Sept. 11 struck the insurance industry hard,
The industry has absorbed the shock—

After

BY ANNE RICHARDSON

In the wake of Sept. 11, insurers are quietly paying billions in claims from the terrorist attacks that took an estimated 3,000 lives and reduced New York's tallest towers to rubble. It was a disaster of previously unimaginable proportions. In the words of Saxon Riley, chairman of Lloyd's of London, it was also "the most complex insurance event the world has ever seen."

Because of Sept. 11, insurers are absorbing massive losses—the largest ever recorded. And they're looking ahead. If there's a next time, they want to be more prepared. They're providing less terrorism coverage than they used to; they're examining previously unnoticed risks. And they're seeking a federal backstop: Without it, many say, the economic consequences will be far worse next time.

Calculating the Losses

Insurers mobilized swiftly after Sept. 11 to start handling the terrorism claims they never expected to see. The claims process has been moving along well, with many claims paid quickly.

"The industry's response was exemplary," says Dave Powell,

and figuring out the losses will take years.

this time. But what about next time?

math

a consulting actuary at Tillinghast-Towers Perrin. "We've not had denials of basic coverage, no one's tried to duck out on a war exclusion, I haven't heard loud complaints. You don't expect to receive applause—the absence of complaint is a pretty good sign, I think, that the industry has done a good job."

The job is far from over.

How Much, and Where?

Estimates of 9/11 insured losses vary widely, ranging from $30 billion to $70 billion for the global property-casualty (P/C) industry. At an April Casualty Actuarial Society seminar on the effects of the Sept. 11 attacks, actuaries said that losses of $35 billion to $50 billion seem more likely. In early May, the Insurance Information Institute estimated that insured losses will total about $38 billion, as shown in Fig. 1.

"A lot of the losses are still being figured out," says George Phillips, vice president and associate actuary at Transatlantic Reinsurance Co. The calculations are especially complex because the 9/11 attacks resulted in losses for so many kinds of insurance, including liability, property, business interruption,

© Reuters NewMedia Inc./CORBIS

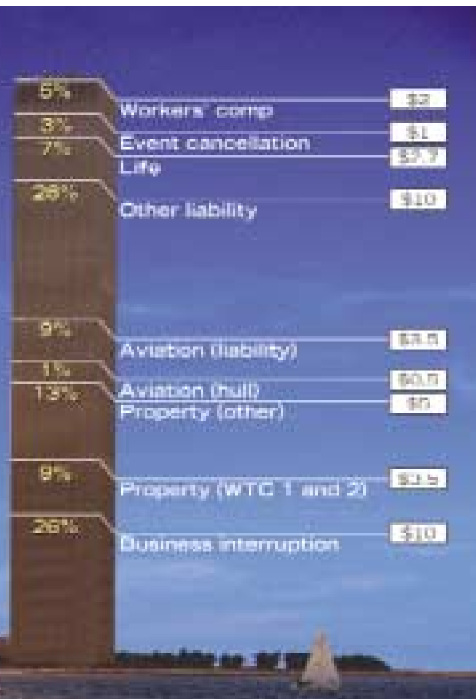

FIGURE 1
Estimated total for insured losses from the Sept. 11 attacks: $38.2 billion
(in $ billions)

SOURCE: INSURANCE INFORMATION INSTITUTE

aviation, life, and workers' compensation. The extent of the "clash loss" (combinations of loss from different lines of insurance) came as a shock to many insurers.

Also, liability losses are a huge unknown quantity—and will be for some time. As of late April, it was reported that fewer than 15 percent of the eligible families had signed up for the Sept. 11th Victim Compensation Fund. (The fund requires participants to give up their right to sue. In return, they'll receive payment, on average, of about $1.85 million, with most getting at least $250,000.) But most hadn't gone to court yet, either: By late April, according to the *New York Times*, only a "handful of people" had opted out of the fund to file suit, mostly on behalf of passengers on the planes that hit the World Trade Center.

