

# Terrorism – Its Economic Impact and Insurability

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# 1 Economic Impact of Terrorism

2 Impact on the Insurance Industry

3 Insurability of Terrorism

4 Conclusions

# Costs of Terrorism

## Direct / Immediate:

- Value of lives lost
- Costs associated with deaths & injuries (incl. loss of productive capacity, lost wages)
- Damaged goods
- Destroyed structures
- Damaged infrastructure
- Rescue and repair costs
- Reduced short-term commerce

## Indirect / Secondary:


- Raised insurance premiums / exclusion of coverage
- Increased security costs
- Greater compensations to those at high-risk locations
- Long-run changes in commerce:
  - Reduced GDP growth
  - Lost FDI
  - Changes in inflation
  - Increased unemployment



## Economic Consequences of Terrorism

- Flight of capital, Diverting Foreign Direct Investment
- Destroying infrastructure
- Redirecting public investment funds to security
- Limiting trade
- Impact on specific industries
- Loss of expertise
- Expensive security measures
- Rising cost of doing business
  - Higher insurance premiums, expensive security precautions, potentially: higher salaries to at-risk employees)
- Loss of innovation

## Factors influencing the severity of impact on an economy

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- characteristics of attacks (incl. frequency & severity)
  - how vital affected sectors are for the economy
  - size of GDP, economic maturity, breadth of economic activities
  - (international) perception of likelihood of future events

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# 9/11: Third largest loss in insurance history

## THE FIVE MOST COSTLY WORLD INSURANCE LOSSES, 1970 – 2008 <sup>1</sup>

#	Date	Country	Event	Insured loss in 2008 USD millions <sup>2</sup>
1	Aug 25, 2005	U.S., Gulf of Mexico, Bahamas, North Atlantic	Hurricane Katrina; floods, dams burst, damage to oil rigs	71,300
2	Aug 23, 1992	U.S., Bahamas	Hurricane Andrew; floods	24,552
<b>3</b>	<b>Sep 11, 2001</b>	<b>U.S.</b>	<b>Terror attacks on WTC, Pentagon &amp; other buildings</b>	<b>22,835</b>
4	Jan 17, 1994	U.S.	Northridge earthquake (magnitude 6.6)	20,337
5	Sep 9, 2008	U.S., Carribean, Gulf of Mexico et al.	Hurricane Ike; floods, offshore damage	20,000

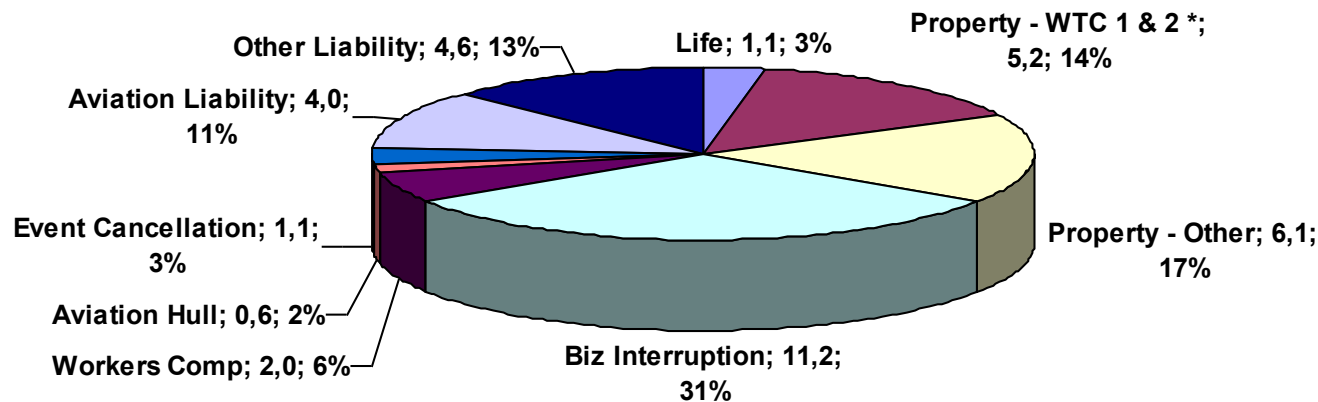


<sup>1</sup> Property and business interruption losses, excluding life and liability losses. Includes flood losses in the United States insured via the National Flood Insurance Program. <sup>2</sup> Adjusted to 2008 dollars by Swiss Re  
 Note: Loss data shown here may differ from figures shown elsewhere for the same event due to differences in the date of publication, the geographical area covered and other criteria used by organizations collecting the data

