ISSUES AND OPTIONS IN THE MANAGEMENT OF TERRORISM RISK THROUGH INSURANCE

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Powerpoint presentation

This document is circulated for Session 1 of the Conference on Catastrophic Risks and Insurance, to be held on 22-23 November 2004 at the OECD Headquarters, 2 rue André Pascal, 75016 Paris, starting at 9:00 a.m.

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Issues and Options in the Management of Terrorism Risk Through Insurance

Robert T. Reville

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Center for Terrorism Risk Management Policy

• Empirical nonpartisan policy research on terrorism risk management
  – Insurance, liability, victims’ compensation, security resource allocation

• Policy research center within the RAND Corporation
  – Based in Santa Monica, CA
  – Offices in USA (3), Netherlands, UK, Germany, Qatar

• Joint effort with Risk Management Solutions (RMS)

• Supported by private sector (insurance, reinsurance, insureds) and public sector
CTRMP Conducts Policy Research on Terrorism Compensation System

- Insurance
- Government Assistance
- Charity
- Tort

Compensation System

- Determines fraction of losses borne by injured parties
- Determines who pays
- Determines transaction costs and time to payment
- Creates incentives for physical and financial risk management
A Compensation System Is Integral to a National Strategy to Combat Terrorism

- Helps the economy rebound after an attack, reducing economic vulnerability

- Creates incentives to adopt security measures, reducing physical vulnerability

- Can reduce the amount of panic and social fragmentation caused by attacks, thwarting the aims of terrorists
Roadmap

- Findings about insurance from study of 9/11 compensation

- Issues and options for government intervention in the market for terrorism insurance

- Research in progress in the CTRMP
The Compensation System Distributes Funds to Various Victim Groups

Mechanism
- Insurance
- Government Assistance
- Charity
- Tort

Victim Groups
- Civilians Killed/Seriously Injured
- ERs Killed/Seriously Injured
- Businesses
- Workers
- Residents
- Environmental Exposures
- Emotional Injuries
Insurance Provided the Largest Amount of Benefits; Tort Has Played Minor Role So Far

- Insurance ($19.6 B)
- Government Assistance ($15.8 B)
- Charity ($2.7 B)

Total Benefits ($ billions): $38.1 B
Most Benefits Went to Businesses

- Businesses: $23.3 B
- Residents: $0.9 B
- ERs Killed/Seriously Injured: $1.9 B
- Civilians Killed/Seriously Injured: $8.7 B
- Workers: $1.7 B
- Environmental Exposures: $0.7 B
- Emotional Injuries: $0.2 B

Total Benefits: $38.1 B
Government Provided Most of the Benefits to Civilians Killed or Seriously Injured

- **Insurance ($2 B)**
- **Government ($5.96 B)**
- **Charity ($0.71 B)**

Benefits ($ billions)

- $8.67 B (23%)
Insurance Paid Most of Benefits to Businesses

Insurance ($16.98 B)

Gov’t ($6.24 B)

Charity ($0.11 B)

Benefits ($ billions)

$23.33 B (61%)
Insurance Paid Most of Benefits to Businesses

- Insurance ($16.98 B)
- Gov’t ($6.24 B)
- Charity ($0.11 B)

Total Benefits: $23.33 B (61%)

Benefits ($ billions)

Property damage
Business interruption
Insurance Paid Most of Benefits to Businesses

Insurance ($16.98 B)  Gov’t ($6.24 B)

Benefits ($ billions)

0  5  10  15  20  25

Property damage  Low-interest loans
Business interruption  Grants

Charity ($0.11 B)  Tax breaks
Incentives to locate in NYC

$23.33 B (61%)
Roadmap

• Findings about insurance from study of 9/11 compensation

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In Developing Policies, Five Issues Must Be Considered in Light of System Goals

1. To what extent can private insurance provide terrorism insurance at commercially viable rates?
2. To what extent can individuals and businesses accurately assess terrorism risk?
3. How should national security considerations factor into policies on insurance and the compensation system more generally?
4. How should payments to cover terrorism losses be financed?
5. How much should government policies be tailored to different insurance market segments or types of attack?
Three Fundamentally Different Policy Approaches Exist

Rely on Private Insurance Markets
1. Catastrophe bonds
2. Pre-funded, tax-free reserves
3. Voluntary pool for workers’ compensation

Public-Private Partnership
1. TRIA remains in place
2. TRIA is expanded
3. TRIA is rolled back and replaced with industry pool
4. Mandatory government-sponsored insurance

Provide Compensation Directly
1. Government-provided compensation with partial recovery
2. Government-provided compensation with nearly full recovery
More Work Is Needed to Explore the Circumstances Under Which Each Approach Makes the Most Sense

Expected magnitude of attacks in U.S.

Very large

Very rare

Small

Rely on private insurance markets

Expected frequency of attacks in U.S.

Frequent
Each Approach Makes Sense Under Different Conditions

- Very large
  - Expected magnitude of attacks in U.S.
- Small
  - Expected frequency of attacks in U.S.

- Rely on private insurance markets
- Public-private partnership
Each Approach Makes Sense Under Different Conditions

Expected frequency of attacks in U.S.

- Very rare
- Frequent

Expected magnitude of attacks in U.S.

- Very large
- Small

- Provide compensation directly
- Public-private partnership
- Rely on private insurance markets
Roadmap

• Findings about insurance from study of 9/11 compensation

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• Research in progress in the CTRMP
Further CTRMP Research Will Address a Variety of Issues

- Quantitatively evaluating policy options under different attack scenarios
- The Future of Terrorism and the Architecture of TRIA
- Improving models for the frequency of attacks
- Examining role of tort liability in the risk management and compensation system
- Exploring ways to improve information sharing in terrorism insurance