"The real issue is liability," Powell says. "We now have something over 3,000 people who haven't decided what they're going to do yet." Even workers' comp claims can't be accurately estimated yet, he says. He notes that health problems like post-traumatic stress syndrome and respiratory impairments often emerge over time, not immediately. However, the workers' comp share of the losses (an estimated $2 billion as of early May) is a fraction of the liability share (an estimated $13.5 billion as of early May).

In mid-April, the Insurance Services Office (ISO) and the National Association of Independent Insurers reported that the U.S. P/C industry had suffered an after-tax net loss of $7.9 billion in 2001, its first-ever annual loss. (See Fig. 2.) A year earlier, in contrast, the industry had a $20.6 billion profit. Major contributors to the $7.9 billion overall loss: poor investment results and soaring underwriting losses that were partly due to the Sept. 11 attacks.

"This has been a wake-up call for the U.S. insurance industry that we are part of the rest of the world—meaning terrorism is a real threat. We were kind of oblivious to that," says John Kollar, an ISO vice president and chairman of the American Academy of Actuaries Extreme Events Committee. "We were fat, dumb, happy Americans thinking this is heaven on earth, not ever envisioning that something like this could happen—particularly not something of this magnitude."

Assessing New Risks

Sept. 11 taught insurers some harsh lessons. They found they had enormously costly concentrations of risk that they hadn't noticed before. And they learned that they hadn't taken the threat of terrorism nearly seriously enough. No one had worried about whether the United States could suffer a terrorist attack whose insured losses—and overall consequences—would far exceed previous records for hurricanes, earthquakes, and other natural disasters. (See Fig. 3.)

"The biggest effect of Sept. 11 on the industry is to help insurers understand that those kinds of things can happen, and they need to find a way to deal with them," says Robert Anker, president-elect of the American Academy of Actuaries. "There's been an awakening that the industry didn't have the capacity to handle every kind of loss, or series of losses, that could happen."

Reinsurers have been hardest hit by Sept. 11. An April report by the American Academy of Actuaries Extreme Events Committee estimates that 60 percent to 80 percent of the overall losses from the attacks—or as much as $56 billion—will be borne by reinsurers. Their response was quick: In the immediate aftermath of Sept. 11, the reinsurance market for commercial terrorism coverage all but vanished.

By the time this article was written in early May, commercial terrorism reinsurance had become more available—but only on a limited basis, and at far higher prices than before Sept. 11.

"You can buy some amount of terrorism coverage for anyplace you care to name, but it might cost a lot," says Paul Kneuer, chief actuary at Holborn Corp., a reinsurance brokerage firm. "There's plenty of capacity for a well-structured, well-priced deal. And there's almost no capacity for something that's priced wrong."

Availability can also depend on who needs the coverage, and where. Terrorism reinsurance remains especially scarce in central areas of major cities, especially for large businesses and American icons, according to Kneuer and others. Not surprisingly, there's been a trickle-down effect. This time last year, most general property and liability insurance for businesses included terrorism coverage, and no one gave much thought to it. Now, it's considered separately, it's far more expensive, and it's far harder to get. Without reinsurance behind them, primary insurers have had to find ways to reduce their own risk.

The New York Metropolitan Transit Authority's previous insurance policy, for example, covered its entire estimated $1 billion loss from the World Trade Center attacks. Now, according to *USA Today*, it's paying $7.5 million for just $70 million in terrorism coverage—and that's after a $30 million deductible.

"On a deal-by-deal basis, they're doing it," says Frank Pierson, senior vice president of the Centre Group, an insurance-based merchant finance company. "What they worry about is giving terrorism coverage to everyone, like they used to. Then they're just exposing themselves to another $40 billion-to-$50 billion loss—which they can't afford to do."