Source: Swiss Re, *sigma*, No. 2/2009

# Loss Distribution by Type of Insurance from September 11 Terrorist Attacks

in bn USD (stated in 2006 Dollars), %



**Total Insured Losses Estimate: USD 35.9bn**

\* Final settlement amount on claims on the WTC complex itself of USD 4.55bn as announced on May 23, 2007 by New York State and Port Authority of New York and New Jersey. Figure is adjusted to 2006 price level.

Source: Insurance Information Institute



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## The problem of insurability: Terrorism risk vs. 'standard' insurance risks

### Preconditions for insurability:

- Occurrence of event of damage must be accidental / random
- Insurance benefits must be clearly definable
- Probability of damage must be calculable (in advance)
- Risks must be independent of each other
- Risks must not be too big



The insurance industry's standard tools of risk assessment cannot properly be applied to terrorist attacks:

1. Risk adequate premium hardly calculable (or prohibitively expensive)
2. Limited control of accumulation of risk, limited reinsurance capacity

## Guarantees by the State: Pro's & Con's



*“The state is not an insurance business”* K. Bodewig, German Minister of Transport, November 2001

- Efficiency
- Cost
- Expertise



- Reasonable from a macroeconomic perspective:  
Security as an important factor of production
- Politically justifiable:  
Security is a central task of the state
- Without alternative:  
Insurance companies have an obligation not to take on risks exceeding their capacity

# Terrorism insurance: Selected Examples

## Schemes with government involvement:

- Australia, Belgium, France, Germany, Netherlands, Spain, U.K., U.S., Israel, Namibia, South Africa,...

## Schemes without government involvement:

- Austria, Finland, Switzerland, Bahrain (& other Arab countries), Hong Kong, India, Taiwan,...

