Expiration of terrorism risk insurance act could hurt national security, study finds

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Allowing the federal terrorism risk insurance act to expire could have negative consequences for U.S. national security, according to a new study from the RAND Corporation.

Insurance markets were unprepared for the aftermath of the terrorist attacks of Sept. 11, 2001. Terrorism risk insurance quickly became either unavailable or extremely expensive. Congress reacted by passing the Terrorism Risk Insurance Act, which provided government support by providing mechanisms for spreading losses across policyholders nationwide or using government payments to cover the most-extreme losses.

The current terrorism risk insurance program will expire in 2014 and Congress again is considering the appropriate government role in terrorism insurance markets.

"Our study finds that if the act expires and the take-up rate for terrorism insurance falls, then our country would be less resilient to future terrorist attacks," said Henry Willis, lead author of the study and director of the Homeland Security and Defense Center at RAND, a nonprofit research organization.

The RAND study found that terrorism remains a real—albeit uncertain—national security threat, with the most likely scenarios involving arson or explosives being used to damage property or conventional explosives or firearms used to kill and injure civilians.

Terrorism has occurred persistently in the U.S. since 2001, yet complex terrorist attacks have not occurred. However, there are active terrorist groups who do aspire to conduct more complex attacks on U.S. targets, and the possibility remains that sometime in the future, one of these groups may succeed.

An examination of past attacks is only of limited use for accurately predicting the probability of future attacks or losses from attacks different than those that have occurred, Willis said. For that reason, there are limits to how terrorism risk models can be used to understand future terrorism risks.

The current terrorism risk insurance program has a $27.5 billion threshold for aggregate losses that are paid by the insurance industry and commercial policyholders before the government program begins paying.

The threshold ensures that the insurance industry, rather than the taxpayer, is ultimately responsible for paying for those incidents that are within the range of the industry's modeling capability. At the same time, that threshold permits insurance companies and policyholders to manage risks from incidents that involve deep uncertainty that cannot be adequately quantified using modeling.

Willis and study co-author Omar Al-Shahery say terrorism insurance also can contribute to making communities more resilient to terrorism events. Access to appropriately priced terrorism insurance can promote economic growth, making resources available to address national security threats or other social problems. Recovery and rebuilding will be more rapid and efficient if the take-up rate for terrorism insurance is high.

In these cases, policies and decision-making are clear about how much compensation will be available after an attack and how it will be distributed. The more-rapid recovery can reduce the consequences of subsequent attacks, thus contributing to national security.

More information: www.rand.org/pubs/research_reports/RR573.html

Provided by RAND Corporation

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