SOURCES: A.M. BEST, INSURANCE INFORMATION INSTITUTE, INSURANCE SERVICES OFFICE

FIGURE 2
For the first time, the P/C insurance industry posted a net loss in 2001
(in $ billions)

Nor can they afford the previously unsuspected concentrations of risk that Sept. 11 exposed—both geographically and across types of coverage. For example, worker's compensation insurers have traditionally tried to spread their risk of catastrophic loss by providing coverage to many companies, Anker notes. But they hadn't worried much about the risk that might be posed by insuring multiple companies that all had offices in a landmark building.

"The workers' comp catastrophe that everybody had modeled was always something that affected a single employer. A factory explosion, or something like that, was all we had imagined," Anker says. "But 9/11 brought a kind of stacking of loss that no one had conceived of—all of a sudden, with the World Trade Center, we have a huge workers' comp loss, with many deaths at some companies. And it could have been even worse—both the death toll and the number of people with major injuries could have been much higher."

Similarly, Kollar says, "People are trying to figure out, 'How much terrorism risk have I as an insurer taken on?' If you've written everybody in a two-block area, and a bomb explodes there, you've taken a big hit. But if you have one building in every ZIP code, one bomb isn't going to cause a big loss. That's the thing you have to look at as an insurer."

Insurance companies are also reassessing their exposure across lines. No other catastrophe has ever created such huge losses in so many types of insurance. Reinsurers, says Kneuer, are "getting very careful about accumulating the same risk in multiple ways—if a plane hits a building, they don't want to have to pay for both the plane and the building without pricing for that concentration."

And insurers are trying to calculate what their losses would be under a worst-case scenario. "Rather than saying all of our policies have terrorism coverage, now I want to say none of them have it until I add them all up and see what's the most I could ever pay out, no matter what happened to me," one actuary says. "There's comfort in that for an insurance company." At the same time, some specialty companies are working to develop models for terrorism risk. Those are likely to be more helpful for severity assessments than frequency estimates, according to another actuary.

The potential effect of multiple disasters is another issue Sept. 11 has raised, says Phillips. "What if something else comes on the heels of 9/11 before there's a chance to really recover financially from this?" he said. "What would have happened if we'd had a big hurricane Sept. 30?"

This focus on analyzing and pricing various combinations of risk is good news for actuaries, said one reinsurance buyer. "Actuaries are much more involved in the process," he says. "It's been hard to get your business done over a three-martini lunch in recent years—and it's impossible now."

Terrorism Exclusions

Unlike reinsurers, which are largely unregulated, primary insurers had to get approval from state insurance departments to remove terrorism coverage from many of their new commercial P/C policies and renewals. As part of the initial response to September 11, the National Association of Insurance Commis-

