CENTER STUDY PROVIDES CONCEPTUAL AND EMPIRICAL ANALYSIS OF NATIONAL TERRORISM INSURANCE POLICY OPTIONS

PHILADELPHIA, PA, AUGUST 11, 2005 -- A report issued today by the Risk Management and Decision Processes Center at the Wharton School of the University of Pennsylvania provides new evidence supporting short-term continuation but modification of the existing national terrorism insurance program created by the Terrorism Risk Insurance Act of 2002 (TRIA). The report concludes that, although TRIA has provided a temporary solution to the problems that commercial firms have had in obtaining adequate terrorism coverage after 9/11, it is not an appropriate long-term program.

The study makes several long-term recommendations about how to deal with the potentially devastating financial consequences of terrorist attacks on U.S. soil. One key recommendation is a call for Congress or the White House to establish a national commission on terrorism risk coverage, which should be given the time and the scope to comprehensively assess the issues involved before permanent legislation is enacted.

TRIA and Beyond: Terrorism Risk Financing in the U.S provides public policymakers, key industry representatives and other interested parties with a comprehensive analysis of the roles both the public and private sectors can – and should – play with respect to protection against terrorism risk in light of the September 11, 2001 attack.

The authors reached their principal findings and conclusions after an exhaustive 225-page examination of the intrinsic characteristics of terrorism risks, its insurability, and regulatory restrictions that impede a private market solution for terrorism coverage. Special attention is given to the supply and demand for terrorism insurance coverage. Using scenarios of terrorist attacks in major cities in the United States, the report examines loss-sharing arrangements between victims, insurers, policyholders and taxpayers under TRIA and alternative programs.

The researchers also analyzed the current demand for terrorism coverage by firms in different parts of the country with special attention given to the real estate, chemical and retail sectors, and the role that domestic captive insurance companies play.

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The study concludes that there is a role and responsibility for government in collaboration with the private sector to provide protection against terrorism losses. There are several reasons for this private-public partnership:

- Federal government policy and actions significantly influence the risk of terrorism.
- The private market currently has limited capacity to provide coverage for extreme losses from terrorism.
- States constrain insurance rates, and mandate coverage for particular lines of coverage, such as workers’ compensation and property insurance.
- Federal disaster assistance following a major attack will likely be significantly greater if there is no predefined public sector role in a terrorism insurance program.
- Creation of a pure government program excludes insurer expertise and financial and operational capacity.

The report also includes specific policy recommendations for members of Congress who are currently drafting legislation to restructure the TRIA program for the short-term. The authors call for increasing the program’s trigger for “certified events” from $5 million to $500 million, so that private insurers and reinsurers would be wholly responsible for any attack where aggregate losses totaled less than $500 million.

The second short-term recommendation is to clarify how any government recoupment process provision applies to all affected parties. Currently, according to the authors, there is uncertainty associated with TRIA’s recoupment process. They note that “aside from the equity issues associated with this feature of TRIA, the law has introduced additional uncertainty in the loss sharing process between the insurers, all commercial policyholders and taxpayers. Knowing in advance who is responsible for paying losses is an important component of any program that involves the public and private sectors.”

If a TRIA-like program is renewed for a short period of time, then the authors recommend options be considered in designing a long-term program for managing financial risks associated with terrorism. These options are not mutually exclusive and include:

- Having businesses self-insure through capital management strategies such as decreased use of debt finance in relation to equity, and by utilizing warrants.
- Reduce insurers/reinsurers tax costs of holding capital by allowing some form of tax-deferred reserves for terrorism coverage.
- Deploying capital of reinsurers by creating a TRIA-like program without individual insurer deductibles that only would provide government payments once losses exceeded a large aggregate threshold.
- Creation of mutual insurance pools to deal with specific lines of coverage, possibly with limited federal backing for large-scale terrorist attacks.
- Creation of publicly administered mutual insurance wherein each insurer would choose a level of protection and pay an estimated premium.
- Provision of federal reinsurance with explicit premiums, which would reduce or eliminate the need for ex post recoupment against all policyholders.

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In addition to these recommendations, the authors list critical issues that requiring further consideration or investigation. Among these issues are:

- Gaining knowledge of the amount of terrorism premiums collected by insurers;
- Possible federal pre-emption of certain state insurance regulations and requirements;
- Including domestic terrorism in any national terrorism insurance program;
- Developing incentive programs for security investment and mitigation.

The study builds on research undertaken by the Risk Management and Decision Processes Center over the past four years, coupled with 17 years of research on how to manage and finance low probability-high consequence events. Members of the Wharton research team are (in alphabetical order):

- Neil Doherty, Professor and Chairperson of the Insurance and Risk Management Department;
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- Scott Harrington, Professor of Health Care Systems, Insurance and Risk Management;
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- Erwann Michel-Kerjan, Senior Research Fellow, Risk Management and Decision Processes Center;
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