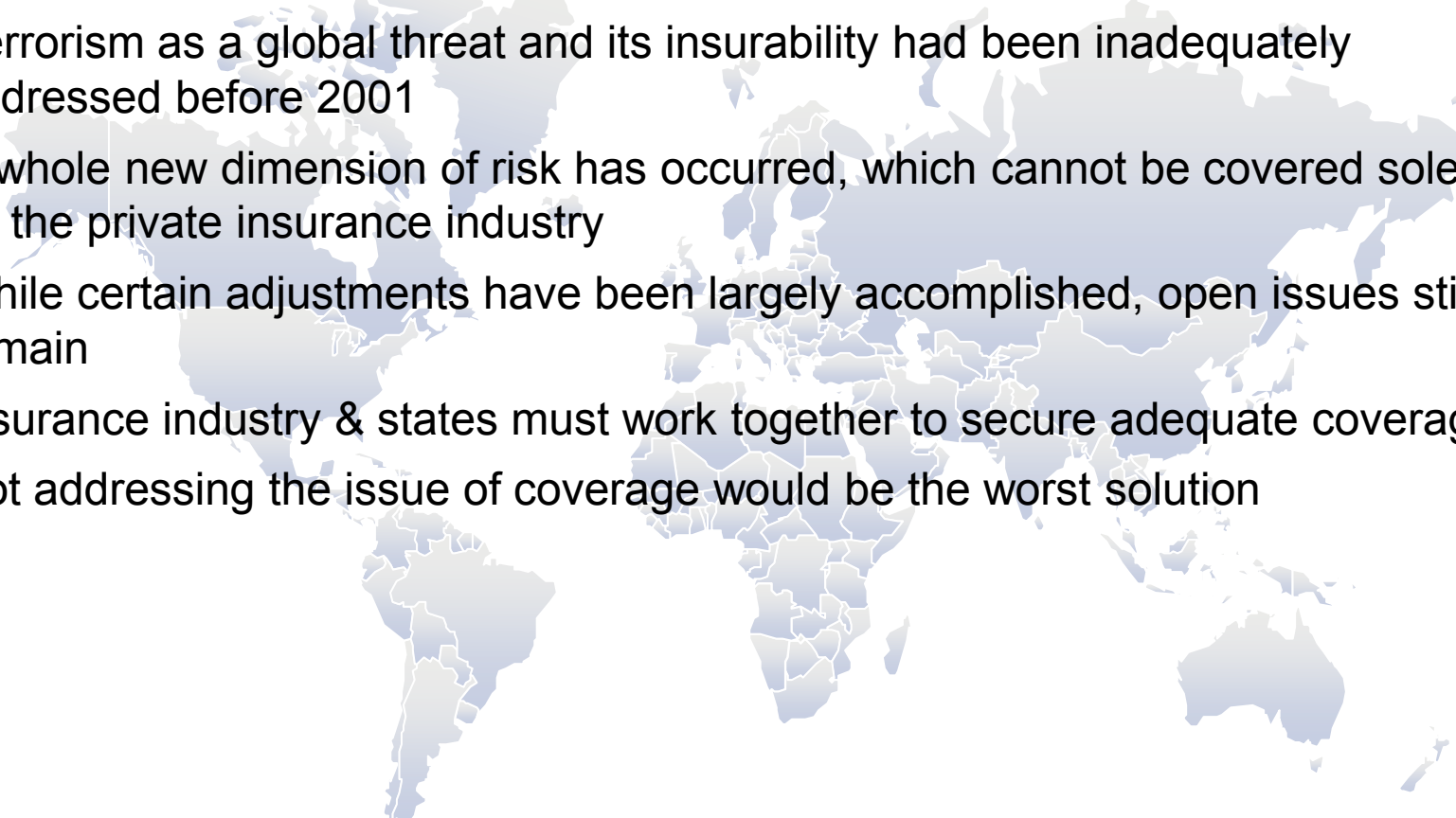
## No scheme:

- Canada, Denmark, Italy, Norway, Portugal, Sweden, Japan, Korea, Mexico, China, Malaysia, Philippines, Argentina, Brazil, Chile, Colombia, Peru,...

Country	Germany	Canada	France	U.S.A.	Great Britain
Mandatory Coverage	No, but a standard property damage/ business interruption coverage can be provided via special insurance company EXTREMUS	No	Yes (property damage/business interruption)	Insurers are required to make available coverage against acts of terrorism	No, but if requested by the insured, coverage must be offered
Limit	n/a	Now terrorism is excluded.	TSI (=total sum insured) / policy limit	TSI / policy limit	TSI / FLEXA (=Fire, Lightning, Explosion, Aircraft) limit
Coverage	n/a Fire following a terrorism event is excluded if terrorism is not specifically covered	Terrorism is excluded. Fire following a terrorism event is excluded as well, but the legal environment in this respect is untested	Terrorism as defined by the law including fire following	Terrorism as defined in the wording and certified by the treasury including fire following	Terrorism as defined by treasury including fire following
Premium	n/a	None	Percentage surcharge on the total premium based on TSI range of the policy	Surcharge based on occupancies and location of risk	Surcharge based on location of risk
Pool	No, but EXTREMUS as special insurance company	No	Yes ('GAREAT')	No, but federal backstop (TRIPRA)	Yes ('PoolRe')

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## Conclusions

- Terrorism as a global threat can profoundly impact national economies
  - Terrorism as a global threat and its insurability had been inadequately addressed before 2001
  - A whole new dimension of risk has occurred, which cannot be covered solely by the private insurance industry
  - While certain adjustments have been largely accomplished, open issues still remain
  - Insurance industry & states must work together to secure adequate coverage
  - Not addressing the issue of coverage would be the worst solution
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# Thank you for your attention!