1/4
Mitchell Group
Page 23

SOURCE: BASED ON INFORMATION FROM THE INSURANCE INFORMATION INSTITUTE AND SWISS RE

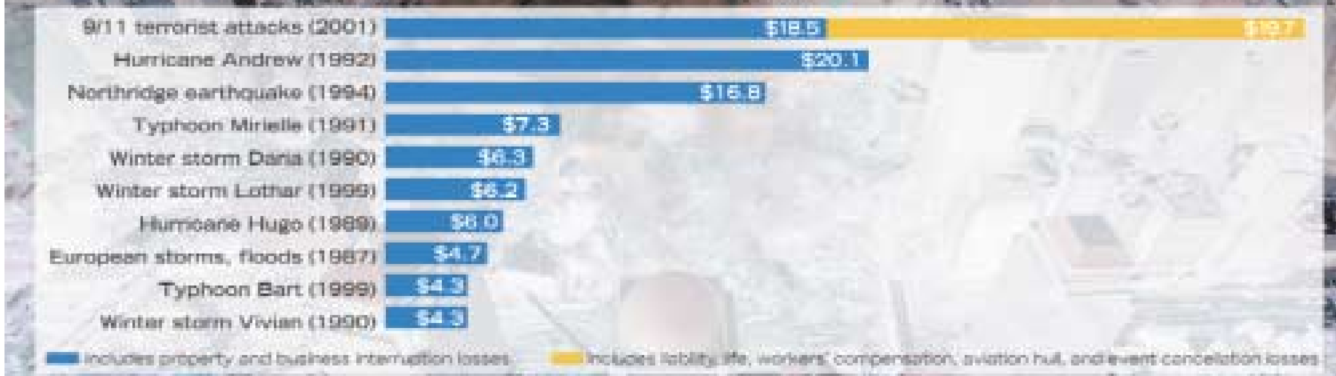

FIGURE 3
The 10 worst: Biggest catastrophes, by insured losses (in $ billions)

sioners (NAIC) worked with the Insurance Services Office to create new terrorism policy exclusions. By late February, all but five states—the important exceptions of New York, California, Florida, Georgia, and Texas—had adopted them.

Noting the exclusions, NAIC President Terri Vaughan said in February that state insurance departments had been "forced to take appropriate regulatory actions to preserve the solvency and stability of the nation's insurance industry" when Congress failed to enact a terrorism insurance bill before Jan. 1.

The exclusions may be applied to new or renewed commercial property and commercial general liability policies. They provide that terrorism losses will be covered for a terrorist act if the act doesn't involve the release of nuclear, biological, or chemical materials and if the total insured damages to all types of property in the United States, Canada, Puerto Rico, and U.S. territories and possessions don't exceed $25 million.

Also, no commercial property or commercial general liability losses are covered if the $25 million threshold is reached, and no commercial general liability losses are covered if 50 or more people are killed or seriously hurt by a terrorist event. (A February report by the U.S. General Accounting Office said NAIC officials had estimated that a $25 million loss to a single insurer would threaten the solvency of 886 companies that together represent about 44 percent of all the commercial P/C insurers in the United States.)

Insurers also have other ways to reduce their exposure to terrorism risk. For example, some large corporations can get commercial insurance coverage through unregulated surplus lines; terrorism can be excluded from those kinds of policies without any approval from regulators.

However, terrorism coverage can't be excluded from every kind of policy. In almost every state, workers' compensation insurers aren't allowed to exclude coverage for a particular type of event. In about 30 states, standard fire policy language requires insurers to pay losses from a fire, regardless of what caused it. (Industry representatives told the GAO that there will probably be efforts to change this requirement.) Also, the NAIC has indicated that, with limited exceptions, state regulators are unlikely to approve terrorism exclusions for personal P/C policies and for individual and group life and health policies.

Mostly, insurers have concentrated their attention on commercial policies. And even there, terrorism coverage has apparently become more available than many expected in the first weeks after Sept. 11. Insurance industry representatives cite several possible reasons, including fear of competition, an unwillingness to say no to key customers, and the amount of time that has passed without a major terrorist attack in the United States.

"On Sept. 17, we'd had one attack in the last week. We've now had one attack in the last eight months. The data looks different at this time, and that's affecting the market," says Kneuer.

Less Is More

It's not just terrorism coverage that's been affected by Sept. 11. Mies van der Rohe's architectural mantra, "less is more," also applies to property and liability insurance. Prices were already rising last fall, and Sept. 11 accelerated the trend, making a hard market even harder.

The April report by the American Academy of Actuaries Extreme Events Committee said prices for commercial insurance rose 11 percent to 16 percent during the fall of 2001, while homeowners' insurance rose 10 percent. During the first quarter of this year, according to Robert Hartwig, senior vice president and chief economist for the Insurance Information Institute, commercial premiums were rising by about 30 percent.

And sometimes by far more. An unnamed company that develops and owns more than 100 non-trophy buildings in East Coast cities and suburbs told the GAO that its previous blanket property policy had covered $300 million per property, per occurrence, for a premium of $1 million. This year, the same amount of coverage was available—but for $5 million, and excluding terrorism.

Since September, said the Academy's report, P/C price increases have accelerated, coverage limits have been imposed, and "the burden of bearing terrorism risk has begun to migrate from the reinsurance market back to the primary market and onto the business community at large."

The high prices have attracted new capital into the market, including some new capital for terrorism coverage. But even with

that infusion of capital, actuaries said, policyholders now bear much of the terrorism risk that used to be in the hands of reinsurers.

Looking for Backup

In the wake of Sept. 11, many industry officials and regulators argue that a federal backstop for terrorism insurance is badly needed. Yes, they say, insurers are absorbing the losses of Sept. 11—but next time will be different.

"We've hit the snooze button on terrorism," says Rade Musulin, chairman of the Florida Insurance Council. "We need to do something, because there will be another 9/11. I hate to say that, but there will be one somewhere, sometime. And when it happens, there's going to be a very chaotic response. We got a warning shot on 9/11—we could have a total market meltdown next time."

The lack of a federal backstop, many say, is already hurting the economy. "Because exposed parties are using various coping strategies to minimize panic behavior, there has been a perception in some quarters that no economic disruption is occurring," Alice Schroeder, a senior insurance analyst for Morgan Stanley, told Congress in February. "On the contrary, we believe that transfer of a significant amount of risk from insurers to customers by definition is a meaningful economic disruption."

In April, President Bush called on the Senate to pass a terrorism insurance bill. "It is a jobs issue," he said in a speech to business leaders. "If people can't buy insurance on a construction project, they're not going to build the project. And if they don't build the project, somebody's not working. . . . And we in Washington must deal with it, and deal with it in a hurry, because the pace of new construction is dropping dramatically in America."

To bolster his point, Bush said that nonresidential construction had dropped 3 percent since January 2002 and 17 percent since February 2001. He also gave several examples of building projects that were on hold because of lack of terrorism insurance. Among them: a proposed $400 million Hyatt Corp. office building in downtown Chicago that would create 2,500 jobs. "But they've got a problem finding terrorism insurance, and so they're not getting financing for the project," Bush said.

The president added that lack of affordable terrorism insurance could also affect charities, pension funds, and the transportation industry. And in the future, he said, it would be "really hard for our economy to recover a second time if there's an attack without adequate terrorism insurance."

The absence of a federal backstop is creating a "stealth catastrophe," according to one actuary. Without adequate terrorism insurance, urban economic growth and efforts to revitalize cities will suffer gradually and largely invisibly, he said. "Congress only knows how to react to visible disasters. They're oblivious to invisible erosion," he added.

Terrorism insurance legislation has been in limbo in the Senate since late last year. The House passed a terrorism insurance bill (H.R. 3210) in November that would lend the insurance industry money to help pay future terrorism claims. But a bipartisan compromise has remained stalled in the Senate because of disagreement over "tort reform" provisions that would limit or prohibit the payment of punitive damages.

Not everyone is convinced that broad federal legislation is necessary. "We don't need a general backup," says Robert Hunter, director of insurance for the Consumer Federation of America. "I think lower Manhattan has some problems, and real estate has significant problems . . . but almost every entity that's been listed as a reason we need terrorism insurance has gotten coverage now. It's more expensive, but it's available." He adds that there's no need for Congress to provide "free reinsurance" to insurers, and some reinsurers agree.

Not surprisingly, the Insurance Information Institute's Hartwig sees it differently. "The question is, would a federal backstop increase availability, bring more capacity into the market, and thereby affect prices? And the answer to that is yes."

But the most important issue, says Anker, is what happens if there's a next time. "The industry can't take another shock like that," he says. "If the industry surplus takes another hit like that, it isn't just the commercial markets that will be in trouble all of a sudden. It's homeowners' insurance, it's auto insurance—the next one will affect everybody." ●

ANNE RICHARDSON IS MANAGING EDITOR, NEW MEDIA AND MEMBER PUBLICATIONS, AT THE AMERICAN ACADEMY OF ACTUARIES IN WASHINGTON.

1/4
CPS
Page 25